

ASSURED GUARANTY LTD  
Form 10-Q  
November 09, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended September 30, 2018

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 98-0429991  
(State or other jurisdiction (I.R.S. employer  
of incorporation) 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 every Interactive Data File required to be submitted 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 such files). Yes  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 5, 2018 was 105,667,478 (includes 51,746 unvested restricted shares).



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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Assured Guaranty Ltd.

Condensed Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

|   | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|---|--------------------------------|-------------------------------|
| Assets  |                                |                               |
| Investment portfolio:   |                                |                               |
| Fixed-maturity securities, available-for-sale, at fair value (amortized cost of \$10,006 and \$10,187)                    | \$ 10,192                      | \$ 10,674                     |
| Short-term investments, at fair value   | 738                            | 627                           |
| Other invested assets   | 95                             | 94                            |
| Total investment portfolio  | 11,025                         | 11,395                        |
| Cash  | 82                             | 144                           |
| Premiums receivable, net of commissions payable   | 916                            | 915                           |
| Ceded unearned premium reserve  | 61                             | 119                           |
| Deferred acquisition costs  | 103                            | 101                           |
| Salvage and subrogation recoverable   | 471                            | 572                           |
| Financial guaranty variable interest entities' assets, at fair value  | 596                            | 700                           |
| Other assets  | 485                            | 487                           |
| Total assets  | \$ 13,739                      | \$ 14,433                     |
| Liabilities and shareholders' equity  |                                |                               |
| Unearned premium reserve  | \$ 3,538                       | \$ 3,475                      |
| Loss and loss adjustment expense reserve  | 1,147                          | 1,444                         |
| Long-term debt  | 1,249                          | 1,292                         |
| Credit derivative liabilities   | 239                            | 271                           |
| Financial guaranty variable interest entities' liabilities with recourse, at fair value                                   | 545                            | 627                           |
| Financial guaranty variable interest entities' liabilities without recourse, at fair value                                | 104                            | 130                           |
| Other liabilities   | 334                            | 355                           |
| Total liabilities   | 7,156                          | 7,594                         |
| Commitments and contingencies (see Note 14)   |                                |                               |
| Common stock (\$0.01 par value, 500,000,000 shares authorized; 106,637,701 and 116,020,852 shares issued and outstanding) | 1                              | 1                             |
| Additional paid-in capital  | 200                            | 573                           |
| Retained earnings   | 6,303                          | 5,892                         |
| Accumulated other comprehensive income, net of tax of \$33 and \$89   | 78                             | 372                           |
| Deferred equity compensation  | 1                              | 1                             |
| Total shareholders' equity  | 6,583                          | 6,839                         |
| Total liabilities and shareholders' equity  | \$ 13,739                      | \$ 14,433                     |

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



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Assured Guaranty Ltd.

Condensed Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

|  | Three Months<br>Ended<br>September 30,<br>2018 |        | Nine Months<br>Ended<br>September 30,<br>2017 |        |
|--|--|--------|---|--------|
| Revenues   |  |        |   |        |
| Net earned premiums  | \$142  | \$186  | \$423   | \$512  |
| Net investment income  | 98   | 99     | 298   | 322    |
| Net realized investment gains (losses):  |  |        |   |        |
| Other-than-temporary impairment losses   | (8 )   | (20 )  | (23 )   | (23 )  |
| Less: portion of other-than-temporary impairment loss recognized in other comprehensive income | 1  | (7 )   | (3 )  | 6      |
| Net impairment loss  | (9 )   | (13 )  | (20 )   | (29 )  |
| Other net realized investment gains (losses)   | 2  | 20     | 6   | 83     |
| Net realized investment gains (losses)   | (7 )   | 7      | (14 )   | 54     |
| Net change in fair value of credit derivatives:  |  |        |   |        |
| Realized gains (losses) and other settlements  | 1  | (1 )   | 4   | 19     |
| Net unrealized gains (losses)  | 20   | 59     | 99  | 87     |
| Net change in fair value of credit derivatives   | 21   | 58     | 103   | 106    |
| Fair value gains (losses) on financial guaranty variable interest entities                     | 5  | 3      | 11  | 25     |
| Bargain purchase gain and settlement of pre-existing relationships                             | —  | —      | —   | 58     |
| Commutation gains (losses)   | 1  | 255    | (16 )   | 328    |
| Other income (loss)  | 14   | 15     | (17 )   | 53     |
| Total revenues   | 274  | 623    | 788   | 1,458  |
| Expenses   |  |        |   |        |
| Loss and loss adjustment expenses  | 17   | 223    | 43  | 354    |
| Amortization of deferred acquisition costs   | 3  | 5      | 12  | 13     |
| Interest expense   | 23   | 24     | 71  | 73     |
| Other operating expenses   | 56   | 58     | 183   | 183    |
| Total expenses   | 99   | 310    | 309   | 623    |
| Income (loss) before income taxes  | 175  | 313    | 479   | 835    |
| Provision (benefit) for income taxes   |  |        |   |        |
| Current  | 3  | (148 ) | (28 )   | (102 ) |
| Deferred   | 11   | 253    | 74  | 259    |
| Total provision (benefit) for income taxes   | 14   | 105    | 46  | 157    |
| Net income (loss)  | \$161  | \$208  | \$433   | \$678  |
| Earnings per share:  |  |        |   |        |
| Basic  | \$1.48   | \$1.75 | \$3.87  | \$5.56 |
| Diluted  | \$1.47   | \$1.72 | \$3.83  | \$5.48 |

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





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Assured Guaranty Ltd.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |       | Nine<br>Months<br>Ended<br>September<br>30,<br>2017 |       |
|--|--|-------|---|-------|
| Net income (loss)  | \$161  | \$208 | \$433   | \$678 |
| Unrealized holding gains (losses) arising during the period on:  |  |       |   |       |
| Investments with no other-than-temporary impairment, net of tax provision (benefit) of \$(11), \$10, \$(42) and \$63   | (59 )  | 27    | (245 )  | 133   |
| Investments with other-than-temporary impairment, net of tax provision (benefit) of \$(3), \$(7), \$(5) and \$44   | (16 )  | (15 ) | (21 )   | 81    |
| Unrealized holding gains (losses) arising during the period, net of tax  | (75 )  | 12    | (266 )  | 214   |
| Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$0, \$3, \$(2) and \$29   | (7 )   | 4     | (11 )   | 52    |
| Change in net unrealized gains (losses) on investments   | (68 )  | 8     | (255 )  | 162   |
| Net unrealized gains (losses) arising during the period on financial guaranty variable interest entities' liabilities with recourse attributable to changes in instrument-specific credit risk, net of tax provision (benefit) of \$(1), \$-, \$(1) and \$- (see Note 1) | (5 )   | —     | (6 )  | —     |
| Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$0, \$-, \$(1) and \$-  | (2 )   | —     | (5 )  | —     |
| Change in net unrealized gains (losses) on financial guaranty variable interest entities' liabilities with recourse  | (3 )   | —     | (1 )  | —     |
| Other, net of tax provision  | (3 )   | 3     | (6 )  | 15    |
| Other comprehensive income (loss)  | (74 )  | 11    | (262 )  | 177   |
| Comprehensive income (loss)  | \$87   | \$219 | \$171   | \$855 |

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

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Assured Guaranty Ltd.

Condensed Consolidated Statement of Shareholders' Equity (unaudited)

For the Nine Months Ended September 30, 2018

(dollars in millions, except share data)

|   | Common<br>Shares<br>Outstanding | Common<br>Stock<br>Par<br>Value | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Deferred<br>Equity<br>Compensation | Total<br>Shareholders'<br>Equity |
|---|---------------------------------|---------------------------------|----------------------------------|----------------------|---|------------------------------------|----------------------------------|
| Balance at<br>December 31, 2017                   | 116,020,852                     | \$ 1                            | \$ 573                           | \$ 5,892             | \$ 372  | \$ 1                               | \$ 6,839                         |
| Net income  | —                               | —                               | —                                | 433                  | —   | —                                  | 433                              |
| Dividends (\$0.48 per share)                      | —                               | —                               | —                                | (54 )                | —   | —                                  | (54 )                            |
| Common stock repurchases                          | (10,250,175 )                   | 0                               | (380 )                           | —                    | —   | —                                  | (380 )                           |
| Share-based compensation and other                | 867,024                         | 0                               | 7                                | —                    | —   | —                                  | 7                                |
| Other comprehensive loss                          | —                               | —                               | —                                | —                    | (262 )  | —                                  | (262 )                           |
| Effect of adoption of ASU 2016-01<br>(see Note 1) | —                               | —                               | —                                | 32                   | (32 )   | —                                  | —                                |
| Balance at<br>September 30, 2018                  | 106,637,701                     | \$ 1                            | \$ 200                           | \$ 6,303             | \$ 78   | \$ 1                               | \$ 6,583                         |

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

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Assured Guaranty Ltd.

Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

|   | Nine Months<br>Ended<br>September<br>30, |         |
|---|--|---------|
|   | 2018                                     | 2017    |
| Net cash flows provided by (used in) operating activities                           | \$352                                    | \$354   |
| Investing activities  |  |         |
| Fixed-maturity securities:  |  |         |
| Purchases   | (1,478)                                  | (1,615) |
| Sales   | 908                                      | 1,128   |
| Maturities  | 746                                      | 689     |
| Net sales (purchases) of short-term investments                                     | (91 )                                    | (240 )  |
| Net proceeds from paydowns on financial guaranty variable interest entities' assets | 90                                       | 117     |
| Acquisition of MBIA UK Insurance Limited, net of cash acquired                      | —  | 95      |
| Proceeds from maturity of other invested asset                                      | —  | 85      |
| Other   | 19                                       | (27 )   |
| Net cash flows provided by (used in) investing activities                           | 194                                      | 232     |
| Financing activities  |  |         |
| Dividends paid  | (55 )                                    | (53 )   |
| Repurchases of common stock   | (380 )                                   | (431 )  |
| Repurchases of common stock to pay withholding taxes                                | (13 )                                    | (13 )   |
| Net paydowns of financial guaranty variable interest entities' liabilities          | (90 )                                    | (124 )  |
| Paydown of long-term debt   | (73 )                                    | (29 )   |
| Proceeds from option exercises  | 5  | 5       |
| Net cash flows provided by (used in) financing activities                           | (606 )                                   | (645 )  |
| Effect of foreign exchange rate changes   | (2 )                                     | 4       |
| Increase (decrease) in cash and restricted cash                                     | (62 )                                    | (55 )   |
| Cash and restricted cash at beginning of period (see Note 10)                       | 144                                      | 127     |
| Cash and restricted cash at end of period (see Note 10)                             | \$82                                     | \$72    |
| Supplemental cash flow information  |  |         |
| Cash paid (received) during the period for:   |  |         |
| Income taxes  | \$(5 )                                   | \$3     |
| Interest on long-term debt  | \$66                                     | \$53    |

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

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Assured Guaranty Ltd.

Notes to Condensed Consolidated Financial Statements (unaudited)

September 30, 2018

1. Business and Basis of Presentation

Business

Assured Guaranty Ltd. (AGL and, together with its subsidiaries, Assured Guaranty or the Company) is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (U.S.) and international public finance (including infrastructure) and structured finance markets. The Company applies its credit underwriting judgment, risk management skills and capital markets experience primarily to offer financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment (debt service), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom (U.K.), and also guarantees obligations issued in other countries and regions, including Australia and Western Europe. The Company also provides other forms of insurance (non-financial guaranty insurance) that are in line with its risk profile and benefit from its underwriting experience.

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

Basis of Presentation

The unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). In management's opinion, all material adjustments necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated variable interest entities (VIEs) are reflected in the periods presented and are of a normal, recurring nature. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim condensed consolidated financial statements are as of September 30, 2018 and cover the three-month period ended September 30, 2018 (Third Quarter 2018), the three-month period ended September 30, 2017 (Third Quarter 2017), the nine-month period ended September 30, 2018 (Nine Months 2018) and the nine-month period ended September 30, 2017 (Nine

Months 2017). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

The unaudited interim condensed consolidated financial statements include the accounts of AGL, its direct and indirect subsidiaries and its consolidated VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL's Annual Report on Form 10-K for the year ended December 31, 2017, filed with the U.S. Securities and Exchange Commission (SEC).

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

The Company's organizational structure includes various holding companies, two of which - Assured Guaranty US Holdings Inc. (AGUS) and Assured Guaranty Municipal Holdings Inc. (AGMH) - have public debt outstanding. See Note 15, Long-Term Debt and Credit Facilities and Note 18, Subsidiary Information.

The Company combined the operations of its European subsidiaries, AGE, Assured Guaranty (UK) plc (AGUK), Assured Guaranty (London) plc (AGLN) and CIFG Europe S.A. (CIFGE), in a transaction that was completed on November 7, 2018. In the combination, AGUK, AGLN and CIFGE transferred their insurance portfolios to and merged with and into AGE.

## Adopted Accounting Standards

### Financial Instruments

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

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

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

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

### Income Taxes

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

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Future Application of Accounting Standards

Premium Amortization on Purchased Callable Debt Securities

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

Leases

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). Subsequent to the issuance of this ASU, Topic 842 was amended by various updates that clarified the impact and implementation of ASU 2016-02. Collectively, these updates will require lessees to present right-of-use assets and lease liabilities on the balance sheet. The Company currently accounts for its lease agreements, where the Company is the lessee, as operating leases and, therefore, does not record these leases on its condensed consolidated balance sheet. Upon adoption, the Company will report an increase in both assets and liabilities as a result of including right-of-use assets and lease liabilities, primarily related to the Company's office space leases. The amended guidance will allow entities to recognize and measure leases at the adoption date prospectively. These updates are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company intends to adopt these updates on January 1, 2019.

Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU provides a new current expected credit loss model to account for credit losses on certain financial assets and off-balance sheet exposures (e.g., reinsurance recoverables, premium receivables, held-to-maturity debt securities, and loan commitments). That model requires an entity to estimate lifetime credit losses related to those financial assets recorded at amortized cost, based on relevant historical information, adjusted for current conditions and reasonable and supportable forecasts that could affect the collectability of the reported amount. The ASU also makes targeted amendments to the current impairment model for available-for-sale debt securities, which includes requiring the recognition of an allowance rather than a direct write-down of the investment. The allowance may be reversed in the event that the credit of an issuer improves. In addition, the ASU eliminates the existing guidance for purchased credit impaired assets and introduces a new model for purchased financial assets with credit deterioration, such as the Company's loss mitigation securities. That new model would require the recognition of an initial allowance for credit losses and an increase to the purchase price.

The ASU is effective for fiscal years, and interim period within those fiscal years, beginning after December 15, 2019. For reinsurance recoverables, premiums receivable and debt instruments such as loans and held to maturity securities, entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted. The changes to the impairment model for available-for-sale securities and changes to purchased financial assets with credit deterioration are to be applied prospectively. Early adoption of the amendments is permitted. The Company does not plan to early adopt this ASU. The Company is evaluating the effect that this ASU will have on its financial statements.

Targeted Improvements to the Accounting for Long-Duration Contracts



In August 2018, the FASB issued ASU 2018-12, Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts. The amendments in this ASU:

- improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount future cash flows,
- simplify and improve the accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts,
- simplify the amortization of deferred acquisition costs, and
- improve the effectiveness of the required disclosures.

This ASU does not impact the Company's financial guaranty insurance contracts, but may impact its accounting for certain non-financial guaranty contracts. This ASU is effective for fiscal years, and interim periods within those fiscal years,

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beginning after December 15, 2020. Early adoption of the amendments is permitted. The Company does not expect this ASU to have a material effect on its condensed consolidated financial statements.

## Changes to the Disclosure Requirements for Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU removed, modified and added additional disclosure requirements on fair value measurements in Topic 820. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments will be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments will be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company is in the process of determining what impact this ASU will have on its condensed consolidated financial statements.

## 2. Assumption of Insured Portfolio and Business Combinations

## Reinsurance of Syncora Guarantee Inc.'s Insured Portfolio

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

Effect of SGI Transaction  
As of June 1, 2018

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

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

**MBIA UK Insurance Limited**

AGC completed its acquisition (the MBIA UK Acquisition) of MBIA UK Insurance Limited (MBIA UK), the U.K. operating subsidiary of MBIA Insurance Corporation (MBIA) on January 10, 2017 (the MBIA UK Acquisition Date). As consideration for the outstanding shares of MBIA UK plus \$23 million in cash, AGC exchanged all its holdings of notes issued

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in the Zohar II 2005-1 transaction (Zohar II Notes), which were insured by MBIA. AGC's Zohar II Notes had total outstanding principal of approximately \$347 million and fair value of \$334 million as of the MBIA UK Acquisition Date. The MBIA UK Acquisition added approximately \$12 billion of net par insured on January 10, 2017. In connection with the MBIA UK Acquisition in the first quarter of 2017, the Company recognized a \$56 million bargain purchase gain and a \$2 million gain on settlement of pre-existing relationships.

MBIA UK was renamed Assured Guaranty (London) Ltd. and on June 1, 2017, was re-registered as a public limited company (plc). In a business combination completed on November 7, 2018, it transferred its insurance portfolio to and merged with and into AGE. See Note 1, Business and Basis of Presentation for additional information on the Company's European subsidiaries combination.

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

### 3. Ratings

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

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

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

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

There can be no assurance that any of the rating agencies will not take negative action on the financial strength ratings (or similar ratings) of AGL's insurance subsidiaries in the future or cease to rate one or more of AGL's insurance subsidiaries, either voluntarily or at the request of that subsidiary.

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

#### 4. Outstanding Exposure

The Company primarily writes financial guaranty contracts in insurance form. Until 2009, the Company also wrote some of its financial guaranty contracts in credit derivative form, and has acquired or reinsured portfolios both before and after

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2009 that include financial guaranty contracts in credit derivative form. Whether written as an insurance contract or as a credit derivative, the Company considers these financial guaranty contracts. The Company also writes a relatively small amount of non-financial guaranty insurance. The Company seeks to limit its exposure to losses by underwriting obligations that it views as investment grade at inception, although on occasion it may underwrite new issuances that it views as BIG, typically as part of its loss mitigation strategy for existing troubled exposures. The Company also seeks to acquire portfolios of insurance from financial guarantors that are no longer writing new business by acquiring such companies, providing reinsurance on a portfolio of insurance or reassuming a portfolio of reinsurance it had previously ceded; in such instances, it evaluates the risk characteristics of the target portfolio, which may include some BIG exposures, as a whole in the context of the proposed transaction. The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, typically requires rigorous subordination or collateralization requirements. Reinsurance may be used in order to reduce net exposure to certain insured transactions.

Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. The Company also includes within public finance similar obligations issued by territorial and non-U.S. sovereign and sub-sovereign issuers and governmental authorities.

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 9, Variable Interest Entities. Unless otherwise specified, the outstanding par and debt service amounts presented in this note include outstanding exposures on VIEs whether or not they are consolidated. The Company also provides non-financial guaranty insurance and reinsurance on transactions without special purpose entities but with similar risk profiles to its structured finance exposures written in financial guaranty form.

### Surveillance Categories

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

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

Exposures identified as BIG are subjected to further review to determine the probability of a loss. See Note 5, Expected Loss to be Paid, for additional information. Surveillance personnel then assign each BIG transaction to the

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

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

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

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

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

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

#### Financial Guaranty Exposure

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

The following table presents the gross and net debt service for financial guaranty contracts.

#### Financial Guaranty

##### Debt Service Outstanding

|                          | Gross Debt Service<br>Outstanding |                      | Net Debt Service<br>Outstanding |                      |
|--------------------------|-----------------------------------|----------------------|---------------------------------|----------------------|
|                          | September 30,<br>2018             | December 31,<br>2017 | September 30,<br>2018           | December 31,<br>2017 |
|                          | (in millions)                     |                      |                                 |                      |
| Public finance           | \$367,910                         | \$ 393,010           | \$364,731                       | \$ 386,092           |
| Structured finance       | 14,391                            | 15,482               | 13,962                          | 15,026               |
| Total financial guaranty | \$382,301                         | \$ 408,492           | \$378,693                       | \$ 401,118           |

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of \$440 million of gross par as of the date of this filing. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.





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## Financial Guaranty Portfolio by Internal Rating

As of September 30, 2018

| Rating<br>Category           | Public Finance<br>U.S. |       |   | Public Finance<br>Non-U.S. |       |   | Structured Finance<br>U.S |       |   | Structured Finance<br>Non-U.S |       |   | Total                  |       |   |
|------------------------------|------------------------|-------|---|----------------------------|-------|---|---------------------------|-------|---|-------------------------------|-------|---|------------------------|-------|---|
|                              | Net Par<br>Outstanding | %     |   | Net Par<br>Outstanding     | %     |   | Net Par<br>Outstanding    | %     |   | Net Par<br>Outstanding        | %     |   | Net Par<br>Outstanding | %     |   |
|                              | (dollars in millions)  |       |   |                            |       |   |                           |       |   |                               |       |   |                        |       |   |
| AAA                          | \$428                  | 0.2   | % | \$2,422                    | 5.4   | % | \$1,691                   | 15.9  | % | \$278                         | 23.6  | % | \$4,819                | 1.9   | % |
| AA                           | 22,715                 | 12.0  |   | 200                        | 0.4   |   | 3,412                     | 32.2  |   | 65                            | 5.5   |   | 26,392                 | 10.7  |   |
| A                            | 108,914                | 57.2  |   | 14,047                     | 31.4  |   | 1,532                     | 14.4  |   | 213                           | 18.1  |   | 124,706                | 50.5  |   |
| BBB                          | 52,190                 | 27.4  |   | 26,995                     | 60.4  |   | 1,027                     | 9.7   |   | 518                           | 44.1  |   | 80,730                 | 32.7  |   |
| BIG                          | 6,171                  | 3.2   |   | 1,071                      | 2.4   |   | 2,949                     | 27.8  |   | 102                           | 8.7   |   | 10,293                 | 4.2   |   |
| Total net par<br>outstanding | \$190,418              | 100.0 | % | \$44,735                   | 100.0 | % | \$10,611                  | 100.0 | % | \$1,176                       | 100.0 | % | \$246,940              | 100.0 | % |

## Financial Guaranty Portfolio by Internal Rating

As of December 31, 2017

| Rating<br>Category           | Public Finance<br>U.S. |       |   | Public Finance<br>Non-U.S. |       |   | Structured Finance<br>U.S |       |   | Structured Finance<br>Non-U.S |       |   | Total                  |       |   |
|------------------------------|------------------------|-------|---|----------------------------|-------|---|---------------------------|-------|---|-------------------------------|-------|---|------------------------|-------|---|
|                              | Net Par<br>Outstanding | %     |   | Net Par<br>Outstanding     | %     |   | Net Par<br>Outstanding    | %     |   | Net Par<br>Outstanding        | %     |   | Net Par<br>Outstanding | %     |   |
|                              | (dollars in millions)  |       |   |                            |       |   |                           |       |   |                               |       |   |                        |       |   |
| AAA                          | \$877                  | 0.4   | % | \$2,541                    | 5.9   | % | \$1,655                   | 14.7  | % | \$319                         | 22.5  | % | \$5,392                | 2.1   | % |
| AA                           | 30,016                 | 14.3  |   | 205                        | 0.5   |   | 3,915                     | 34.9  |   | 76                            | 5.4   |   | 34,212                 | 12.9  |   |
| A                            | 118,620                | 56.7  |   | 13,936                     | 32.5  |   | 1,630                     | 14.5  |   | 210                           | 14.9  |   | 134,396                | 50.7  |   |
| BBB                          | 52,739                 | 25.2  |   | 24,509                     | 57.1  |   | 763                       | 6.8   |   | 703                           | 49.7  |   | 78,714                 | 29.7  |   |
| BIG                          | 7,140                  | 3.4   |   | 1,731                      | 4.0   |   | 3,261                     | 29.1  |   | 106                           | 7.5   |   | 12,238                 | 4.6   |   |
| Total net par<br>outstanding | \$209,392              | 100.0 | % | \$42,922                   | 100.0 | % | \$11,224                  | 100.0 | % | \$1,414                       | 100.0 | % | \$264,952              | 100.0 | % |

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## Components of BIG Portfolio

## Financial Guaranty Portfolio

## Components of BIG Net Par Outstanding

As of September 30, 2018

|  | BIG Net Par Outstanding |        |          | Total BIG | Net Par<br>Outstanding |
|--|-------------------------|--------|----------|-----------|------------------------|
|  | BIG 1                   | BIG 2  | BIG 3    |           |                        |
|  | (in millions)           |        |          |           |                        |
| Public finance:                                    |                         |        |          |           |                        |
| U.S. public finance                                | \$ 1,559                | \$ 390 | \$ 4,222 | \$ 6,171  | \$ 190,418             |
| Non-U.S. public finance                            | 821                     | 250    | —        | 1,071     | 44,735                 |
| Public finance                                     | 2,380                   | 640    | 4,222    | 7,242     | 235,153                |
| Structured finance:                                |                         |        |          |           |                        |
| U.S. Residential mortgage-backed securities (RMBS) | 268                     | 254    | 2,038    | 2,560     | 4,566                  |
| Triple-X life insurance transactions               | —                       | —      | 85       | 85        | 1,185                  |
| Trust preferred securities (TruPS)                 | 81                      | —      | —        | 81        | 1,034                  |
| Other structured finance                           | 173                     | 82     | 70       | 325       | 5,002                  |
| Structured finance                                 | 522                     | 336    | 2,193    | 3,051     | 11,787                 |
| Total  | \$ 2,902                | \$ 976 | \$ 6,415 | \$ 10,293 | \$ 246,940             |

## Financial Guaranty Portfolio

## Components of BIG Net Par Outstanding

As of December 31, 2017

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

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

| Description | Net Par Outstanding  |                      |          | Number of Risks (2)                       |                      |       |
|-------------|--|----------------------|----------|---|----------------------|-------|
|             | Financial<br>Guaranty<br>Insurance<br>(1)<br>(dollars in millions) | Credit<br>Derivative | Total    | Financial<br>Guaranty<br>Insurance<br>(1) | Credit<br>Derivative | Total |
| BIG:        |  |                      |          |   |                      |       |
| Category 1  | \$2,746  | \$ 156               | \$2,902  | 130                                       | 6                    | 136   |
| Category 2  | 968  | 8                    | 976      | 41  | 2                    | 43    |
| Category 3  | 6,337  | 78                   | 6,415    | 146                                       | 8                    | 154   |
| Total BIG   | \$10,051   | \$ 242               | \$10,293 | 317                                       | 16                   | 333   |

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

| Description | Net Par Outstanding  |                      |          | Number of Risks (2)                       |                      |       |
|-------------|--|----------------------|----------|---|----------------------|-------|
|             | Financial<br>Guaranty<br>Insurance<br>(1)<br>(dollars in millions) | Credit<br>Derivative | Total    | Financial<br>Guaranty<br>Insurance<br>(1) | Credit<br>Derivative | Total |
| BIG:        |  |                      |          |   |                      |       |
| Category 1  | \$4,301  | \$ 227               | \$4,528  | 139                                       | 7                    | 146   |
| Category 2  | 1,344  | 17                   | 1,361    | 46  | 3                    | 49    |
| Category 3  | 6,255  | 94                   | 6,349    | 150                                       | 9                    | 159   |
| Total BIG   | \$11,900   | \$ 338               | \$12,238 | 335                                       | 19                   | 354   |

(1) Includes net par outstanding for VIEs.

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

#### Exposure to Puerto Rico

The Company had insured exposure to general obligation bonds of the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations aggregating \$4.8 billion net par as of September 30, 2018, all of which was rated BIG. Puerto Rico has experienced significant general fund budget deficits and a challenging economic environment since at least the financial crisis. Beginning on January 1, 2016, a number of Puerto Rico exposures have defaulted on bond payments, and the Company has now paid claims on all of its Puerto Rico exposures except for Puerto Rico Aqueduct and Sewer Authority (PRASA), Municipal Finance

Agency (MFA) and University of Puerto Rico (U of PR).

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

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

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

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

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

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

The Oversight Board has certified a number of fiscal plans (in some instances certifying revisions of previously certified plans) for the Commonwealth, PRHTA, PREPA and PRASA. The Company does not believe the certified fiscal plans for the Commonwealth, PRHTA, PREPA or PRASA comply with certain mandatory requirements of PROMESA.

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

The Company participates in mediation and negotiations relating to its Puerto Rico exposure. The Company is a party to a consensual resolution for COFINA debt memorialized in an agreement dated September 20, 2018. The Company has not agreed to the potential resolution of the PREPA debt announced in July 2018. See discussions below.

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

The Company groups its Puerto Rico exposure into three categories:

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

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

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

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

Constitutionally Guaranteed

General Obligation. As of September 30, 2018, the Company had \$1,341 million insured net par outstanding of the general obligations of Puerto Rico, which are supported by the good faith, credit and taxing power of the Commonwealth. Despite the requirements of Article VI of its Constitution, the Commonwealth defaulted on the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to the Commonwealth.

On October 23, 2018, the Oversight Board certified a revised fiscal plan for the Commonwealth. The revised certified Commonwealth fiscal plan indicates an expected primary budget surplus, if fiscal plan reforms are enacted, of \$17.0 billion that would be available for debt service over the six-year forecast period ending 2023. The Company believes the available surplus set forth in the Oversight Board's revised certified fiscal plan (which assumes certain fiscal reforms are implemented by the Commonwealth) should be sufficient to cover contractual debt service of Commonwealth general obligation issuance and of authorities and public corporations directly implicated by the Commonwealth's general fund during the forecast period. However, the revised certified Commonwealth fiscal plan indicates a net primary budget deficit for the period from 2023 through 2058, and there can be no assurance that the fiscal reforms will be enacted or, if they are, that the forecasted primary budget surplus will occur or, if it does, that such funds will be used to cover contractual debt service.

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

Public Corporations - Certain Revenues Potentially Subject to Clawback

PRHTA. As of September 30, 2018, the Company had \$844 million insured net par outstanding of PRHTA (transportation revenue) bonds and \$475 million insured net par outstanding of PRHTA (highways revenue) bonds. The transportation revenue bonds are secured by a subordinate gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to \$120 million annually of taxes on crude oil, unfinished oil and derivative products. The highways revenue bonds are secured by a gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The non-toll revenues consisting of excise taxes and fees collected by the Commonwealth on behalf of PRHTA and its bondholders that are statutorily allocated to PRHTA and its bondholders are potentially subject to clawback. Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to



PRHTA.

On June 28, 2018, the Oversight Board certified a revised fiscal plan for PRHTA. The revised certified PRHTA fiscal plan projects very limited capacity to pay debt service over the six-year forecast period.

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

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PRIFA. As of September 30, 2018, the Company had \$16 million insured net par outstanding of PRIFA bonds, which are secured primarily by the return to Puerto Rico of federal excise taxes paid on rum. These revenues are potentially subject to the clawback. The Company has been making claim payments on the PRIFA bonds since January 2016.

Other Public Corporations

PREPA. As of September 30, 2018, the Company had \$848 million insured net par outstanding of PREPA obligations, which are secured by a lien on the revenues of the electric system. The Company has been making claim payments on these bonds since July 1, 2017.

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

The Oversight Board did not certify the PREPA RSA under Title VI of PROMESA as the Company believes was required by PROMESA, but rather, on July 2, 2017, commenced proceedings for PREPA under Title III of PROMESA.

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

On August 1, 2018, the Oversight Board certified a revised fiscal plan for PREPA.

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

On August 1, 2018, the Oversight Board certified a revised fiscal plan for PRASA.

MFA. As of September 30, 2018, the Company had \$303 million net par outstanding of bonds issued by MFA secured by a lien on local property tax revenues. The MFA bond accounts contained sufficient funds to make the MFA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

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

On September 20, 2018, the Commonwealth, the Oversight Board, and senior and subordinate COFINA creditors, including the Company, representing a total of approximately \$10 billion of COFINA debt, executed an amended and restated Plan Support Agreement (COFINA PSA) allocating between the senior and subordinate COFINA

bondholders the portion to be received by COFINA of the pledged sales tax base amount (PSTBA) of the 5.5% Sales and Use Taxes (SUT). Under the COFINA PSA, the Company expects implied recoveries, including fees for parties to the COFINA PSA, will total in the mid-90% range for the senior bonds and approach 60% for the subordinate bonds, and both senior and subordinate COFINA creditors will exchange their positions for new senior closed lien COFINA bonds. The COFINA PSA includes a term sheet that details the terms and conditions of the settlement reached on June 7, 2018 among the court-appointed agents for COFINA and the Commonwealth to resolve a dispute between the Commonwealth and COFINA regarding ownership of the PSTBA. The June 7, 2018 agreement in principle, which was filed with the Federal District Court for Puerto Rico, requires, among other things, that future challenges to it be barred by the court or made illegal, and provides that, beginning July 1, 2018, the SUT would be paid first to COFINA until it has received 53.65% of the PSTBA and that the remaining 46.35% of the PSTBA would be paid to the Commonwealth thereafter. The June 7, 2018 agreement in principle does not impact SUT in excess of the PSTBA, which is paid to the Commonwealth. The Company is reserving its contractual voting rights as sole bondholder of certain Commonwealth general obligation bonds and its related subrogee rights with respect to both the SUT revenues allocated

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to the Commonwealth and other available resources of the Commonwealth. Under the Constitution of the Commonwealth, such revenues and resources must be used to pay general obligation debt before any other claim, debt or expense, including government expenses.

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

Puerto Rico Recovery Litigation

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

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

On May 16, 2017, The Bank of New York Mellon, as trustee for the bonds issued by COFINA, filed an adversary complaint for interpleader and declaratory relief with the Federal District Court for Puerto Rico to resolve competing and conflicting demands made by various groups of COFINA bondholders, insurers of certain COFINA Bonds and COFINA, regarding funds held by the trustee for certain COFINA bond debt service payments scheduled to occur on and after June 1, 2017. On May 19, 2017, an order to show cause was entered permitting AGM to intervene in this matter. On September 20, 2018, the Oversight Board, the Commonwealth, and senior and subordinate COFINA bondholders, including AGM, entered into the COFINA PSA described above. The Company believes that the dispute would be resolved if the court approved the COFINA PSA.

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

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

On July 18, 2017, AGM and AGC filed in the Federal District Court for Puerto Rico a motion for relief from the automatic stay in the PREPA Title III bankruptcy proceeding and a form of complaint seeking the appointment of a receiver for PREPA. The court denied the motion on September 14, 2017, but on August 8, 2018, the First Circuit vacated and remanded the

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court's decision. On October 3, 2018, AGM and AGC, together with other bond insurers, filed a motion with the court to lift the automatic stay to commence an action against PREPA for the appointment of a receiver.

On May 23, 2018, AGM and AGC filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment declaring that (i) the Oversight Board lacked authority to develop or approve the new fiscal plan for Puerto Rico which it certified on April 19, 2018 (Revised Fiscal Plan); (ii) the Revised Fiscal Plan and the Fiscal Plan Compliance Law (Compliance Law) enacted by the Commonwealth to implement the original Commonwealth Fiscal Plan violate various sections of PROMESA; (iii) the Revised Fiscal Plan, the Compliance Law and various moratorium laws and executive orders enacted by the Commonwealth to prevent the payment of debt service (a) are unconstitutional and void because they violate the Contracts, Takings and Due Process Clauses of the U.S. Constitution and (b) are preempted by various sections of PROMESA; and (iv) no Title III plan of adjustment based on the Revised Fiscal Plan can be confirmed under PROMESA. On August 13, 2018, the court-appointed magistrate judge granted the Commonwealth's and the Oversight Board's motion to stay this adversary proceeding pending a decision by the First Circuit in an appeal of an unrelated adversary proceeding decision by Ambac Assurance Corporation, which may resolve certain similar issues.

On July 23, 2018, AGC and AGM filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment (i) declaring the members of the Oversight Board are officers of the U.S. whose appointments were unlawful under the Appointments Clause of the U.S. Constitution; (ii) declaring void ab initio the unlawful actions taken by the Oversight Board to date, including (x) development of the Commonwealth's Fiscal Plan, (y) development of PRHTA's Fiscal Plan, and (z) filing of the Title III cases on behalf of the Commonwealth and PRHTA; and (iii) enjoining the Oversight Board from taking any further action until the Oversight Board members have been lawfully appointed in conformity with the Appointments Clause of the U.S. Constitution. The Title III court dismissed a similar lawsuit filed by another party in the Commonwealth's Title III case in July 2018. On August 3, 2018, a stipulated judgment was entered against AGM and AGC at their request based upon the court's July decision in the other Appointments Clause lawsuit and, on the same date, AGM and AGC appealed the stipulated judgment to the First Circuit. On August 15, 2018, the court consolidated, for purposes of briefing and oral argument, AGM and AGC's appeal with the other Appointments Clause lawsuit. On September 7, 2018, the United States Court of Appeals for the First Circuit consolidated AGM's and AGC's appeal with a third Appointments Clause lawsuit.

#### Puerto Rico Par and Debt Service Schedules

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

#### Puerto Rico

##### Gross Par and Gross Debt Service Outstanding

|                         | Gross Par<br>Outstanding |                      | Gross Debt Service<br>Outstanding |                      |
|-------------------------|--------------------------|----------------------|-----------------------------------|----------------------|
|                         | September<br>2018        | December 31,<br>2017 | September<br>2018                 | December 31,<br>2017 |
|                         | (in millions)            |                      |                                   |                      |
| Exposure to Puerto Rico | \$4,971                  | \$ 5,186             | \$8,037                           | \$ 8,514             |

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Puerto Rico

Net Par Outstanding

|  | As of<br>September<br>2018 | As of<br>December 31,<br>2017 |
|--|----------------------------|-------------------------------|
|  | (in millions)              |                               |
| Commonwealth Constitutionally Guaranteed                               |                            |                               |
| Commonwealth of Puerto Rico - General Obligation Bonds (1)             | \$1,341                    | \$ 1,419                      |
| PBA  | 141                        | 141                           |
| Public Corporations - Certain Revenues Potentially Subject to Clawback |                            |                               |
| PRHTA (Transportation revenue) (1)                                     | 844                        | 882                           |
| PRHTA (Highways revenue) (1)   | 475                        | 495                           |
| PRCCDA   | 152                        | 152                           |
| PRIFA  | 16                         | 18                            |
| Other Public Corporations  |                            |                               |
| PREPA (1)  | 848                        | 853                           |
| PRASA  | 373                        | 373                           |
| MFA  | 303                        | 360                           |
| COFINA (1)   | 273                        | 272                           |
| U of PR  | 1                          | 1                             |
| Total net exposure to Puerto Rico                                      | \$4,767                    | \$ 4,966                      |

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

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

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

|                                | Scheduled<br>Net<br>Par<br>Amortization<br>(in millions) | Scheduled<br>Net Debt<br>Service<br>Amortization<br>(in millions) |
|--------------------------------|--|---|
| 2018 (October 1 - December 31) | \$0  | \$ 3  |
| 2019 (January 1 - March 31)    | 0  | 117   |
| 2019 (April 1 - June 30)       | 0  | 3   |
| 2019 (July 1 - September 30)   | 224  | 341   |
| 2019 (October 1 - December 31) | 0  | 3   |
| Subtotal 2019                  | 224  | 464   |
| 2020                           | 285  | 516   |
| 2021                           | 147  | 364   |
| 2022                           | 137  | 345   |
| 2023-2027                      | 1,229  | 2,128   |
| 2028-2032                      | 812  | 1,436   |
| 2033-2037                      | 1,217  | 1,572   |
| 2038-2042                      | 453  | 602   |
| 2043-2047                      | 263  | 316   |
| Total                          | \$4,767  | \$ 7,746  |

## Exposure to the U.S. Virgin Islands

As of September 30, 2018, the Company had \$496 million insured net par outstanding to the U.S. Virgin Islands and its related authorities (USVI), of which it rated \$222 million BIG. The \$274 million USVI net par the Company rated investment grade was composed primarily of bonds secured by a lien on matching fund revenues related to excise taxes on products produced in the USVI and exported to the U.S., primarily rum. The \$222 million BIG USVI net par comprised (a) Public Finance Authority bonds secured by a gross receipts tax and the general obligation, full faith and credit pledge of the USVI and (b) bonds of the Virgin Islands Water and Power Authority secured by a net revenue pledge of the electric system.

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

## Non-Financial Guaranty Exposure



The Company also provides non-financial guaranty insurance and reinsurance on transactions with similar risk profiles to its structured finance exposures written in financial guaranty form. All non-financial guaranty exposures shown in the table below are rated investment grade internally.

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## Non-Financial Guaranty Exposure

|  | Gross Exposure           |                         | Net Exposure             |                         |
|--|--------------------------|-------------------------|--------------------------|-------------------------|
|  | As of September 30, 2018 | As of December 31, 2017 | As of September 30, 2018 | As of December 31, 2017 |
|  | (in millions)            |                         |                          |                         |
| Capital relief triple-X life reinsurance (1) | \$ 883                   | \$ 773                  | \$ 766                   | \$ 675                  |
| Aircraft residual value insurance policies   | 340                      | 201                     | 218                      | 140                     |

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

## 5. Expected Loss to be Paid

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

## Loss Estimation Process

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

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

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

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

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

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

The following tables present a roll forward of net expected loss to be paid for all contracts. The Company used risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 3.20% with a weighted average of 3.03% as of September 30, 2018 and 0.00% to 2.78% with a weighted average of 2.38% as of December 31, 2017. Expected losses to be

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paid for transactions denominated in currencies other than the U.S. dollar represented approximately 3.2% and 3.7% of the total as of September 30, 2018 and December 31, 2017, respectively.

## Net Expected Loss to be Paid

## Roll Forward

|   | Third Quarter |         | Nine Months |         |
|---|---------------|---------|-------------|---------|
|   | 2018          | 2017    | 2018        | 2017    |
|   | (in millions) |         |             |         |
| Net expected loss to be paid, beginning of period                                 | \$1,432       | \$1,297 | \$1,303     | \$1,198 |
| Net expected loss to be paid on the SGI portfolio as of June 1, 2018 (see Note 2) | —             | —       | 131         | —       |
| Net expected loss to be paid on the MBIA UK portfolio as of January 10, 2017      | —             | —       | —           | 21      |
| Economic loss development (benefit) due to:                                       |               |         |             |         |
| Accretion of discount   | 10            | 8       | 27          | 24      |
| Changes in discount rates   | (9 )          | (6 )    | (15 )       | 28      |
| Changes in timing and assumptions   | (1 )          | 202     | (17 )       | 246     |
| Total economic loss development (benefit)   | 0             | 204     | (5 )        | 298     |
| Net (paid) recovered losses   | (241 )        | (209 )  | (238 )      | (225 )  |
| Net expected loss to be paid, end of period                                       | \$1,191       | \$1,292 | \$1,191     | \$1,292 |

## Net Expected Loss to be Paid

## Roll Forward by Sector

## Third Quarter 2018

|                          | Net Expected<br>Loss to be<br>Paid<br>(Recovered) as of<br>June 30,<br>2018<br>(in millions) |                                   |           | Net Expected<br>Loss to be Paid<br>(Recovered) as of<br>September 30,<br>2018<br>(2) |  |
|--------------------------|--|-----------------------------------|-----------|--|--|
|                          | Economic Loss<br>Development /<br>(Benefit)  | (Paid)<br>Recovered<br>Losses (1) |           |  |  |
| Public finance:          |  |                                   |           |  |  |
| U.S. public finance      | \$ 1,041   | \$ 42                             | \$ (251 ) | \$ 832   |  |
| Non-U.S. public finance  | 41   | (3 )                              | —         | 38   |  |
| Public finance           | 1,082  | 39                                | (251 )    | 870  |  |
| Structured finance:      |  |                                   |           |  |  |
| U.S. RMBS                | 326  | (40 )                             | 17        | 303  |  |
| Other structured finance | 24   | 1                                 | (7 )      | 18   |  |
| Structured finance       | 350  | (39 )                             | 10        | 321  |  |
| Total                    | \$1,432  | \$ 0                              | \$ (241 ) | \$ 1,191   |  |

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

|                          | Net Expected<br>Loss to be<br>Paid (Recovered)<br>as of<br>June 30,<br>2017<br>(in millions) |        |   | Economic Loss (Paid)<br>Development /<br>Recovered<br>Losses (1) | Net Expected<br>Loss to be<br>Paid (Recovered)<br>as of<br>September 30,<br>2017 |
|--------------------------|--|--------|---|--|--|
| Public finance:          |  |        |   |  |  |
| U.S. public finance      | \$ 1,044   | \$ 229 |   | \$ (227 )  | \$ 1,046   |
| Non-U.S. public finance  | 42   | 0      |   | 5  | 47   |
| Public finance           | 1,086  | 229    |   | (222 )   | 1,093  |
| Structured finance:      |  |        |   |  |  |
| U.S. RMBS                | 182  | (19    | ) | 13   | 176  |
| Other structured finance | 29   | (6     | ) | 0  | 23   |
| Structured finance       | 211  | (25    | ) | 13   | 199  |
| Total                    | \$ 1,297   | \$ 204 |   | \$ (209 )  | \$ 1,292   |

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

|                          | Net Expected<br>Loss to be<br>Paid (Recovered)<br>as of<br>December 31,<br>2017<br>(2) |        |  | Net<br>Expected<br>Loss to<br>be Paid<br>on SGI<br>Portfolio<br>as of June<br>1, 2018 | Economic Loss (Paid)<br>Development /<br>Recovered<br>Losses (1) | Net Expected<br>Loss to be Paid<br>(Recovered) as of<br>September 30,<br>2018<br>(2) |
|--------------------------|--|--------|--|---|--|--|
| Public finance:          |  |        |  |   |  |  |
| U.S. public finance      | \$ 1,157   | \$ 0   |  | \$ 59   | \$ (384 )  | \$ 832   |
| Non-U.S. public finance  | 46   | 1      |  | (9 )  | 0  | 38   |
| Public finance           | 1,203  | 1      |  | 50  | (384 )   | 870  |
| Structured finance:      |  |        |  |   |  |  |
| U.S. RMBS                | 73   | 130    |  | (52 )   | 152  | 303  |
| Other structured finance | 27   | —      |  | (3 )  | (6 )   | 18   |
| Structured finance       | 100  | 130    |  | (55 )   | 146  | 321  |
| Total                    | \$ 1,303   | \$ 131 |  | \$ (5 )   | \$ (238 )  | \$ 1,191   |

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

|                          | Net Expected<br>Loss to be Paid<br>(Recovered)<br>as of<br>December 31,<br>2016 | Net<br>Expected<br>Loss to<br>be Paid<br>(Recovered)<br>on MBIA<br>basis of<br>January<br>10, 2017<br><br>(in millions) | Economic Loss<br>(Paid)<br>Development /<br>(Benefit) | (Paid)<br>Recovered<br>Losses (1) | Net Expected<br>Loss to be<br>Paid (Recovered)<br>as of<br>September 30,<br>2017 |
|--------------------------|---|---|---|-----------------------------------|--|
| Public finance:          |   |   |   |                                   |  |
| U.S. public finance      | \$871   | \$ —  | \$ 431  | \$ (256 )                         | \$ 1,046   |
| Non-U.S. public finance  | 33  | 13  | (4 )  | 5                                 | 47   |
| Public finance           | 904   | 13  | 427   | (251 )                            | 1,093  |
| Structured finance:      |   |   |   |                                   |  |
| U.S. RMBS                | 206   | —   | (70 )   | 40                                | 176  |
| Other structured finance | 88  | 8   | (59 )   | (14 )                             | 23   |
| Structured finance       | 294   | 8   | (129 )  | 26                                | 199  |
| Total                    | \$1,198   | \$ 21   | \$ 298  | \$ (225 )                         | \$ 1,292   |

Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance (1)recoverable on paid losses included in other assets. The Company paid \$6 million and \$7 million in loss adjustment expenses (LAE) for Third Quarter 2018 and 2017, respectively, and \$17 million and \$16 million in LAE for Nine Months 2018 and 2017, respectively.

(2) Includes expected LAE to be paid of \$15 million as of September 30, 2018 and \$23 million as of December 31, 2017.

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

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

|                              | Net Expected Loss to<br>be Paid (Recovered) |                               | Net Economic Loss<br>Development<br>(Benefit) |                          |                        |                        |
|------------------------------|---|-------------------------------|---|--------------------------|------------------------|------------------------|
|                              | As of<br>September 30,<br>2018              | As of<br>December 31,<br>2017 | Third<br>Quarter<br>2018                      | Third<br>Quarter<br>2017 | Nine<br>Months<br>2018 | Nine<br>Months<br>2017 |
| Financial guaranty insurance | \$1,112                                     | \$ 1,226                      | \$ 1  | \$ 207                   | \$ (9 )                | \$ 328                 |
| FG VIEs (1) and other        | 83  | 91                            | (3 )  | (2 )                     | (7 )                   | (6 )                   |

|                        |         |          |     |        |         |        |
|------------------------|---------|----------|-----|--------|---------|--------|
| Credit derivatives (2) | (4 )    | (14 )    | 2   | (1 )   | 11      | (24 )  |
| Total                  | \$1,191 | \$ 1,303 | \$0 | \$ 204 | \$ (5 ) | \$ 298 |

(1) See Note 9, Variable Interest Entities.

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

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### Selected U.S. Public Finance Transactions

The Company insured general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$4.8 billion net par as of September 30, 2018, all of which was BIG. For additional information regarding the Company's exposure to general obligations of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, see "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

As of September 30, 2018, the Company had insured \$331 million net par outstanding of general obligation bonds issued by the City of Hartford, Connecticut, most of which was rated BIG at December 31, 2017. In the first quarter of 2018, the State of Connecticut entered into a contract assistance agreement with the City of Hartford under which the state will pay the debt service costs of the City's general obligation bonds, including those insured by the Company. As a result, the Company reduced the corresponding expected losses as of March 31, 2018 and upgraded this exposure to investment grade.

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

On February 25, 2015, a plan of adjustment resolving the bankruptcy filing of the City of Stockton, California under chapter 9 of the U.S. Bankruptcy Code became effective. As of September 30, 2018, the Company's net par subject to the plan consisted of \$110 million of pension obligation bonds. As part of the plan of adjustment, the City will repay any claims paid on the pension obligation bonds from certain fixed payments and certain variable payments contingent on the City's revenue growth.

The Company projected that its total net expected loss across its troubled U.S. public finance exposures as of September 30, 2018 including those mentioned above, would be \$832 million, compared with a net expected loss of \$1,157 million as of December 31, 2017. The economic loss development in Third Quarter 2018 was \$42 million, which was primarily attributable to Puerto Rico exposures. The economic loss development for Nine Months 2018 was \$59 million, which was primarily attributable to Puerto Rico exposures, partially offset by a benefit related to the State of Connecticut's agreement to pay the debt service costs of certain bonds of the City of Hartford, including the bonds insured by the Company.

### Selected Non - U.S. Public Finance Transactions

The Company insures and reinsures transactions with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the sub-sovereigns also to default. The Company's exposure net of reinsurance to these Spanish and Portuguese exposures is \$437 million and \$71 million, respectively. The Company rates all of these exposures BIG due to the financial condition of Spain and Portugal and their dependence on the sovereign.



The Company also has exposure to infrastructure bonds dependent on payments from Hungarian governmental entities. The Company's exposure, net of reinsurance, to these Hungarian transactions is \$179 million, all of which was rated BIG.

The Company also insures an obligation backed by the availability and toll revenues of a major arterial road into a city in the U.K. with \$201 million of net par outstanding as of September 30, 2018. This transaction has been underperforming due to higher costs compared with expectations at underwriting. In the first quarter of 2018, the Company changed its traffic assumptions for this road, resulting in a benefit.

These transactions, together with other non-U.S. public finance insured obligations, had expected loss to be paid of \$38 million as of September 30, 2018, compared with \$46 million as of December 31, 2017. The economic benefit of approximately \$3 million for Third Quarter 2018 was attributable mainly to changes in certain probability of default assumptions. The economic benefit of approximately \$9 million during Nine Months 2018 was attributable mainly to the U.K. arterial road and changes in probability of default assumptions mentioned above.

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## U.S. RMBS Loss Projections

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

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

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

## Net Economic Loss Development (Benefit)

## U.S. RMBS

|                       | Third<br>Quarter<br>2018 | 2017  | Nine<br>Months<br>2018 | 2017   |
|-----------------------|--------------------------|-------|------------------------|--------|
|                       | (in millions)            |       |                        |        |
| First lien U.S. RMBS  | \$(13)                   | \$ 1  | \$4                    | \$(22) |
| Second lien U.S. RMBS | (27 )                    | (20 ) | (56)                   | (48 )  |

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

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

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## First Lien Liquidation Rates

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

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

In the most heavily weighted scenario (the base case), after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 4.75 years after the initial 36-month CDR plateau period. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified or delinquent in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period represent defaults attributable to borrowers that are currently performing or are projected to reperform.

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

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continue for another 18 months. The Company determines its initial loss severity based on actual recent experience. Each quarter the Company reviews available data and (if necessary) adjusts its severities based on its observations. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period, declining to 40% in the base case over 2.5 years.

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

Key Assumptions in Base Case Expected Loss Estimates  
First Lien RMBS

|                         | As of<br>September 30, 2018 |                     | As of<br>June 30, 2018 |                     | As of<br>December 31, 2017 |                     |
|-------------------------|-----------------------------|---------------------|------------------------|---------------------|----------------------------|---------------------|
|                         | Range                       | Weighted<br>Average | Range                  | Weighted<br>Average | Range                      | Weighted<br>Average |
| <b>Alt-A First Lien</b> |                             |                     |                        |                     |                            |                     |
| Plateau CDR             | 0.9% - 11.2%                | 4.6%                | 0.7% - 12.2%           | 4.7%                | 1.3% - 9.8%                | 5.2%                |
| Final CDR               | 0.0% - 0.6%                 | 0.2%                | 0.0% - 0.6%            | 0.2%                | 0.1% - 0.5%                | 0.3%                |
| Initial loss severity:  |                             |                     |                        |                     |                            |                     |
| 2005 and prior          | 60%                         |                     | 60%                    |                     | 60%                        |                     |
| 2006                    | 70%                         |                     | 80%                    |                     | 80%                        |                     |
| 2007+                   | 70%                         |                     | 70%                    |                     | 70%                        |                     |
| <b>Option ARM</b>       |                             |                     |                        |                     |                            |                     |
| Plateau CDR             | 2.1% - 8.7%                 | 5.8%                | 2.1% - 8.5%            | 5.9%                | 2.5% - 7.0%                | 5.9%                |
| Final CDR               | 0.1% - 0.4%                 | 0.3%                | 0.1% - 0.4%            | 0.3%                | 0.1% - 0.3%                | 0.3%                |
| Initial loss severity:  |                             |                     |                        |                     |                            |                     |
| 2005 and prior          | 60%                         |                     | 60%                    |                     | 60%                        |                     |
| 2006                    | 60%                         |                     | 70%                    |                     | 70%                        |                     |
| 2007+                   | 70%                         |                     | 75%                    |                     | 75%                        |                     |
| <b>Subprime</b>         |                             |                     |                        |                     |                            |                     |
| Plateau CDR             | 2.3% - 18.6%                | 6.7%                | 3.2% - 18.4%           | 6.9%                | 3.5% - 13.1%               | 7.8%                |
| Final CDR               | 0.1% - 0.9%                 | 0.3%                | 0.2% - 0.9%            | 0.3%                | 0.2% - 0.7%                | 0.4%                |
| Initial loss severity:  |                             |                     |                        |                     |                            |                     |
| 2005 and prior          | 80%                         |                     | 80%                    |                     | 80%                        |                     |
| 2006                    | 75%                         |                     | 85%                    |                     | 90%                        |                     |
| 2007+                   | 95%                         |                     | 95%                    |                     | 95%                        |                     |

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

CPR is not used. These CPR assumptions are the same as those the Company used for June 30, 2018 and December 31, 2017.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the CDR returned to its modeled equilibrium, which was defined as 5% of the initial CDR. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios as of September 30, 2018 and December 31, 2017.

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Total expected loss to be paid on all first lien U.S. RMBS was \$237 million and \$123 million as of September 30, 2018 and December 31, 2017, respectively. The reinsurance of the SGI portfolio added \$113 million of net expected loss to first lien U.S. RMBS on June 1, 2018. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of September 30, 2018 as it used as of June 30, 2018 and December 31, 2017, increasing and decreasing the periods of stress from those used in the base case.

In the Company's most stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the CDR was assumed to occur over 15 months, expected loss to be paid would increase from current projections by approximately \$57 million for all first lien U.S. RMBS transactions.

In the Company's least stressful scenario where the CDR plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the CDR recovery was more pronounced (including an initial ramp-down of the CDR over nine months), expected loss to be paid would decrease from current projections by approximately \$35 million for all first lien U.S. RMBS transactions.

U.S. Second Lien RMBS Loss Projections

Second lien RMBS transactions include both home equity lines of credit (HELOC) and closed end second lien mortgages. The Company believes the primary variable affecting its expected losses in second lien RMBS transactions is the amount and timing of future losses in the collateral pool supporting the transactions. Expected losses are also a function of the structure of the transaction, the voluntary prepayment rate (typically also referred to as CPR of the collateral), the interest rate environment, and assumptions about loss severity.

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. The Company estimates the amount of loans that will default over the next six months by calculating current representative liquidation rates. Similar to first liens, the Company then calculates a CDR for six months, which is the period over which the currently delinquent collateral is expected to be liquidated. That CDR is then used as the basis for the plateau CDR period that follows the embedded plateau losses.

For the base case scenario, the CDR (the plateau CDR) was held constant for six months. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. (The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting.) In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising six months of delinquent loan liquidations, followed by 28 months of decrease to the steady state CDR, the same as of June 30, 2018 and December 31, 2017.

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

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

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

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

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



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the Company's continued uncertainty about the projected performance of the borrowers in these transactions. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. This pattern is generally consistent with how the Company modeled the CPR as of June 30, 2018 and December 31, 2017. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

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

The Company continues to evaluate the assumptions affecting its modeling results. The Company believes the most important driver of its projected second lien RMBS losses is the performance of its HELOC transactions. Total expected loss to be paid on all second lien U.S. RMBS was \$66 million as of September 30, 2018 and total expected recovery on all second lien U.S. RMBS was \$50 million as of December 31, 2017, respectively. This change was due primarily to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017 and the addition of \$17 million of net expected loss on second lien U.S. RMBS assumed in the SGI Transaction on June 1, 2018.

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

Key Assumptions in Base Case Expected Loss Estimates  
HELOCs

|  | As of<br>September 30, 2018 |                     | As of<br>June 30, 2018 |                     | As of<br>December 31, 2017 |                     |
|--|-----------------------------|---------------------|------------------------|---------------------|----------------------------|---------------------|
|  | Range                       | Weighted<br>Average | Range                  | Weighted<br>Average | Range                      | Weighted<br>Average |
| Plateau CDR                                      | 2.9%-31.7%                  | 11.5%               | 4.8%-28.5%             | 11.1%               | 2.7%-19.9%                 | 11.4%               |
| Final CDR trended down to                        | 2.5%-3.2%                   | 2.5%                | 2.5%-3.2%              | 2.5%                | 2.5%-3.2%                  | 2.5%                |
| Liquidation rates:                               |                             |                     |                        |                     |                            |                     |
| Delinquent/Modified in the<br>Previous 12 Months | 20%                         |                     | 20%                    |                     | 20%                        |                     |
| 30 – 59 Days Delinquent                          | 40                          |                     | 40                     |                     | 45                         |                     |
| 60 – 89 Days Delinquent                          | 55                          |                     | 55                     |                     | 60                         |                     |
| 90+ Days Delinquent                              | 75                          |                     | 75                     |                     | 75                         |                     |
| Bankruptcy                                       | 55                          |                     | 55                     |                     | 55                         |                     |
| Foreclosure                                      | 65                          |                     | 65                     |                     | 70                         |                     |
| Real Estate Owned                                | 100                         |                     | 100                    |                     | 100                        |                     |
| Loss severity                                    | 98%                         |                     | 98%                    |                     | 98%                        |                     |

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

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

#### Breaches of Representations and Warranties

As of September 30, 2018, the Company had a net R&W receivable of \$13 million from R&W counterparties, compared to a net R&W receivable of \$117 million as of December 31, 2017. The decrease was due primarily to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017.

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### Other Structured Finance

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

The Company has insured or reinsured \$1.2 billion net par of student loan securitizations issued by private issuers that are classified as structured finance. Of this amount, \$111 million is rated BIG. In general, the projected losses are due to: (i) the poor credit performance of private student loan collateral and high loss severities, or (ii) high interest rates on auction rate securities with respect to which the auctions have failed.

The Company projected that its total net expected loss across its troubled non-RMBS structured finance exposures as of September 30, 2018 including those mentioned above was \$18 million and is primarily attributable to structured student loans. The economic loss development during Third Quarter 2018 was \$1 million primarily related to increases in LAE. The economic benefit during Nine Months 2018 was \$3 million primarily attributable to the commutation of certain assumed student loan transactions.

### Recovery Litigation

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

### Public Finance Transactions

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

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

### RMBS Transactions

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

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November 29, 2016, the Appellate Division of the Supreme Court of the State of New York ruled that the court's decision dismissing with prejudice CIFGNA's material misrepresentation in the inducement of insurance claim should be modified to grant CIFGNA leave to re-plead such claim. On February 27, 2017, AGC (as successor to CIFGNA) filed an amended complaint which includes a claim for material misrepresentation in the inducement of insurance.

## 6. Contracts Accounted for as Insurance

## Premiums

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

## Net Earned Premiums

|  | Third<br>Quarter |       | Nine<br>Months |       |
|--|------------------|-------|----------------|-------|
|  | 2018             | 2017  | 2018           | 2017  |
|  | (in millions)    |       |                |       |
| Scheduled net earned premiums                    | \$95             | \$96  | \$275          | \$296 |
| Accelerations from refundings and terminations   | 40               | 87    | 131            | 204   |
| Accretion of discount on net premiums receivable | 6                | 3     | 14             | 11    |
| Financial guaranty insurance net earned premiums | 141              | 186   | 420            | 511   |
| Non-financial guaranty net earned premiums       | 1                | 0     | 3              | 1     |
| Net earned premiums (1)                          | \$142            | \$186 | \$423          | \$512 |

(1) Excludes \$3 million and \$3 million for Third Quarter 2018 and 2017, respectively, and \$9 million and \$11 million for Nine Months 2018 and 2017, respectively, related to consolidated FG VIEs.

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

|  | Nine Months   |        |
|--|---------------|--------|
|  | 2018          | 2017   |
|  | (in millions) |        |
| Beginning of year  | \$915         | \$576  |
| Less: Non-financial guaranty insurance premium receivable      | 1             | 0      |
| FG insurance premiums receivable                               | 914           | 576    |
| Premiums receivable from acquisitions (see Note 2)             | —             | 270    |
| Gross written premiums on new business, net of commissions (1) | 508           | 225    |
| Gross premiums received, net of commissions (2)                | (477 )        | (216 ) |
| Adjustments:   |               |        |
| Changes in the expected term                                   | (2 )          | 0      |
| Accretion of discount, net of commissions on assumed business  | 5             | 13     |
| Foreign exchange translation and remeasurement (3)             | (23 )         | 54     |
| Cancellation of assumed reinsurance                            | (10 )         | —      |
| FG insurance premium receivable (4)                            | 915           | 922    |
| Non-financial guaranty insurance premium receivable            | 1             | 0      |
| September 30,  | \$916         | \$922  |

For transactions where the Company replaces a previous Assured Guaranty financial guaranty contract, gross written premiums in this table represents only the incremental amount in excess of the original gross written premiums. Nine Months 2018 includes \$330 million of gross written premiums assumed from SGI on June 1, 2018. See Note 2, Assumption of Insured Portfolio and Business Combinations.

(1) Nine Months 2018 includes \$275 million of cash received from SGI on June 1, 2018.

(3) Includes foreign exchange gain (loss) on remeasurement recorded in the condensed consolidated statements of operations of \$(8) million in Third Quarter 2018, \$19 million in Third Quarter 2017, \$(21) million in Nine Months 2018 and \$52 million in Nine Months 2017. The remaining foreign exchange translation is recorded in other comprehensive income.

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

Approximately 72%, 72% and 71% of installment premiums at September 30, 2018, December 31, 2017 and September 30, 2017, respectively, are denominated in currencies other than the U.S. dollar, primarily the euro and pound sterling.

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

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

|                                | As of<br>September 30,<br>2018<br>(in millions) |
|--------------------------------|---|
| 2018 (October 1 - December 31) | \$ 32   |
| 2019                           | 93  |
| 2020                           | 98  |
| 2021                           | 80  |
| 2022                           | 80  |
| 2023-2027                      | 296   |
| 2028-2032                      | 196   |
| 2033-2037                      | 109   |
| After 2037                     | 111   |
| Total (1)                      | \$ 1,095  |

(1) Excludes expected cash collections on consolidated FG VIEs of \$11 million.

## Scheduled Financial Guaranty Insurance Net Earned Premiums

|                                  | As of<br>September 30,<br>2018<br>(in millions) |
|----------------------------------|---|
| 2018 (October 1 - December 31)   | \$ 91   |
| 2019                             | 329   |
| 2020                             | 299   |
| 2021                             | 272   |
| 2022                             | 247   |
| 2023-2027                        | 963   |
| 2028-2032                        | 639   |
| 2033-2037                        | 378   |
| After 2037                       | 320   |
| Net deferred premium revenue (1) | 3,538   |
| Future accretion                 | 179   |
| Total future net earned premiums | \$ 3,717  |

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of \$68 million and non-financial guaranty business net earned premium of \$12 million.

Selected Information for Financial Guaranty Insurance  
Policies Paid in Installments

| As of         | As of        |
|---------------|--------------|
| September 30, | December 31, |

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|   | 2018   |   | 2017   |                       |
|---|--------|---|--------|-----------------------|
|   |        |   |        | (dollars in millions) |
| Premiums receivable, net of commission payable            | \$ 915 |   | \$ 914 |                       |
| Gross deferred premium revenue                            | 1,324  |   | 1,205  |                       |
| Weighted-average risk-free rate used to discount premiums | 2.2    | % | 2.3    | %                     |
| Weighted-average period of premiums receivable (in years) | 9.1    |   | 9.2    |                       |

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## Financial Guaranty Insurance Losses

## Insurance Contracts' Loss Information

The following table provides information on net reserve (salvage), which includes loss and LAE reserves and salvage and subrogation recoverable, both net of reinsurance. To discount loss reserves, the Company used risk-free rates for U.S. dollar denominated financial guaranty insurance obligations that ranged from 0.0% to 3.20% with a weighted average of 3.04% as of September 30, 2018 and 0.0% to 2.78% with a weighted average of 2.39% as of December 31, 2017.

## Net Reserve (Salvage)

|                                 | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |   |
|---------------------------------|--------------------------------|-------------------------------|---|
|                                 | (in millions)                  |                               |   |
| Public finance:                 |                                |                               |   |
| U.S. public finance             | \$ 611                         | \$ 901                        |   |
| Non-U.S. public finance         | 16                             | 21                            |   |
| Public finance                  | 627                            | 922                           |   |
| Structured finance:             |                                |                               |   |
| U.S. RMBS (1)                   | 15                             | (114)                         | ) |
| Other structured finance        | 22                             | 40                            |   |
| Structured finance              | 37                             | (74)                          | ) |
| Subtotal                        | 664                            | 848                           |   |
| Other payable (recoverable) (3) | (3)                            | (4)                           | ) |
| Total                           | \$ 661                         | \$ 844                        |   |

(1) Excludes net reserves of \$50 million and \$55 million as of September 30, 2018 and December 31, 2017, respectively, related to consolidated FG VIEs.

## Components of Net Reserves (Salvage)

|   | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |   |
|---|--------------------------------|-------------------------------|---|
|   | (in millions)                  |                               |   |
| Loss and LAE reserve  | \$ 1,147                       | \$ 1,444                      |   |
| Reinsurance recoverable on unpaid losses (1)                    | (34)                           | (44)                          | ) |
| Loss and LAE reserve, net                                       | 1,113                          | 1,400                         |   |
| Salvage and subrogation recoverable                             | (471)                          | (572)                         | ) |
| Salvage and subrogation payable (2)                             | 22                             | 20                            |   |
| Other payable (recoverable) (1)                                 | (3)                            | (4)                           | ) |
| Salvage and subrogation recoverable, net, and other recoverable | (452)                          | (556)                         | ) |
| Net reserves (salvage)  | \$ 661                         | \$ 844                        |   |

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

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

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The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (i) the contra-paid which represent the claim payments made and recoveries received that have not yet been recognized in the statement of operations, (ii) salvage and subrogation recoverable for transactions that are in a net recovery position where the Company has not yet received recoveries on claims previously paid (and therefore recognized in income but not yet received), and (iii) loss reserves that have already been established (and therefore expensed but not yet paid).

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

|   | As of<br>September 30,<br>2018<br>(in millions) |
|---|---|
| Net expected loss to be paid - financial guaranty insurance (1)                   | \$ 1,112  |
| Contra-paid, net  | 73  |
| Salvage and subrogation recoverable, net of reinsurance                           | 449   |
| Loss and LAE reserve - financial guaranty insurance contracts, net of reinsurance | (1,112 )  |
| Other recoverable (payable)   | 3   |
| Net expected loss to be expensed (present value) (2)                              | \$ 525  |

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

(2) Excludes \$45 million as of September 30, 2018, 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 accelerations, commutations, changes in expected lives and updates to loss estimates. This table excludes amounts related to FG VIEs, which are eliminated in consolidation.

Net Expected Loss to be Expensed  
Financial Guaranty Insurance Contracts

|                                  | As of<br>September 30,<br>2018<br>(in millions) |
|----------------------------------|---|
| 2018 (October 1 – December 31)   | \$ 9  |
| 2019                             | 37  |
| 2020                             | 38  |
| 2021                             | 42  |
| 2022                             | 42  |
| 2023-2027                        | 171   |
| 2028-2032                        | 112   |
| 2033-2037                        | 61  |
| After 2037                       | 13  |
| Net expected loss to be expensed | 525   |
| Future accretion                 | 181   |

Total expected future loss and LAE \$ 706

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

Loss and LAE  
Reported on the  
Condensed Consolidated Statements of Operations

|                          | Loss (Benefit) |       |             |       |
|--------------------------|----------------|-------|-------------|-------|
|                          | Third Quarter  |       | Nine Months |       |
|                          | 2018           | 2017  | 2018        | 2017  |
|                          | (in millions)  |       |             |       |
| Public finance:          |                |       |             |       |
| U.S. public finance      | \$42           | \$233 | \$76        | \$424 |
| Non-U.S. public finance  | (3 )           | 0     | (5 )        | (3 )  |
| Public finance           | 39             | 233   | 71          | 421   |
| Structured finance:      |                |       |             |       |
| U.S. RMBS (1)            | (21 )          | (5 )  | (17 )       | (19 ) |
| Other structured finance | (1 )           | (5 )  | (11 )       | (48 ) |
| Structured finance       | (22 )          | (10 ) | (28 )       | (67 ) |
| Loss and LAE             | \$17           | \$223 | \$43        | \$354 |

(1) Excludes a benefit of \$3 million and a loss of \$1 million for Third Quarter 2018 and 2017, respectively, an losses of \$0 million and \$5 million for Nine Months 2018 and 2017, respectively, related to consolidated FG VIEs.

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

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

|   | BIG Categories        |         |         |        |          |         | Total<br>BIG, Net | Effect of<br>Consolidating<br>FG VIEs | Total    |
|---|-----------------------|---------|---------|--------|----------|---------|-------------------|---------------------------------------|----------|
|   | BIG 1                 |         | BIG 2   |        | BIG 3    |         |                   |                                       |          |
|   | Gross                 | Ceded   | Gross   | Ceded  | Gross    | Ceded   |                   |                                       |          |
|   | (dollars in millions) |         |         |        |          |         |                   |                                       |          |
| Number of risks (1)                                   | 130                   | (10 )   | 41      | (1 )   | 146      | (7 )    | 317               | —                                     | 317      |
| Remaining weighted-average contract period (in years) | 8.2                   | 6.7     | 13.2    | 2.2    | 10.1     | 9.3     | 9.9               | —                                     | 9.9      |
| Outstanding exposure:                                 |                       |         |         |        |          |         |                   |                                       |          |
| Principal   | \$2,819               | \$(73 ) | \$974   | \$(6 ) | \$6,495  | \$(158) | \$10,051          | \$ —                                  | \$10,051 |
| Interest  | 1,261                 | (31 )   | 622     | (1 )   | 3,256    | (74 )   | 5,033             | —                                     | 5,033    |
| Total (2)   | \$4,080               | \$(104) | \$1,596 | \$(7 ) | \$9,751  | \$(232) | \$15,084          | \$ —                                  | \$15,084 |
| Expected cash outflows (inflows)                      | \$99                  | \$(5 )  | \$284   | \$(1 ) | \$4,028  | \$(79 ) | \$4,326           | \$(295 )                              | \$4,031  |
| Potential recoveries (3)                              | (464 )                | 23      | (107 )  | 0      | (2,434 ) | 55      | (2,927 )          | 189                                   | (2,738 ) |
| Subtotal  | (365 )                | 18      | 177     | (1 )   | 1,594    | (24 )   | 1,399             | (106 )                                | 1,293    |
| Discount  | 91                    | (5 )    | (53 )   | 0      | (236 )   | (2 )    | (205 )            | 24                                    | (181 )   |
|   | \$(274 )              | \$13    | \$124   | \$(1 ) | \$1,358  | \$(26 ) | \$1,194           | \$(82 )                               | \$1,112  |

Present value of expected cash  
flows

|                          |          |        |        |        |        |         |        |         |        |
|--------------------------|----------|--------|--------|--------|--------|---------|--------|---------|--------|
| Deferred premium revenue | \$ 110   | \$(4 ) | \$ 157 | \$ 0   | \$ 561 | \$(2 )  | \$ 822 | \$(66 ) | \$ 756 |
| Reserves (salvage)       | \$(302 ) | \$ 13  | \$ 42  | \$(1 ) | \$ 982 | \$(24 ) | \$ 710 | \$(50 ) | \$ 660 |

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

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

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

(2) Includes BIG amounts related to FG VIEs.

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

#### Ratings Impact on Financial Guaranty Business

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

See Note 6, Contracts Accounted for as Insurance, in Part II, Item 8. "Financial Statements and Supplementary Data" of AGL's Annual Report on Form 10-K for the year ended December 31, 2017 for additional information on (i) the Company's potential termination payments under interest rate swaps, (ii) the variable rate demand obligations exposure, and (iii) the potential payment obligations under guaranteed investment contracts and availability of sufficient eligible and liquid assets to AGMH's former subsidiary, FSA Asset Management LLC, to satisfy any expected withdrawal and collateral posting obligations.

#### 7. Fair Value Measurement

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



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

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During Nine Months 2018, no changes were made to the Company's valuation models that had, or are expected to have, a material impact on the Company's condensed consolidated balance sheets or statements of operations and comprehensive income.

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

The categorization within the fair value hierarchy is determined based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. The fair value hierarchy prioritizes model inputs into three broad levels as follows, with Level 1 being the highest and Level 3 the lowest. An asset's or liability's categorization is based on the lowest level of significant input to its valuation.

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

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

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

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1, Level 2 and Level 3 except for one transfer from Level 2 into Level 3 during Nine Months 2017 because starting in the second quarter of 2017 the price of the security included a significant unobservable assumption.

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-Term Investments

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing models, which take into account: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, industry and economic events, and sector groupings. Additional valuation factors that can be taken into account are nominal spreads and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news.

Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently or those that are distressed trades, and therefore may not be indicative of the market. The extent of the use of each input is

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dependent on the asset class and the market conditions. The valuation of fixed-maturity investments is more subjective when markets are less liquid due to the lack of market based inputs.

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

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

The Company, on a quarterly basis:

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

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

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

As of September 30, 2018, the Company used models to price 119 securities (primarily securities that were purchased or obtained for loss mitigation or other risk management purposes), which were 13% or \$1,411 million of the Company's fixed-maturity securities and short-term investments at fair value. Most Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price appreciation/depreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the security including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

## Other Invested Assets

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

## Other Assets

### Committed Capital Securities

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

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### Supplemental Executive Retirement Plans

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

### Contracts Accounted for as Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The following is a description of the fair value methodology applied to the Company's insured CDS that are accounted for as credit derivatives. The Company did not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate such contracts; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. In transactions where the counterparty does not have the right to terminate, such transactions are generally terminated for an amount that approximates the present value of future premiums or for a negotiated amount, rather than at fair value.

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

Due to the lack of quoted prices and other observable inputs for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through internally developed, proprietary models that use both observable and unobservable market data inputs. There is no established market where financial guaranty insured credit derivatives are actively traded; therefore, management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's transactions to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and how the Company's own credit spread affects the pricing of its transactions.

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

### Assumptions and Inputs

The various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts are as follows: the gross spread, the allocation of gross spread among the bank profit, net spread and hedge cost, and the weighted average life which is based on debt service schedules. The Company obtains gross spreads on its outstanding contracts from market data sources published by third parties (e.g., dealer spread tables for the collateral similar to assets within the Company's transactions), as well as collateral-specific spreads provided by trustees or obtained from market sources. The bank profit represents the profit the originator, usually an investment bank, realizes for structuring and funding the transaction; the net spread represents the premiums paid to the Company for the Company's credit protection provided; and the hedge cost represents the cost of CDS protection purchased by the originator to hedge its counterparty credit risk exposure to the Company.

With respect to CDS transactions for which there is an expected claim payment within the next twelve months, the allocation of gross spread reflects a higher allocation to the cost of credit rather than the bank profit component. In the current

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market, it is assumed that a bank would be willing to accept a lower profit on distressed transactions in order to remove these transactions from its financial statements.

The following spread hierarchy is utilized in determining which source of gross spread to use. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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

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

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

• Credit spreads provided by the counterparty of the CDS.

• Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

## Information by Credit Spread Type (1)

|   | As of<br>September 30,<br>2018 | % | As of<br>December 31,<br>2017 | % |
|---|--------------------------------|---|-------------------------------|---|
| Based on actual collateral specific spreads | 21                             | % | 14                            | % |
| Based on market indices                     | 34                             | % | 48                            | % |
| Provided by the CDS counterparty            | 45                             | % | 38                            | % |
| Total                                       | 100                            | % | 100                           | % |

(1) Based on par.

The rates used to discount future expected premium cash flows ranged from 2.44% to 3.17% at September 30, 2018 and 1.72% to 2.55% at December 31, 2017.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed and the daily closing price of the market index related to the specific asset class and rating of the transaction. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on a similar transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the

same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transaction's current spread.

The premium the Company receives is referred to as the "net spread." The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its transactions. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGC or AGM. For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGC and AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGC or AGM affects the amount of spread on CDS transactions that the Company retains and, hence,



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their fair value. As the cost to acquire CDS protection referencing AGC or AGM increases, the amount of premium the Company retains on a transaction generally decreases.

In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 0.2%, 0.2% and 16%, based on fair value, of the Company's CDS contracts were fair valued using this minimum premium as of September 30, 2018, June 30, 2018 and December 31, 2017, respectively. The percentage of transactions that price using the minimum premiums fluctuates due to changes in AGC's credit spreads. In general when AGC's credit spreads narrow, the cost to hedge AGC's name declines and more transactions price above previously established floor levels. Meanwhile, when AGC's credit spreads widen, the cost to hedge AGC's name increases causing more transactions to price at previously established floor levels. Due to the low volume of CDS contracts remaining in AGM's portfolio, changes in AGM's credit spreads do not significantly affect the overall percentage of transactions fair valued using the minimum premium. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC and AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGC's and AGM's own credit spread has resulted in the bank or transaction originator hedging a portion of its exposure to AGC and AGM. This reduces the amount of contractual cash flows AGC and AGM can capture as premium for selling its protection.

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

A credit derivative liability on protection sold is the result of contractual cash inflows on in-force transactions that are less than what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would realize a loss representing the difference between the lower contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts and taking the present value of such amounts discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

### Strengths and Weaknesses of Model

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

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

- The model takes into account the transaction structure and the key drivers of market value.
- The model maximizes the use of market-driven inputs whenever they are available.
- The model is a consistent approach to valuing positions.

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

• There is no exit market or any actual exit transactions; therefore, the Company's exit market is a hypothetical one based on the Company's entry market.

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

• The markets for the inputs to the model are highly illiquid, which impacts their reliability.

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

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Fair Value Option on FG VIEs' Assets and Liabilities

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

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

The third-party utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithms designed to aggregate market color, received by the independent third-party, on comparable bonds.

The models to price the FG VIEs' liabilities used, where appropriate, the same inputs used in determining fair value of FG VIEs' assets and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest, taking into account the Company's own credit risk.

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

Not Carried at Fair Value

For the assets and liabilities listed below, which are not carried at fair value, there were no changes to the valuation techniques and inputs used to determine fair value since December 31, 2017.

- Other Assets and Other Liabilities, which consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.

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

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



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## Financial Instruments Carried at Fair Value

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

## Fair Value Hierarchy of Financial Instruments Carried at Fair Value

As of September 30, 2018

|  | Fair Value Hierarchy |         |         |         |
|--|----------------------|---------|---------|---------|
|  | Fair Value           | Level 1 | Level 2 | Level 3 |
|  | (in millions)        |         |         |         |
| Assets:  |                      |         |         |         |
| Investment portfolio, available-for-sale (1):            |                      |         |         |         |
| Fixed-maturity securities                                |                      |         |         |         |
| Obligations of state and political subdivisions          | \$4,988              | \$—     | \$4,889 | \$99    |
| U.S. government and agencies                             | 242                  | —       | 242     | —       |
| Corporate securities                                     | 2,147                | —       | 2,087   | 60      |
| Mortgage-backed securities:                              |                      |         |         |         |
| RMBS   | 948                  | —       | 649     | 299     |
| Commercial mortgage-backed securities (CMBS)             | 528                  | —       | 528     | —       |
| Asset-backed securities                                  | 1,055                | —       | 102     | 953     |
| Non-U.S. government securities                           | 284                  | —       | 284     | —       |
| Total fixed-maturity securities                          | 10,192               | —       | 8,781   | 1,411   |
| Short-term investments                                   | 738                  | 460     | 278     | —       |
| Other invested assets (2)                                | 7                    | —       | 0       | 7       |
| FG VIEs' assets, at fair value (3)                       | 596                  | —       | —       | 596     |
| Other assets (3) (4)                                     | 127                  | 26      | 42      | 59      |
| Total assets carried at fair value                       | \$11,660             | \$486   | \$9,101 | \$2,073 |
| Liabilities:   |                      |         |         |         |
| Credit derivative liabilities (3)                        | \$239                | \$—     | \$—     | \$239   |
| FG VIEs' liabilities with recourse, at fair value (5)    | 545                  | —       | —       | 545     |
| FG VIEs' liabilities without recourse, at fair value (3) | 104                  | —       | —       | 104     |
| Total liabilities carried at fair value                  | \$888                | \$—     | \$—     | \$888   |

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

|  | Fair Value Hierarchy |         |         |         |
|--|----------------------|---------|---------|---------|
|  | Fair Value Level 1   | Level 2 | Level 3 |         |
|  | (in millions)        |         |         |         |
| Assets:  |                      |         |         |         |
| Investment portfolio, available-for-sale (1):            |                      |         |         |         |
| Fixed-maturity securities                                |                      |         |         |         |
| Obligations of state and political subdivisions          | \$5,760              | \$—     | \$5,684 | \$76    |
| U.S. government and agencies                             | 285                  | —       | 285     | —       |
| Corporate securities                                     | 2,018                | —       | 1,951   | 67      |
| Mortgage-backed securities:                              |                      |         |         |         |
| RMBS   | 861                  | —       | 527     | 334     |
| CMBS   | 549                  | —       | 549     | —       |
| Asset-backed securities                                  | 896                  | —       | 109     | 787     |
| Non-U.S. government securities                           | 305                  | —       | 305     | —       |
| Total fixed-maturity securities                          | 10,674               | —       | 9,410   | 1,264   |
| Short-term investments                                   | 627                  | 464     | 162     | 1       |
| Other invested assets (2)                                | 7                    | —       | 0       | 7       |
| FG VIEs' assets, at fair value (3)                       | 700                  | —       | —       | 700     |
| Other assets (3) (4)                                     | 123                  | 25      | 36      | 62      |
| Total assets carried at fair value                       | \$12,131             | \$489   | \$9,608 | \$2,034 |
| Liabilities:   |                      |         |         |         |
| Credit derivative liabilities (3)                        | \$271                | \$—     | \$—     | \$271   |
| FG VIEs' liabilities with recourse, at fair value (3)    | 627                  | —       | —       | 627     |
| FG VIEs' liabilities without recourse, at fair value (3) | 130                  | —       | —       | 130     |
| Total liabilities carried at fair value                  | \$1,028              | \$—     | \$—     | \$1,028 |

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

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

(3) Change in fair value is included in the condensed consolidated statements of operations.

(4) Includes credit derivative assets.

(5) Change in fair value attributable to ISCR is recorded in OCI with the remainder of the change in fair value recorded in the condensed consolidated statements of operations.

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## Changes in Level 3 Fair Value Measurements

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

## Fair Value Level 3 Rollforward

## Recurring Basis

## Third Quarter 2018

## Fixed-Maturity Securities

|  | Obligations<br>of State<br>Political<br>Subdivisions | Corporate<br>Securities | RMBS  | Asset-<br>Backed<br>Securities | FG VIEs'<br>Assets at<br>Fair<br>Value | Other<br>(8) | Credit<br>Derivative<br>Asset<br>(Liability),<br>net (5) | FG<br>VIEs'<br>Liabilities<br>with<br>Recourse,<br>at Fair<br>Value | FG VIEs'<br>Liabilities<br>without<br>Recourse,<br>at Fair<br>Value |
|--|--|-------------------------|-------|--------------------------------|--|--------------|--|---|---|
|  | (in millions)  |                         |       |                                |  |              |  |   |   |
| Fair value as of<br>June 30, 2018  | \$92   | \$ 63                   | \$311 | \$ 897                         | \$ 627                                 | \$61         | \$(257 )   | \$(571 )  | \$(108 )  |
| Total pretax realized<br>and unrealized<br>gains/(losses)<br>recorded in: (1)                                  |  |                         |       |                                |  |              |  |   |   |
| Net income (loss)  | 1  | (2)2                    | (2)3  | (2)14                          | (2)(1 )                                | (3)(1 )      | (4)21  | (6)3  | (3)1 (3)  |
| Other comprehensive<br>income (loss)   | 6  | (5 )                    | 0     | (12 )                          | —                                      | 0            | —  | (3 )  | —   |
| Purchases  | —  | —                       | —     | 64                             | —                                      | —            | —  | —   | —   |
| Settlements  | —  | —                       | (15 ) | (10 )                          | (30 )                                  | —            | (1 )   | 26  | 3   |
| Fair value as of<br>September 30, 2018   | \$99   | \$ 60                   | \$299 | \$ 953                         | \$ 596                                 | \$60         | \$(237 )   | \$(545 )  | \$(104 )  |
| Change in unrealized<br>gains/(losses) related<br>to financial<br>instruments held as of<br>September 30, 2018 | \$6  | \$( 5 )                 | \$1   | \$(11 )                        | \$2                                    | (3)\$(1 )    | (4)\$20  | (6)\$(1 )   | (3)\$1 (3)  |

Table of ContentsFair Value Level 3 Rollforward  
Recurring Basis  
Third Quarter 2017

|  | Fixed-Maturity Securities                       |                      |       |                         |                               |            |  | FG VIEs' Liabilities with Recourse, at Fair Value | FG VIEs' Liabilities without Recourse, at Fair Value |
|--|---|----------------------|-------|-------------------------|-------------------------------|------------|--|---|--|
|  | Obligations of State and Political Subdivisions | Corporate Securities | RMBS  | Asset-Backed Securities | FG VIEs' Assets at Fair Value | Other (8)  | Credit Derivative Asset (Liability), net (5) |   |  |
|  | (in millions)                                   |                      |       |                         |                               |            |  |   |  |
| Fair value as of June 30, 2017   | \$91  | \$ 63                | \$357 | \$ 656                  | \$ 757                        | \$ 65      | \$ (361 )                                    | \$ (689 )   | \$ (131 )  |
| Total pretax realized and unrealized gains/(losses) recorded in: (1)                               |   |                      |       |                         |                               |            |  |   |  |
| Net income (loss)  | (8 )  | (2)1                 | (2)5  | (2)15                   | (2)4                          | (3)(4 )    | (4)58  | (6)(3 )   | (3)(1 )  |
| Other comprehensive income (loss)  | (1 )  | 2                    | (1 )  | 2                       | —                             | 0          | —  | —   | —  |
| Purchases  | —   | —                    | 13    | 106                     | —                             | —          | —  | —   | —  |
| Settlements  | —   | —                    | (28 ) | (7 )                    | (36 )                         | —          | 1  | 35  | 3  |
| FG VIE deconsolidations  | —   | —                    | —     | —                       | (18 )                         | —          | —  | 0   | 18   |
| Fair value as of September 30, 2017  | \$82  | \$ 66                | \$346 | \$ 772                  | \$ 707                        | \$ 61      | \$ (302 )                                    | \$ (657 )   | \$ (111 )  |
| Change in unrealized gains/(losses) related to financial instruments held as of September 30, 2017 | \$(1 )  | \$ 2                 | \$ 0  | \$ 2                    | \$ 10                         | (3)\$ (4 ) | (4)\$ 51                                     | (6)\$ (3 )  | (3)\$ (1 )   |

Fair Value Level 3 Rollforward  
Recurring Basis  
Nine Months 2018

|                                    | Fixed-Maturity Securities                       |                      |       |                         |                               |           |  | FG VIEs' Liabilities with Recourse, at Fair Value | FG VIEs' Liabilities without Recourse, at Fair Value |
|------------------------------------|---|----------------------|-------|-------------------------|-------------------------------|-----------|--|---|--|
|                                    | Obligations of State and Political Subdivisions | Corporate Securities | RMBS  | Asset-Backed Securities | FG VIEs' Assets at Fair Value | Other (7) | Credit Derivative Asset (Liability), net (5) |   |  |
|                                    | (in millions)                                   |                      |       |                         |                               |           |  |   |  |
| Fair value as of December 31, 2017 | \$76  | \$ 67                | \$334 | \$ 787                  | \$ 700                        | \$ 64     | \$ (269 )                                    | \$ (627 )   | \$ (130 )  |



Total pretax realized  
and unrealized  
gains/(losses)

recorded in: (1)

|  |      |         |        |        |        |         |            |          |          |            |
|--|------|---------|--------|--------|--------|---------|------------|----------|----------|------------|
| Net income (loss)  | 3    | (2)(2 ) | (2)16  | (2)43  | (2)3   | (3)(3 ) | (4)103     | (6)(1 )  | (3)3     | (3)        |
| Other comprehensive<br>income (loss)   | 17   | (5 )    | (10 )  | (3 )   | —      | 0       | —          | (1 )     | —        |            |
| Purchases  | 4    | —       | 9      | 164    | —      | —       | —          | —        | —        |            |
| Issuances  | —    | —       | —      | —      | —      | —       | (68 )      | (9)—     | —        |            |
| Settlements  | (1 ) | —       | (50 )  | (38 )  | (90 )  | (1 )    | (3 )       | 83       | 7        |            |
| FG VIE<br>deconsolidations   | —    | —       | —      | —      | (17 )  | —       | —          | 1        | 16       |            |
| Fair value as of<br>September 30, 2018   | \$99 | \$ 60   | \$299  | \$ 953 | \$ 596 | \$60    | \$(237 )   | \$(545 ) | \$(104 ) |            |
| Change in unrealized<br>gains/(losses) related<br>to financial<br>instruments held as of<br>September 30, 2018 | \$17 | \$(5 )  | \$(7 ) | \$(1 ) | \$13   | (3)\$   | (3)(4)\$93 | (6)\$    | (2 )     | (3)\$2 (3) |

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Fair Value Level 3 Rollforward  
Recurring Basis  
Nine Months 2017

|  | Fixed-Maturity Securities                                |                         |        |                                |  | Other<br>(8) | Credit<br>Derivative<br>Asset<br>(Liability),<br>net (5) | FG<br>VIEs'<br>Liabilities<br>with<br>Recourse,<br>at Fair<br>Value | FG VIEs'<br>Liabilities<br>without<br>Recourse,<br>at Fair<br>Value |
|--|--|-------------------------|--------|--------------------------------|--|--------------|--|---|---|
|  | Obligations<br>of State and<br>Political<br>Subdivisions | Corporate<br>Securities | RMBS   | Asset-<br>Backed<br>Securities | FG VIEs'<br>Assets at<br>Fair<br>Value |              |  |   |   |
|  | (in millions)  |                         |        |                                |  |              |  |   |   |
| Fair value as of<br>December 31, 2016  | \$39   | \$ 60                   | \$365  | \$ 805                         | \$ 876                                 | \$65         | \$ (389 )  | \$ (807 )   | \$ (151 )   |
| MBIA UK<br>Acquisition   | —  | —                       | —      | 7                              | —                                      | —            | —  | —   | —   |
| Total pretax realized<br>and unrealized<br>gains/(losses) recorded<br>in: (1)                                  |  |                         |        |                                |  |              |  |   |   |
| Net income (loss)  | (6 )   | (2)4                    | (2)23  | (2)100                         | (2)32                                  | (3)(4 )      | (4)106   | (6)(14 )  | (3)(4 )   |
| Other comprehensive<br>income (loss)   | (4 )   | 2                       | 25     | 60                             | —                                      | 0            | —  | —   | —   |
| Purchases  | —  | —                       | 42     | 162                            | —                                      | —            | —  | —   | —   |
| Settlements  | (2 )   | —                       | (109 ) | (362 )                         | (117 )                                 | —            | (19 )  | 113   | 11  |
| FG VIE<br>consolidations   | —  | —                       | —      | —                              | 21                                     | —            | —  | 0   | (21 )   |
| FG VIE<br>deconsolidations   | —  | —                       | —      | —                              | (105 )                                 | —            | —  | 51  | 54  |
| Transfers into Level 3   | 55   | —                       | —      | —                              | —                                      | —            | —  | —   | —   |
| Fair value as of<br>September 30, 2017   | \$82   | \$ 66                   | \$346  | \$ 772                         | \$ 707                                 | \$61         | \$ (302 )  | \$ (657 )   | \$ (111 )   |
| Change in unrealized<br>gains/(losses) related<br>to financial<br>instruments held as of<br>September 30, 2017 | \$(4 )   | \$ 2                    | \$25   | \$ 126                         | \$ 50                                  | (3)\$(4 )    | (4)\$63  | (6)\$(12 )  | (3)\$(4 )   |

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

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

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

(4)Recorded in net investment income and other income.

Represents the net position of credit derivatives. Credit derivative assets (recorded in other assets) and credit (5) derivative liabilities (presented as a separate line item) are shown gross in the condensed consolidated balance sheet based on net exposure by counterparty.

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

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

(8) Includes CCS and other invested assets.

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

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## Level 3 Fair Value Disclosures

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

| Financial Instrument Description<br>(1)         | Fair Value at<br>September 30,<br>2018<br>(in millions) | Significant Unobservable Inputs | Range                  | Weighted Average<br>as a Percentage of<br>Current Par<br>Outstanding |
|---|---|---------------------------------|------------------------|--|
| Assets (2):                                     |   |                                 |                        |  |
| Fixed-maturity securities:                      |   |                                 |                        |  |
| Obligations of state and political subdivisions | \$ 99   | Yield                           | 4.5 %-29.7%            | 9.1%   |
| Corporate securities                            | 60  | Yield                           | 27.3%                  |  |
| RMBS  | 299   | CPR                             | 2.8 %-18.0%            | 6.3%   |
|   |   | CDR                             | 1.5 %-8.8%             | 5.4%   |
|   |   | Loss severity                   | 40.0 %-125.0%          | 82.2%  |
|   |   | Yield                           | 5.3 %-7.9%             | 6.2%   |
| Asset-backed securities:                        |   |                                 |                        |  |
| Triple-X life insurance transactions            | 642   | Yield                           | 6.6 %-6.7%             | 6.7%   |
| Collateralized loan obligations (CLO) /TruPS    | 256   | Yield                           | 3.5 %-4.7%             | 4.2%   |
| Others  | 55  | Yield                           | 11.2%                  |  |
| FG VIEs' assets, at fair value                  | 596   | CPR                             | 0.9 %-17.5%            | 9.3%   |
|   |   | CDR                             | 1.3 %-23.5%            | 5.6%   |
|   |   | Loss severity                   | 60.0 %-100.0%          | 79.8%  |
|   |   | Yield                           | 4.5 %-10.3%            | 6.9%   |
| Other assets                                    | 57  | Implied Yield<br>Term (years)   | 5.9 %-6.5%<br>10 years | 6.2%   |
| Liabilities:                                    |   |                                 |                        |  |
| Credit derivative liabilities, net              | (237)   | Year 1 loss estimates           | 0.0 %-64.0%            | 2.3%   |
|   |   | Hedge cost (in bps)             | 3.8 -57.8              | 17.2   |
|   |   | Bank profit (in bps)            | 8.3 -503.3             | 68.8   |
|   |   | Internal floor (in bps)         | 8.8 -30.0              | 10.1   |
|   |   | Internal credit rating          | AAA -CCC               | AA-  |
| FG VIEs' liabilities, at fair value             | (649)   | CPR                             | 0.9 %-17.5%            | 9.3%   |
|   |   | CDR                             | 1.3 %-23.5%            | 5.6%   |
|   |   | Loss severity                   | 60.0 %-100.0%          | 79.8%  |
|   |   | Yield                           | 4.2 %-10.3%            | 5.4%   |

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

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

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## Quantitative Information About Level 3 Fair Value Inputs

At December 31, 2017

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

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

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



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

## Fair Value of Financial Instruments

|  | As of<br>September 30, 2018 |                         | As of<br>December 31, 2017 |                         |
|--|-----------------------------|-------------------------|----------------------------|-------------------------|
|  | Carrying<br>Amount          | Estimated<br>Fair Value | Carrying<br>Amount         | Estimated<br>Fair Value |
|  | (in millions)               |                         |                            |                         |
| <b>Assets:</b>                                       |                             |                         |                            |                         |
| Fixed-maturity securities                            | \$10,192                    | \$ 10,192               | \$10,674                   | \$ 10,674               |
| Short-term investments                               | 738                         | 738                     | 627                        | 627                     |
| Other invested assets                                | 49                          | 51                      | 60                         | 61                      |
| FG VIEs' assets, at fair value                       | 596                         | 596                     | 700                        | 700                     |
| Other assets   | 235                         | 235                     | 220                        | 220                     |
| <b>Liabilities:</b>                                  |                             |                         |                            |                         |
| Financial guaranty insurance contracts (1)           | 3,237                       | 6,254                   | 3,330                      | 7,104                   |
| Long-term debt                                       | 1,249                       | 1,520                   | 1,292                      | 1,627                   |
| Credit derivative liabilities                        | 239                         | 239                     | 271                        | 271                     |
| FG VIEs' liabilities with recourse, at fair value    | 545                         | 545                     | 627                        | 627                     |
| FG VIEs' liabilities without recourse, at fair value | 104                         | 104                     | 130                        | 130                     |
| Other liabilities                                    | 72                          | 72                      | 55                         | 55                      |

(1) Carrying amount includes the assets and liabilities related to financial guaranty insurance contract premiums, losses, and salvage and subrogation and other recoverables net of reinsurance.

## 8. Contracts Accounted for as Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS). The credit derivative portfolio also includes interest rate swaps.

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, there are more circumstances under which the Company may be obligated to make payments. Similar to a financial guaranty insurance contract, the Company would be obligated to pay if the obligor failed to make a scheduled payment of principal or interest in full. However, the Company may also be required to pay if the obligor becomes bankrupt or if the reference obligation were restructured if, after negotiation, those credit events are specified in the documentation for the credit derivative transactions. Furthermore, the Company may be required to make a payment due to an event that is unrelated to the performance of the obligation referenced in the credit derivative. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. In that case, the Company may be required to make a termination payment to its swap counterparty upon such termination. Absent such an event of default or termination event, the Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.





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## Credit Derivative Net Par Outstanding by Sector

The components of the Company's credit derivative net par outstanding are presented in the table below. The increase in credit derivative net par outstanding from year-end 2017 was a result of the June 1, 2018 SGI Transaction discussed in Note 2, Assumption of Insured Portfolio and Business Combinations; as part of that transaction, the Company reinsured SGI's insurance of credit derivatives within its portfolio, primarily infrastructure finance and regulated utility transactions, with a net par of \$1.5 billion and a credit derivative liability of \$68 million. The credit derivatives assumed from SGI have no expected losses. The estimated remaining weighted average life of credit derivatives was 11.7 years at September 30, 2018 and December 31, 2017.

## Credit Derivatives (1)

| Asset Type  | As of<br>September 30,<br>2018 |                      | As of<br>December 31,<br>2017 |                      |
|---|--------------------------------|----------------------|-------------------------------|----------------------|
|   | Net Par<br>Outstanding         | Net<br>Fair<br>Value | Net Par<br>Outstanding        | Net<br>Fair<br>Value |
|   | (in millions)                  |                      |                               |                      |
| Pooled infrastructure   | \$1,408                        | \$(35 )              | \$1,561                       | \$(42 )              |
| Infrastructure finance  | 1,306                          | (71 )                | 572                           | (36 )                |
| U.S. RMBS   | 765                            | (30 )                | 916                           | (53 )                |
| Pooled corporate obligations (TruPS collateralized debt obligations (CDOs)) | 702                            | (32 )                | 878                           | (72 )                |
| Other (2)   | 2,294                          | (69 )                | 2,280                         | (66 )                |
| Total   | \$6,475                        | \$(237)              | \$6,207                       | \$(269)              |

(1) Expected loss to be recovered were \$4 million as of September 30, 2018 and \$14 million as of December 31, 2017.

(2) This comprises numerous transactions across various asset classes, such as regulated utilities, municipal utilities, health care revenue and consumer receivables.

## Distribution of Credit Derivative Net Par Outstanding by Internal Rating

| Ratings                               | As of<br>September 30,<br>2018 |            | As of<br>December 31,<br>2017 |            |
|---------------------------------------|--------------------------------|------------|-------------------------------|------------|
|                                       | Net Par<br>Outstanding         | % of Total | Net Par<br>Outstanding        | % of Total |
|                                       | (dollars in millions)          |            |                               |            |
| AAA                                   | \$1,960                        | 30.3 %     | \$2,144                       | 34.6 %     |
| AA                                    | 1,674                          | 25.8       | 1,170                         | 18.8       |
| A                                     | 1,247                          | 19.3       | 1,517                         | 24.5       |
| BBB                                   | 1,352                          | 20.9       | 1,038                         | 16.7       |
| BIG (1)                               | 242                            | 3.7        | 338                           | 5.4        |
| Credit derivative net par outstanding | \$6,475                        | 100.0 %    | \$6,207                       | 100.0 %    |

(1)BIG comprises U.S. RMBS and TruPS CDOs.



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## Fair Value of Credit Derivatives

## Net Change in Fair Value of Credit Derivative Gain (Loss)

|   | Third<br>Quarter<br>2018 | 2017 | Nine<br>Months<br>2018 | 2017  |
|---|--------------------------|------|------------------------|-------|
|   | (in millions)            |      |                        |       |
| Realized gains on credit derivatives  | \$2                      | \$4  | \$6                    | \$15  |
| Net credit derivative losses (paid and payable) recovered and recoverable and other settlements | (1 )                     | (5 ) | (2 )                   | 4     |
| Realized gains (losses) and other settlements   | 1                        | (1 ) | 4                      | 19    |
| Net unrealized gains (losses):  |                          |      |                        |       |
| Pooled infrastructure   | 4                        | (1 ) | 7                      | 4     |
| U.S. RMBS   | (2 )                     | 11   | 25                     | 24    |
| Pooled corporate obligations  | 7                        | 35   | 38                     | 41    |
| Infrastructure finance  | 10                       | 0    | 27                     | 2     |
| Other   | 1                        | 14   | 2                      | 16    |
| Net unrealized gains (losses)   | 20                       | 59   | 99                     | 87    |
| Net change in fair value of credit derivatives  | \$21                     | \$58 | \$103                  | \$106 |

During Third Quarter 2018, unrealized fair value gains were generated primarily as a result of price improvements on the underlying collateral of the Company's CDS. This was the primary driver of the unrealized fair value gains in the Pooled Corporate Obligations and Infrastructure Finance sectors. The unrealized fair value gains were partially offset by unrealized fair value losses related to the decreased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection decreased during the period. For those CDS transactions that were pricing at or above their floor levels, when the cost of purchasing CDS protection on AGC and AGM, which management refers to as the CDS spread on AGC and AGM, decreased, the implied spreads that the Company would expect to receive on these transactions increased.

During Nine Months 2018, unrealized fair value gains were generated primarily as a result of the increase in credit given to the primary insurer on one of the Company's second-to-pay CDS policies, CDS terminations, and price improvements on the underlying collateral of the Company's CDS. The unrealized fair value gains were partially offset by unrealized fair value losses related to the decreased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection decreased during the period.

During Third Quarter and Nine Months 2017, unrealized fair value gains were generated primarily as a result of CDS terminations in the Other sector, run-off of net par outstanding, and tighter implied net spreads. The tighter implied net spreads were primarily a result of price improvements on the underlying collateral of the Company's CDS and the increased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection increased during the period. For those CDS transactions that were pricing at or above their floor levels, when the cost of purchasing CDS protection on AGC and AGM increased, the implied net spreads that the Company would expect to receive on these transactions decreased.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structural terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost based on the price to purchase

credit protection on AGC and AGM. The Company determines its own credit risk based on quoted CDS prices traded on AGC and AGM at each balance sheet date.

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## CDS Spread on AGC and AGM

Quoted price of CDS contract (in basis points)

|                       | As of<br>September 30,<br>2018 | As of<br>June 30,<br>2018 | As of<br>December 31,<br>2017 | As of<br>September 30,<br>2017 | As of<br>June 30,<br>2017 | As of<br>December 31,<br>2016 |
|-----------------------|--------------------------------|---------------------------|-------------------------------|--------------------------------|---------------------------|-------------------------------|
| Five-year CDS spread: |                                |                           |                               |                                |                           |                               |
| AGC                   | 77                             | 105                       | 163                           | 190                            | 136                       | 158                           |
| AGM                   | 81                             | 106                       | 145                           | 190                            | 140                       | 158                           |
| One-year CDS spread   |                                |                           |                               |                                |                           |                               |
| AGC                   | 15                             | 22                        | 70                            | 81                             | 15                        | 35                            |
| AGM                   | 17                             | 21                        | 28                            | 81                             | 15                        | 29                            |

## Fair Value of Credit Derivatives Assets (Liabilities)

and Effect of AGC and AGM

Credit Spreads

|  | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|--|--------------------------------|-------------------------------|
| Fair value of credit derivatives before effect of AGC and AGM credit spreads | \$(382)                        | \$(555)                       |
| Plus: Effect of AGC and AGM credit spreads                                   | 145                            | 286                           |
| Net fair value of credit derivatives   | \$(237)                        | \$(269)                       |

The fair value of CDS contracts at September 30, 2018, before considering the implications of AGC's and AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. Offsetting the benefit attributable to AGC's and AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the TruPS CDO, and pooled infrastructure markets as well as continuing market concerns over the 2005-2007 vintages of RMBS.

## Collateral Posting for Certain Credit Derivative Contracts

The transaction documentation with one counterparty for \$333 million of the CDS insured by AGC requires AGC to post collateral, subject to a \$300 million cap, to secure its obligation to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount. The table below summarizes AGC's CDS collateral posting requirements as of September 30, 2018 and December 31, 2017.

## AGC Insured CDS Collateral Posting Requirements

|               | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|---------------|--------------------------------|-------------------------------|
| (in millions) |                                |                               |

|  |        |        |
|--|--------|--------|
| Gross par of CDS with collateral posting requirement | \$ 333 | \$ 497 |
| Maximum posting requirement                          | 300    | 464    |
| Collateral posted                                    | 1      | 18     |

In the first quarter of 2018, the Company terminated all of the CDS contracts with a counterparty as to which it had collateral posting obligations, and the collateral that the Company had been posting to that counterparty was all returned to the Company. The Company still has collateral posting obligations with respect to one counterparty.

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## 9. Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Assured Guaranty does not act as the servicer or collateral manager for any VIE obligations insured by its companies. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate interest income that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

Assured Guaranty is not primarily liable for the debt obligations issued by the VIEs it insures and would only be required to make payments on those insured debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due and only for the amount of the shortfall. AGL's and its subsidiaries' creditors do not have any rights with regard to the collateral supporting the debt issued by the FG VIEs. Proceeds from sales, maturities, prepayments and interest from such underlying collateral may only be used to pay debt service on FG VIEs' liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the FG VIEs' debt, except for net premiums received and net claims paid by Assured Guaranty under the financial guaranty insurance contract. The Company's estimate of expected loss to be paid for FG VIEs is included in Note 5, Expected Loss to be Paid.

As part of the terms of its financial guaranty contracts, the Company, under its insurance contract, obtains certain protective rights with respect to the VIE that give the Company additional controls over a VIE. These protective rights are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company is deemed to be the control party for certain VIEs under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the protective rights that could make the Company the control party have not been triggered, then the VIE is not consolidated. If the Company is deemed no longer to have those protective rights, the VIE is deconsolidated.

## Adoption of ASU 2016-01

Amendments under ASU 2016-01 apply to the Company's FG VIEs' liabilities which the Company had historically elected to measure through the consolidated statements of operations in "fair value gains (losses) on FG VIEs" under the fair value option. For FG VIEs' liabilities with recourse, the portion of the change in fair value caused by changes in ISCR must now be separately presented in OCI as opposed to the consolidated statements of operations.



The inception to date change in fair value of the FG VIEs' liabilities with recourse attributable to the ISCR is calculated by holding all current period assumptions constant for each security and isolating the effect of the change in the Company's CDS spread from the most recent date of consolidation to the current period. In general, if the Company's CDS spread tightens, more value will be assigned to the Company's credit; however, if the Company's CDS widens, less value is assigned to the Company's credit.

On adoption of ASU 2016-01, the Company reclassified a loss of approximately \$33 million, net of tax, from retained earnings to AOCI. This amount represents the portion of the fair value of the FG VIEs' liabilities with recourse that related to the change in the Company's own credit risk from the date of consolidation through January 1, 2018. The accounting and disclosure of the FG VIEs' liabilities without recourse are unchanged.

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## Consolidated FG VIEs

## Number of FG VIEs Consolidated

Nine  
Months  
20182017

Beginning of year 32 32  
Consolidated — 1  
Deconsolidated (1 ) (2 )  
September 30, 31 31

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately \$79 million at September 30, 2018 and \$99 million at December 31, 2017. The aggregate unpaid principal of the FG VIEs' assets was approximately \$350 million greater than the aggregate fair value at September 30, 2018. The aggregate unpaid principal of the FG VIEs' assets was approximately \$361 million greater than the aggregate fair value at December 31, 2017.

The changes in the instrument-specific credit risk of the FG VIEs' assets held as of September 30, 2018 that were recorded in the condensed consolidated statements of operations for Third Quarter 2018 and Nine Months 2018 were gains of \$1 million and \$4 million, respectively. The changes in the ISCR of the FG VIEs' assets held as of September 30, 2017 that were recorded in the condensed consolidated statements of operations for Third Quarter 2017 and Nine Months 2017 were gains of \$8 million and \$32 million, respectively. To calculate the ISCR, the changes in the fair value of the FG VIEs' assets are allocated between changes that are due to the ISCR and changes due to other factors, including interest rates. The ISCR amount is determined by using expected cash flows at the date of consolidation versus current expected cash flows discounted at original contractual rate. The net present value is calculated by discounting the expected cash flows of the underlying security, at the relevant effective interest rate.

The unpaid principal for FG VIEs' liabilities with recourse, which represent obligations insured by AGC or AGM, was \$590 million and \$674 million as of September 30, 2018 and December 31, 2017, respectively. FG VIEs' liabilities with recourse will mature at various dates ranging from 2018 to 2038. The aggregate unpaid principal balance of the FG VIEs' liabilities with and without recourse was approximately \$72 million greater than the aggregate fair value of the FG VIEs' liabilities as of September 30, 2018. The aggregate unpaid principal balance was approximately \$73 million greater than the aggregate fair value of the FG VIEs' liabilities as of December 31, 2017. See Condensed Consolidated Statements of Comprehensive Income and Note 17, Shareholders' Equity, for information on changes in fair value of the FG VIEs' liabilities with recourse that is attributable to changes in the Company's own credit risk.

The table below shows the carrying value of the consolidated FG VIEs' assets and liabilities in the condensed consolidated financial statements, segregated by the types of assets that collateralize their respective debt obligations for FG VIEs' liabilities with recourse.

Consolidated FG VIEs  
By Type of Collateral

| As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|--------------------------------|-------------------------------|
|--------------------------------|-------------------------------|

AssetsLiabilities Assets Liabilities  
(in millions)

With recourse:

|                       |       |        |        |        |
|-----------------------|-------|--------|--------|--------|
| U.S. RMBS first lien  | \$315 | \$ 341 | \$ 362 | \$ 385 |
| U.S. RMBS second lien | 122   | 147    | 144    | 177    |
| Manufactured housing  | 55    | 57     | 64     | 65     |
| Total with recourse   | 492   | 545    | 570    | 627    |
| Without recourse      | 104   | 104    | 130    | 130    |
| Total                 | \$596 | \$ 649 | \$ 700 | \$ 757 |

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The consolidation of FG VIEs affects net income and shareholders' equity due to (i) changes in fair value gains (losses) on FG VIEs' assets and liabilities (effective January 1, 2018 the change in fair value of FG VIEs' liabilities with recourse attributable to ISCR is recorded in OCI, instead of net income), (ii) the elimination of premiums and losses related to the AGC and AGM FG VIEs' liabilities with recourse and (iii) the elimination of investment balances related to the Company's purchase of AGC and AGM insured FG VIEs' debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

## Effect of Consolidating FG VIEs

|  | Third<br>Quarter<br>2018 |       | Nine<br>Months<br>2017 |        |
|--|--------------------------|-------|------------------------|--------|
|  | 2018                     | 2017  | 2018                   | 2017   |
|  | (in millions)            |       |                        |        |
| Net earned premiums                            | \$(3)                    | \$(3) | \$(9)                  | \$(11) |
| Net investment income                          | (1)                      | (2)   | (3)                    | (4)    |
| Fair value gains (losses) on FG VIEs           | 5                        | 3     | 11                     | 25     |
| Loss and LAE                                   | (3)                      | 1     | 0                      | 5      |
| Effect on income before tax                    | (2)                      | (1)   | (1)                    | 15     |
| Less: tax provision (benefit)                  | 0                        | 0     | 0                      | 5      |
| Effect on net income (loss)                    | \$(2)                    | \$(1) | \$(1)                  | \$10   |
| Effect on OCI                                  | \$(2)                    | \$0   | \$0                    | \$0    |
| Effect on cash flows from operating activities | \$1                      | \$6   | \$7                    | \$16   |

|  | As of<br>September 30,<br>2018 |      | As of<br>December 31,<br>2017 |      |
|--|--------------------------------|------|-------------------------------|------|
|  | 2018                           | 2017 | 2018                          | 2017 |
|  | (in millions)                  |      |                               |      |
| Effect on shareholders' equity (decrease) increase | \$ 1                           | \$   | 2                             |      |

Fair value gains (losses) on FG VIEs represent the net change in fair value of the consolidated FG VIEs' assets and FG VIEs' liabilities (effective January 1, 2018 the change in fair value of FG VIEs' liabilities with recourse attributable to ISCR is recorded in OCI, instead of the condensed consolidated statements of operations). During Third Quarter 2018 and Nine Months 2018, the Company recorded pre-tax net fair value gains on consolidated FG VIEs of \$5 million and \$11 million, respectively, in the condensed consolidated statements of operations. The primary driver of the gain during Third Quarter and Nine Months 2018 in fair value of FG VIEs' assets and liabilities was due to improvement in the underlying collateral on FG VIEs' assets.

During Third Quarter and Nine Months 2017, the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of \$3 million and \$25 million, respectively. During Third Quarter 2017, the primary driver of the gain was price depreciation on the FG VIEs' recourse liabilities resulting from the Company's credit risk. During the Nine Months 2017, the primary driver of the gain is price appreciation on the FG VIEs' assets resulting from improvements in the underlying collateral.

## Other Consolidated VIEs

In certain instances where the Company consolidates a VIE that was established as part of a loss mitigation negotiated settlement that results in the termination of the original insured financial guaranty insurance or credit derivative contract, the Company classifies the assets and liabilities of those VIEs in the line items that most accurately reflect the nature of the items, as opposed to within the FG VIEs' assets and FG VIEs' liabilities. The largest of these VIEs had assets of \$85 million and liabilities of \$22 million as of September 30, 2018 and assets of \$86 million and liabilities of \$41 million as of December 31, 2017.

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## Non-Consolidated VIEs

As of September 30, 2018 and December 31, 2017, the Company had financial guaranty contracts outstanding for 514 and 510 VIEs, respectively, that it monitored and did not consolidate based on the Company's analyses which indicate that it is not the primary beneficiary of these VIEs. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities (or VIEs) is included within net par outstanding in Note 4, Outstanding Exposure.

## 10. Investments and Cash

## Adoption of ASU 2016-01

Up until December 31, 2017, the change in fair value of preferred stock investments and certain other equity investments was recorded in OCI. Effective January 1, 2018, in accordance with ASU 2016-01, the change in fair value of these investments is recorded in other income in the condensed consolidated statements of operations. Upon adoption of this section of ASU 2016-01, the Company reclassified a loss of approximately \$1 million, net of tax, from AOCI to retained earnings. See also Note 9, Variable Interest Entities, for the effect of this ASU on FG VIEs.

In addition, in accordance with ASU 2016-01, the Company elected the new measurement alternative for equity securities that were accounted for under the cost method as of December 31, 2017 because they did not have a readily determinable fair value. Effective January 1, 2018, these equity securities will be accounted at cost less any impairment, plus or minus the change resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

## Net Investment Income and Realized Gains (Losses)

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Accrued investment income, which is recorded in Other Assets, was \$98 million and \$97 million as of September 30, 2018 and December 31, 2017, respectively.

## Net Investment Income

|  | Third<br>Quarter |      | Nine Months |       |
|--|------------------|------|-------------|-------|
|  | 2018             | 2017 | 2018        | 2017  |
|  | (in millions)    |      |             |       |
| Income from fixed-maturity securities managed by third parties | \$75             | \$74 | \$224       | \$224 |
| Income from internally managed securities (1)                  | 25               | 28   | 81          | 105   |
| Gross investment income  | 100              | 102  | 305         | 329   |
| Investment expenses  | (2 )             | (3 ) | (7 )        | (7 )  |
| Net investment income  | \$98             | \$99 | \$298       | \$322 |

(1) Nine Months 2017 included accretion on Zohar II Notes used as consideration for the MBIA UK Acquisition. See Note 2, Assumption of Insured Portfolio and Business Combinations.



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The table below presents the components of net realized investment gains (losses). Realized gains and losses on sales of investments are determined using the specific identification method.

## Net Realized Investment Gains (Losses)

|   | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 |
|---|--------------------------|------------------------|--------------------------|------------------------|
|   | (in millions)            |                        |                          |                        |
| Gross realized gains on available-for-sale securities (1) | \$5                      | \$23                   | \$16                     | \$92                   |
| Gross realized losses on available-for-sale securities    | (3 )                     | (3 )                   | (9 )                     | (9 )                   |
| Net realized gains (losses) on other invested assets      | 0                        | 0                      | (1 )                     | 0                      |
| Other-than-temporary impairment (OTTI) (2)                | (9 )                     | (13 )                  | (20 )                    | (29 )                  |
| Net realized investment gains (losses)                    | \$(7)                    | \$7                    | \$(14)                   | \$54                   |

(1) Nine Months 2017 included a gain on Zohar II Notes used as consideration for the MBIA UK Acquisition. See Note 2, Assumption of Insured Portfolio and Business Combinations.

OTTI was primarily a result of a decline in expected cash flows on loss mitigation securities. See Note 10, (2) Investments and Cash, in Part II, Item 8. "Financial Statements and Supplementary Data" of AGL's Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of the Company's policy for determining OTTI.

The proceeds from sales of fixed-maturity securities available-for-sale were \$316 million in Third Quarter 2018, \$350 million in Third Quarter 2017, \$908 million in Nine Months 2018 and \$1,128 million in Nine Months 2017.

The Company recorded, in other income, a gain on change in fair value of equity securities of \$32 million and \$29 million in Third Quarter 2018 and Nine Months 2018, respectively. Both periods include a gain of \$31 million related to the Company's minority interest in the parent company of TMC Bonds LLC, which it sold in Third Quarter 2018.

The following table presents the roll-forward of the credit losses on fixed-maturity securities for which the Company has recognized an OTTI and for which unrealized loss was recognized in OCI.

Roll Forward of Credit Losses  
in the Investment Portfolio

|   | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 |
|---|--------------------------|------------------------|--------------------------|------------------------|
|   | (in millions)            |                        |                          |                        |
| Balance, beginning of period  | \$170                    | \$145                  | \$162                    | \$134                  |
| Additions for credit losses on securities for which an OTTI was not previously recognized | 0                        | 3                      | 0                        | 6                      |
| Reductions for securities sold and other settlements                                      | 0                        | 0                      | 0                        | (4 )                   |
| Additions for credit losses on securities for which an OTTI was previously recognized     | 2                        | 5                      | 10                       | 17                     |
| Balance, end of period  | \$172                    | \$153                  | \$172                    | \$153                  |



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## Investment Portfolio

## Fixed-Maturity Securities and Short-Term Investments

by Security Type

As of September 30, 2018

| Investment Category                             | Percent<br>of<br>Total<br>(1) | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value | AOCI (2)<br>Gain<br>(Loss) on<br>Securities<br>with<br>OTTI | Weighted<br>Average<br>Credit<br>Rating<br>(3) |
|---|-------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|---|--|
| (dollars in millions)                           |                               |                   |                              |                               |                            |   |  |
| Fixed-maturity securities:                      |                               |                   |                              |                               |                            |   |  |
| Obligations of state and political subdivisions | 45 %                          | \$ 4,885          | \$ 141                       | \$ (38 )                      | \$ 4,988                   | \$ 39   | AA-  |
| U.S. government and agencies                    | 2                             | 235               | 8                            | (1 )                          | 242                        | —   | AA+  |
| Corporate securities                            | 21                            | 2,187             | 15                           | (55 )                         | 2,147                      | (12 )   | A  |
| Mortgage-backed securities (4):                 | 0                             |                   |                              |                               |                            |   |  |
| RMBS  | 9                             | 967               | 16                           | (35 )                         | 948                        | (10 )   | A-   |
| CMBS  | 5                             | 537               | 2                            | (11 )                         | 528                        | 0   | AAA  |
| Asset-backed securities                         | 8                             | 893               | 164                          | (2 )                          | 1,055                      | 128   | BB-  |
| Non-U.S. government securities                  | 3                             | 302               | 3                            | (21 )                         | 284                        | —   | AA   |
| Total fixed-maturity securities                 | 93                            | 10,006            | 349                          | (163 )                        | 10,192                     | 145   | A+   |
| Short-term investments                          | 7                             | 738               | 0                            | 0                             | 738                        | —   | AAA  |
| Total investment portfolio                      | 100%                          | \$ 10,744         | \$ 349                       | \$ (163 )                     | \$ 10,930                  | \$ 145  | A+   |

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Fixed-Maturity Securities and Short-Term Investments  
by Security Type  
As of December 31, 2017

| Investment Category                             | Percent<br>of<br>Total<br>(1) | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value | AOCI<br>Gain<br>(Loss) on<br>Securities<br>with<br>OTTI | Weighted<br>Average<br>Credit<br>Rating<br>(3) |
|---|-------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|---|--|
| (dollars in millions)                           |                               |                   |                              |                               |                            |   |  |
| Fixed-maturity securities:                      |                               |                   |                              |                               |                            |   |  |
| Obligations of state and political subdivisions | 51 %                          | \$ 5,504          | \$ 267                       | \$ (11 )                      | \$ 5,760                   | \$ 23   | AA   |
| U.S. government and agencies                    | 2                             | 272               | 14                           | (1 )                          | 285                        | —   | AA+  |
| Corporate securities                            | 18                            | 1,973             | 63                           | (18 )                         | 2,018                      | (6 )  | A  |
| Mortgage-backed securities (4):                 |                               |                   |                              |                               |                            |   |  |
| RMBS  | 8                             | 852               | 26                           | (17 )                         | 861                        | (1 )  | BBB+   |
| CMBS  | 5                             | 540               | 12                           | (3 )                          | 549                        | —   | AAA  |
| Asset-backed securities                         | 7                             | 730               | 166                          | 0                             | 896                        | 136   | B  |
| Non-U.S. government securities                  | 3                             | 316               | 6                            | (17 )                         | 305                        | 0   | AA   |
| Total fixed-maturity securities                 | 94                            | 10,187            | 554                          | (67 )                         | 10,674                     | 152   | A+   |
| Short-term investments                          | 6                             | 627               | 0                            | 0                             | 627                        | —   | AAA  |
| Total investment portfolio                      | 100%                          | \$ 10,814         | \$ 554                       | \$ (67 )                      | \$ 11,301                  | \$ 152  | A+   |

(1) Based on amortized cost.

(2) See Note 17, Shareholders' Equity.

(3) Ratings in the tables above represent the lower of the Moody's and S&P Global Ratings, a division of Standard & Poor's Financial Services LLC (S&P) classifications except for bonds purchased for loss mitigation or risk management strategies, which use internal ratings classifications. The Company's portfolio consists primarily of high-quality, liquid instruments.

(4) U.S. government-agency obligations were approximately 47% of mortgage backed securities as of September 30, 2018 and 39% as of December 31, 2017 based on fair value.

The Company's investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories.

The following tables summarize, for all fixed-maturity securities in an unrealized loss position, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position.

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Fixed-Maturity Securities  
Gross Unrealized Loss by Length of Time  
As of September 30, 2018

|   | Less than 12 months   |                 | 12 months or more |                 | Total      |                 |
|---|-----------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value            | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
|   | (dollars in millions) |                 |                   |                 |            |                 |
| Obligations of state and political subdivisions | \$1,305               | \$ (25 )        | \$ 273            | \$ (13 )        | \$1,578    | \$ (38 )        |
| U.S. government and agencies                    | 20                    | 0               | 25                | (1 )            | 45         | (1 )            |
| Corporate securities                            | 1,144                 | (26 )           | 260               | (29 )           | 1,404      | (55 )           |
| Mortgage-backed securities:                     |                       |                 |                   |                 |            |                 |
| RMBS  | 386                   | (8 )            | 331               | (27 )           | 717        | (35 )           |
| CMBS  | 229                   | (5 )            | 80                | (6 )            | 309        | (11 )           |
| Asset-backed securities                         | 280                   | (1 )            | 11                | (1 )            | 291        | (2 )            |
| Non-U.S. government securities                  | 86                    | (4 )            | 101               | (17 )           | 187        | (21 )           |
| Total   | \$3,450               | \$ (69 )        | \$ 1,081          | \$ (94 )        | \$4,531    | \$ (163 )       |
| Number of securities (1)                        |                       | 1,003           |                   | 311             |            | 1,283           |
| Number of securities with OTTI                  |                       | 23              |                   | 16              |            | 39              |

Fixed-Maturity Securities  
Gross Unrealized Loss by Length of Time  
As of December 31, 2017

|   | Less than 12 months   |                 | 12 months or more |                 | Total      |                 |
|---|-----------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value            | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
|   | (dollars in millions) |                 |                   |                 |            |                 |
| Obligations of state and political subdivisions | \$166                 | \$ (4 )         | \$ 281            | \$ (7 )         | \$447      | \$ (11 )        |
| U.S. government and agencies                    | 151                   | 0               | 18                | (1 )            | 169        | (1 )            |
| Corporate securities                            | 201                   | (1 )            | 240               | (17 )           | 441        | (18 )           |
| Mortgage-backed securities:                     |                       |                 |                   |                 |            |                 |
| RMBS  | 191                   | (5 )            | 213               | (12 )           | 404        | (17 )           |
| CMBS  | 29                    | 0               | 80                | (3 )            | 109        | (3 )            |
| Asset-backed securities                         | 48                    | 0               | 3                 | 0               | 51         | 0               |
| Non-U.S. government securities                  | 20                    | 0               | 140               | (17 )           | 160        | (17 )           |
| Total   | \$806                 | \$ (10 )        | \$ 975            | \$ (57 )        | \$1,781    | \$ (67 )        |
| Number of securities (1)                        |                       | 244             |                   | 264             |            | 499             |
| Number of securities with OTTI (1)              |                       | 17              |                   | 15              |            | 31              |

The number of securities does not add across because lots consisting of the same securities have been purchased at (1) different times and appear in both categories above (i.e., less than 12 months and 12 months or more). If a security appears in both categories, it is counted only once in the total column.

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Of the securities in an unrealized loss position for 12 months or more as of September 30, 2018, 35 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of September 30, 2018 was \$49 million. As of December 31, 2017, of the securities in an unrealized loss position for 12 months or more, 28 securities had unrealized losses greater than 10% of book value with an unrealized loss of \$27 million. The Company considered the credit quality, cash flows, interest rate movements, ability to hold a security to recovery and intent to sell a security in determining whether a security had a credit loss. The Company determined that the unrealized losses recorded as of September 30, 2018 and December 31, 2017 were yield-related and not the result of OTTI.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of September 30, 2018 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities  
by Contractual Maturity  
As of September 30, 2018

|                                       | Amortized<br>Cost | Estimated<br>Fair Value |
|---------------------------------------|-------------------|-------------------------|
|                                       | (in millions)     |                         |
| Due within one year                   | \$229             | \$ 229                  |
| Due after one year through five years | 1,499             | 1,492                   |
| Due after five years through 10 years | 2,426             | 2,411                   |
| Due after 10 years                    | 4,348             | 4,584                   |
| Mortgage-backed securities:           |                   |                         |
| RMBS                                  | 967               | 948                     |
| CMBS                                  | 537               | 528                     |
| Total                                 | \$10,006          | \$ 10,192               |

Based on fair value, investments and restricted cash that are either held in trust for the benefit of third party ceding insurers in accordance with statutory requirements, placed on deposit to fulfill state licensing requirements, or otherwise pledged or restricted total \$262 million and \$287 million, as of September 30, 2018 and December 31, 2017, respectively. The investment portfolio also contains securities that are held in trust by certain AGL subsidiaries for the benefit of other AGL subsidiaries in accordance with statutory and regulatory requirements in the amount of \$1,725 million and \$1,677 million, based on fair value as of September 30, 2018 and December 31, 2017, respectively.

#### Externally Managed Portfolio

As of September 30, 2018, the majority of the investment portfolio is managed by seven outside managers (including Wasmer, Schroeder & Company LLC, in which the Company has a minority interest). The Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. The Company's investment guidelines generally do not permit its outside managers to purchase securities rated lower than A- by S&P or A3 by Moody's, excluding a minimal allocation to corporate securities not rated lower than BBB by S&P or Baa2 by Moody's.

#### Internally Managed Portfolio

The investment portfolio tables shown above include assets managed both externally and internally. The table below presents the components of the total investment portfolio that are internally managed (excluding short-term investments). The internally managed portfolio (other than short term investments) represents approximately 12% and 12% of the investment portfolio, on a fair value basis as of September 30, 2018 and December 31, 2017, respectively. The internally managed portfolio consists primarily of the Company's investments in securities for (i) loss mitigation purposes, (ii) other risk management purposes and (iii) other alternative investments that the Company believes present an attractive investment opportunity.

One of the Company's strategies for mitigating losses has been to purchase loss mitigation securities, at discounted prices. The Company also holds other invested assets that were obtained or purchased as part of negotiated settlements with insured counterparties or under the terms of the financial guaranties (other risk management assets).

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Alternative investments include various funds investing in both equity and debt securities, including catastrophe bonds, as well as investments in investment managers. In February 2017, the Company agreed to purchase up to \$100 million of limited partnership interests in a fund that invests in the equity of private equity managers.

Internally Managed Portfolio  
Carrying Value

|  | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|--|--------------------------------|-------------------------------|
|  | (in millions)                  |                               |
| Assets purchased for loss mitigation and other risk management purposes: |                                |                               |
| Fixed-maturity securities, at fair value                                 | \$ 1,184                       | \$ 1,231                      |
| Other invested assets (1)  | 13                             | 20                            |
| Alternative investments  | 78                             | 69                            |
| Other  | 4                              | 5                             |
| Total  | \$ 1,279                       | \$ 1,325                      |

(1) The Company recognized a \$31 million fair value gain in other income related to the Company's minority interest in the parent company of TMC Bonds LLC, which it sold in Third Quarter 2018.

Cash and Restricted Cash

The following table provides a reconciliation of the cash reported on the condensed consolidated balance sheets and the cash and restricted cash reported in the statements of cash flows.

Cash and Restricted Cash

|                                | As<br>of<br>September<br>2018 | As of<br>December 31,<br>September 30,<br>2017 | As of<br>September 30,<br>2017 | As of<br>December 31,<br>2016 |
|--------------------------------|-------------------------------|--|--------------------------------|-------------------------------|
|                                | (in millions)                 |  |                                |                               |
| Cash                           | \$ 82                         | \$ 144   | \$ 72                          | \$ 118                        |
| Restricted cash (1)            | 0                             | 0  | 0                              | 9                             |
| Total cash and restricted cash | \$ 82                         | \$ 144   | \$ 72                          | \$ 127                        |

(1) Amounts primarily relate to cash held in trust accounts and are reported in other assets in the condensed consolidated balance sheets. See Note 13, Reinsurance and Other Monoline Exposures, for more information.

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## 11. Insurance Company Regulatory Requirements

The table below presents the distributions from AGL's insurance company subsidiaries to the various holding companies.

Distributions by  
Insurance Company Subsidiaries

|   | Third<br>Quarter<br>2018 | Third<br>Quarter<br>2017 | Nine<br>Months<br>2018 | Nine<br>Months<br>2017 |
|---|--------------------------|--------------------------|------------------------|------------------------|
|   | (in millions)            |                          |                        |                        |
| Dividends paid by AGC to AGUS   | \$15                     | \$15                     | \$91                   | \$66                   |
| Dividends paid by AGM to AGMH   | 58                       | 63                       | 131                    | 142                    |
| Dividends paid by AG Re to AGL  | 18                       | 45                       | 98                     | 125                    |
| Dividends paid by MAC to Municipal Assurance Holdings Inc. (MAC Holdings) (1) | 12                       | 12                       | 27                     | 36                     |
| Redemption of common stock by MAC from MAC Holdings (1)                       | —                        | 250                      | —                      | 250                    |
| Repurchase of common stock by AGC from AGUS                                   | —                        | —                        | 200                    | —                      |

(1) MAC Holdings distributed nearly the entire amounts to AGM and AGC, in proportion to their ownership percentages.

## Dividend Restrictions and Capital Requirements

## United States

Under New York insurance law, AGM and MAC may only pay dividends out of "earned surplus," which is the portion of the company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends, transferred to stated capital or capital surplus, or applied to other purposes permitted by law, but does not include unrealized appreciation of assets. AGM and MAC may each pay dividends without the prior approval of the New York Superintendent of Financial Services (New York Superintendent) that, together with all dividends declared or distributed by it during the preceding 12 months, do not exceed the lesser of 10% of its policyholders' surplus (as of its last annual or quarterly statement filed with the New York Superintendent) or 100% of its adjusted net investment income during that period.

The maximum amount available during 2018 for AGM to distribute to AGMH as dividends without regulatory approval is estimated to be approximately \$171 million. Of such \$171 million, \$40 million is estimated to be available for distribution in the fourth quarter of 2018. The maximum amount available during 2018 for MAC to distribute as dividends to MAC Holdings, which is owned by AGM and AGC, without regulatory approval is estimated to be approximately \$27 million, all of which has already been distributed.

Under Maryland's insurance law, AGC may, with prior notice to the Maryland Insurance Commissioner, pay an ordinary dividend that, together with all dividends paid in the prior 12 months, does not exceed the lesser of 10% of its policyholders' surplus (as of the prior December 31) or 100% of its adjusted net investment income during that period. The maximum amount available during 2018 for AGC to distribute as ordinary dividends is approximately \$133 million. Of such \$133 million, approximately \$42 million is available for distribution in the fourth quarter of 2018.

## Bermuda

For AG Re, any distribution (including repurchase of shares) of any share capital, contributed surplus or other statutory capital that would reduce its total statutory capital by 15% or more of its total statutory capital as set out in its previous year's financial statements requires the prior approval of the Bermuda Monetary Authority (Authority). Separately, dividends are paid out of an insurer's statutory surplus and cannot exceed that surplus. Further, annual dividends cannot exceed 25% of total statutory capital and surplus as set out in its previous year's financial statements, which is \$324 million, without AG Re certifying to the Authority that it will continue to meet required margins. Based on the foregoing limitations, in 2018 AG Re has the capacity to (i) make capital distributions in an aggregate amount up to \$128 million without the prior approval



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of the Authority and (ii) declare and pay dividends in an aggregate amount up to approximately \$324 million as of September 30, 2018. Such dividend capacity can be further limited by the actual amount of AG Re's unencumbered assets, which amount changes from time to time due in part to collateral posting requirements. As of September 30, 2018, AG Re had unencumbered assets of approximately \$437 million.

United Kingdom

U.K. company law prohibits each of AGE, AGLN and AGUK from declaring a dividend to its shareholders unless it has "profits available for distribution." The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the U.K. insurance regulatory laws impose no statutory restrictions on a general insurer's ability to declare a dividend, the Prudential Regulation Authority's capital requirements may in practice act as a restriction on dividends. In addition, AGLN currently must confirm that the Prudential Regulation Authority does not object to the payment of any dividend to its parent company before AGLN makes any dividend payment.

12. Income Taxes

Overview

AGL and its Bermuda subsidiaries AG Re, AGRO, and Cedar Personnel Ltd. (Bermuda Subsidiaries) are not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, AGL and its Bermuda Subsidiaries will be exempt from taxation in Bermuda until March 31, 2035. AGL's U.S. and U.K. subsidiaries are subject to income taxes imposed by U.S. and U.K. authorities, respectively, and file applicable tax returns. In addition, AGRO, a Bermuda domiciled company, has elected under Section 953(d) of the U.S. Internal Revenue Code (the Code) to be taxed as a U.S. domestic corporation.

In November 2013, AGL became tax resident in the U.K. although it remains a Bermuda-based company and its administrative and head office functions continue to be carried on in Bermuda. As a U.K. tax resident company, AGL is required to file a corporation tax return with Her Majesty's Revenue & Customs. AGL is subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to any applicable exemptions. The corporation tax rate is at 19% for 2018. Assured Guaranty expects that the dividends AGL receives from its direct subsidiaries will be exempt from U.K. corporation tax due to the exemption in section 931D of the U.K. Corporation Tax Act 2009. In addition, any dividends paid by AGL to its shareholders should not be subject to any withholding tax in the U.K. Assured Guaranty does not expect any profits of non-U.K. resident members of the group to be taxed under the U.K. "controlled foreign companies" regime and has obtained a clearance from Her Majesty's Revenue & Customs confirming this on the basis of current facts.

AGUS files a consolidated federal income tax return with all of its U.S. subsidiaries. AGE, the Company's U.K. subsidiary, had previously elected under U.S. Internal Revenue Code Section 953(d) to be taxed as a U.S. company. In January 2017, AGE filed a request with the U.S. Internal Revenue Service (IRS) to revoke the election, which was approved in May 2017. As a result of the revocation of the Section 953(d) election, AGE is no longer liable to pay future U.S. taxes beginning in 2017.

On January 10, 2017, AGC purchased MBIA UK, a U.K. based insurance company. After the purchase, MBIA UK changed its name to AGLN and continues to file its tax returns in the U.K. as a separate entity. For additional information on the MBIA UK Acquisition, see Note 2, Assumption of Insured Portfolio and Business Combinations.

Assured Guaranty Overseas US Holdings Inc. (AGOUS) and its subsidiaries AGRO and AG Intermediary Inc. file their own consolidated federal income tax return.

Effect of the 2017 Tax Cuts and Jobs Act

On December 22, 2017, the Tax Act was signed into law. The Tax Act changed many items of U.S. corporate income taxation, including a reduction of the corporate income tax rate from 35% to 21%, implementation of a territorial tax system and imposition of a tax on deemed repatriated earnings of non-U.S. subsidiaries. At December 31, 2017, the Company had not completed accounting for the tax effects of the Tax Act; however, the Company made a reasonable estimate of the effects on the existing deferred tax balances and the one-time transition tax. The Company recognized a provisional amount of \$61 million, which was included as a component of income tax expense from continuing operations in 2017. The Company will continue to assess its provision for income taxes as future guidance is issued. Any adjustments, if necessary, during the measurement period guidance outlined in SEC Staff Accounting Bulletin No. 118 will be included in the statement of operations as an adjustment to

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income tax expense in the reporting period when such adjustments are determined. As of September 30, 2018 the Company recorded an additional deferred tax benefit of \$4 million resulting from adjustments made to the one-time transition tax and the write-down of existing deferred tax balances that were identified while completing the 2017 tax return.

## Provision for Income Taxes

The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due, for example, to the variability in loss reserves, fair value of its credit derivatives and VIEs, and foreign exchange gains and losses which prevents the Company from projecting a reliable estimated annual effective tax rate and pretax income for the full year 2018. A discrete calculation of the provision is calculated for each interim period.

The effective tax rates reflect the proportion of income recognized by each of the Company's operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 21% in 2018 and 35% in 2017, U.K. subsidiaries taxed at the U.K. marginal corporate tax rate of 19% unless taxed as a U.S. controlled foreign corporation (CFC), and no taxes for the Company's Bermuda Subsidiaries unless subject to U.S. tax by election. In 2018, due to the Tax Act, CFCs apply the local marginal corporate tax rate. For periods subsequent to April 1, 2017, the U.K. corporation tax rate has been reduced to 19%. For the periods between April 1, 2015 and March 31, 2017, the U.K. corporation tax rate was 20%. The Company's overall effective tax rate fluctuates based on the distribution of income across jurisdictions.

A reconciliation of the difference between the provision for income taxes and the expected tax provision at statutory rates in taxable jurisdictions is presented below.

## Effective Tax Rate Reconciliation

|  | Third Quarter |        | Nine Months |        |
|--|---------------|--------|-------------|--------|
|  | 2018          | 2017   | 2018        | 2017   |
|  | (in millions) |        |             |        |
| Expected tax provision (benefit) at statutory rates in taxable jurisdictions | \$31          | \$116  | \$80        | \$245  |
| Tax-exempt interest  | (6 )          | (12 )  | (18 )       | (36 )  |
| Bargain purchase gain  | —             | —      | —           | (20 )  |
| Change in liability for uncertain tax positions                              | (10 )         | 8      | (16 )       | (27 )  |
| Effect of provision to tax return filing adjustment                          | (1 )          | (8 )   | (1 )        | (8 )   |
| State taxes  | 5             | 1      | 6           | 7      |
| Foreign taxes  | 1             | 1      | 4           | 4      |
| Taxes on reinsurance   | 1             | (1 )   | 0           | (3 )   |
| Effect of adjustments to the provisional amount as a result of Tax Act       | (4 )          | —      | (4 )        | —      |
| Other  | (3 )          | 0      | (5 )        | (5 )   |
| Total provision (benefit) for income taxes                                   | \$14          | \$105  | \$46        | \$157  |
| Effective tax rate   | 8.3 %         | 33.6 % | 9.7 %       | 18.8 % |

The expected tax provision at statutory rates in taxable jurisdictions is calculated as the sum of pretax income in each jurisdiction multiplied by the statutory tax rate of the jurisdiction by which it will be taxed. Pretax income of the Company's subsidiaries which are not U.S. or U.K. domiciled but are subject to U.S. or U.K. tax by election, or as establishment of tax residency, are included at the U.S. or U.K. statutory tax rate. In 2018, due to the Tax Act, CFC's apply the local marginal corporate tax rate. Where there is a pretax loss in one jurisdiction and pretax income in another, the total combined expected tax rate may be higher or lower than any of the individual statutory rates.



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The following table presents pretax income and revenue by jurisdiction.

## Pretax Income (Loss) by Tax Jurisdiction

|                | Third<br>Quarter |       | Nine<br>Months |       |
|----------------|------------------|-------|----------------|-------|
|                | 2018             | 2017  | 2018           | 2017  |
|                | (in millions)    |       |                |       |
| U.S.           | \$128            | \$337 | \$374          | \$713 |
| Bermuda        | 24               | (18 ) | 97             | 143   |
| U.K. and Other | 23               | (6 )  | 8              | (21 ) |
| Total          | \$175            | \$313 | \$479          | \$835 |

## Revenue by Tax Jurisdiction

|                | Third<br>Quarter |       | Nine Months |         |
|----------------|------------------|-------|-------------|---------|
|                | 2018             | 2017  | 2018        | 2017    |
|                | (in millions)    |       |             |         |
| U.S.           | \$191            | \$566 | \$628       | \$1,305 |
| Bermuda        | 47               | 61    | 135         | 165     |
| U.K. and Other | 36               | (4 )  | 25          | (12 )   |
| Total          | \$274            | \$623 | \$788       | \$1,458 |

Pretax income by jurisdiction may be disproportionate to revenue by jurisdiction to the extent that insurance losses incurred are disproportionate.

## Valuation Allowance

The Company has \$13 million of foreign tax credit (FTC) carryovers from previous acquisitions and \$23 million of FTC due to the Tax Act for use against regular tax in future years. FTCs will begin to expire in 2020 and will fully expire by 2027. In analyzing the future realizability of FTCs, the Company notes limitations on future foreign source income due to overall foreign losses as negative evidence. After reviewing positive and negative evidence, the Company came to the conclusion that it is more likely than not that the FTC of \$36 million will not be utilized, and therefore recorded a valuation allowance with respect to this tax attribute.

The Company came to the conclusion that it is more likely than not that the remaining net deferred tax asset will be fully realized after weighing all positive and negative evidence available as required under GAAP. The positive evidence that was considered included the cumulative income the Company has earned over the last three years, and the significant unearned premium income to be included in taxable income. The positive evidence outweighs any negative evidence that exists. As such, the Company believes that no valuation allowance is necessary in connection with this deferred tax asset. The Company will continue to analyze the need for a valuation allowance on a quarterly basis.

## Audits

As of September 30, 2018, AGUS had open tax years with the IRS for 2015 to present. In December 2016, the IRS issued a Revenue Agent Report, for the 2009 - 2012 audit period, which did not identify any material adjustments that were not already accounted for in prior periods. In April 2017, the Company received a final letter from the IRS to close the audit with no additional findings or changes, and as a result the Company released previously recorded uncertain tax position reserves and accrued interest of approximately \$37 million in the second quarter of 2017. AGOUS has open tax years of 2015 forward. The Company's U.K. subsidiaries are not currently under examination and have open tax years of 2016 forward. CIFGNA, which was acquired by AGC during 2016, is not currently under examination and has open tax years of 2015 to present. In September 2018, the Company's French subsidiary, CIFGE, concluded an examination for the period January 1, 2015 through December 31, 2016 with no material adjustments.

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## Uncertain Tax Positions

The Company's policy is to recognize interest related to uncertain tax positions in income tax expense and has accrued \$1 million for Nine Months 2018 and \$1 million for the full year 2017. As of September 30, 2018 and December 31, 2017, the Company has accrued \$1 million and \$3 million of interest, respectively.

The total amount of reserves for unrecognized tax positions, including accrued interest, as of September 30, 2018 and December 31, 2017 that would affect the effective tax rate, if recognized, was \$15 million and \$31 million, respectively. The Company released \$7 million and \$11 million of previously recorded uncertain tax position reserves and accrued interest in the first quarter and third quarter of 2018, respectively, due to the closing of the 2013 and 2014 audit years.

## Tax Assets (Liabilities)

## Deferred and Current Tax Assets (Liabilities) (1)

|                                   | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|-----------------------------------|--------------------------------|-------------------------------|
|                                   | (in millions)                  |                               |
| Deferred tax assets (liabilities) | \$ 71                          | \$ 98                         |
| Current tax assets (liabilities)  | 36                             | 21                            |

(1) Included in other assets or other liabilities on the condensed consolidated balance sheets.

## 13. Reinsurance and Other Monoline Exposures

The Company assumes exposure (Assumed Business) and may cede portions of exposure it has insured (Ceded Business) in exchange for premiums, net of any ceding commissions. Substantially all of the Company's Assumed Business and Ceded Business relates to financial guaranty business, except for a modest amount that relates to AGRO's non-financial guaranty business. The Company historically entered into, and with respect to new business originated by AGRO continues to enter into, ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks.

## Assumed and Ceded Financial Guaranty Business

The Company has assumed financial guaranty business (Assumed Financial Guaranty Business) from third party insurers, primarily other monoline financial guaranty companies that currently are in runoff and no longer actively writing new business (Legacy Monoline Insurers). Under these relationships, the Company assumes a portion of the ceding company's insured risk in exchange for a portion of the ceding company's premium for the insured risk (typically, net of a ceding commission). The Company, if required, secures its reinsurance obligations to these Legacy Monoline Insurers, typically by depositing in trust assets with a market value equal to its assumed liabilities calculated on a U.S. statutory basis.

As of September 30, 2018, the majority of the Company's Assumed Financial Guaranty Business from Legacy Monoline Insurers consisted of business that AGC assumed in the SGI Transaction effective as of June 1, 2018, pursuant to which AGC (among other things) assumed, generally on a 100% quota share basis, substantially all of SGI's insured portfolio. The par value on that date of the exposures reinsured totaled approximately \$11 billion. The reinsured portfolio consisted predominantly of public finance and infrastructure obligations that met Assured

Guaranty's new business underwriting criteria. See Note 2, Assumption of Insured Portfolio and Business Combinations for additional information on the SGI Transaction. The balance of the Company's Assumed Financial Guaranty Business consisted mainly of business that the Company (predominantly AGC and/or AG Re) assumed prior to the 2008-2009 financial crisis from other Legacy Monoline Insurers.

The Company's facultative and treaty agreements with the Legacy Monoline Insurers are generally subject to termination at the option of the ceding company:

•if the Company fails to meet certain financial and regulatory criteria;

•if the Company fails to maintain a specified minimum financial strength rating, or



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upon certain changes of control of the Company.

Upon termination due to one of the above events, the Company typically would be required to return to the ceding company unearned premiums (net of ceding commissions) and loss reserves, calculated on a U.S. statutory basis, attributable to the assumed business (plus in certain cases, an additional required amount), after which the Company would be released from liability with respect to such business.

As of September 30, 2018, if each third party company ceding business to AG Re and/or AGC had a right to recapture such business, and chose to exercise such right, the aggregate amounts that AG Re and AGC could be required to pay to all such companies would be approximately \$42 million and \$347 million, respectively.

The Company has ceded financial guaranty business to non-affiliated companies to limit its exposure to risk. Under these relationships, the Company ceded a portion of its insured risk to the reinsurer in exchange for the reinsurer receiving a share of the Company's premiums for the insured risk (typically, net of a ceding commission). The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. The Company's ceded contracts generally allow the Company to recapture ceded financial guaranty business after certain triggering events, such as reinsurer downgrades.

The following table presents the components of premiums and losses reported in the condensed consolidated statements of operations and the contribution of the Company's Assumed and Ceded Businesses (both financial guaranty and non-financial guaranty).

## Effect of Reinsurance on Statement of Operations

|                   | Third Quarter |       | Nine Months |       |
|-------------------|---------------|-------|-------------|-------|
|                   | 2018          | 2017  | 2018        | 2017  |
|                   | (in millions) |       |             |       |
| Premiums Written: |               |       |             |       |
| Direct            | \$57          | \$46  | \$192       | \$227 |
| Assumed (1)       | (7 )          | (1 )  | 324         | 8     |
| Ceded (2)         | 1             | 27    | 14          | 37    |
| Net               | \$51          | \$72  | \$530       | \$272 |
| Premiums Earned:  |               |       |             |       |
| Direct            | \$127         | \$186 | \$400       | \$516 |
| Assumed           | 19            | 6     | 33          | 20    |
| Ceded             | (4 )          | (6 )  | (10 )       | (24 ) |
| Net               | \$142         | \$186 | \$423       | \$512 |
| Loss and LAE:     |               |       |             |       |
| Direct            | \$18          | \$231 | \$53        | \$377 |
| Assumed           | 1             | (1 )  | (7 )        | (1 )  |
| Ceded             | (2 )          | (7 )  | (3 )        | (22 ) |
| Net               | \$17          | \$223 | \$43        | \$354 |

(1) Negative assumed premiums written were due to changes in expected debt service schedules.

(2) Positive ceded premiums written were due to commutations and changes in expected debt service schedules.



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## Exposure to Reinsurers and Other Monolines (1)

|  | As of<br>September<br>2018<br>(in millions) | As of<br>December 31,<br>2017<br>(in millions) |
|--|---|--|
| Due (To) From:                               |   |  |
| Assumed premium, net of commissions          | \$ 86                                       | \$ 53  |
| Ceded premium, net of commissions            | (27 )                                       | (42 )  |
| Assumed expected loss to be paid             | (46 )                                       | (71 )  |
| Ceded expected loss to be paid               | 15  | 29   |
| Outstanding Exposure:                        |   |  |
| Financial guaranty                           |   |  |
| Ceded par outstanding (2)                    | 2,463                                       | 4,434  |
| Assumed par outstanding                      | 17,625                                      | 8,383  |
| Second-to-pay insured par outstanding (3)    | 6,858                                       | 6,605  |
| Non-financial guaranty exposure (see Note 4) |   |  |
| Ceded  | 239   | 159  |
| Assumed                                      | 1,085                                       | 974  |

The total collateral posted by all non-affiliated reinsurers required to post, or that had agreed to post, collateral as of September 30, 2018 and December 31, 2017 was approximately \$85 million and \$118 million, respectively.

(1) Such collateral is posted (i) in the case of certain reinsurers not authorized or "accredited" in the U.S., in order for the Company to receive credit for the liabilities ceded to such reinsurers, and (ii) in the case of certain reinsurers authorized in the U.S., on terms negotiated with the Company.

(2) Of the total par ceded to unrated or BIG rated reinsurers, \$237 million and \$296 million is rated BIG as of September 30, 2018 and December 31, 2017, respectively.

The par on second-to-pay exposure where the ratings of the primary insurer and underlying transaction are both BIG and/or not rated is \$163 million and \$204 million as of September 30, 2018 and December 31, 2017, respectively. Second-to-pay insured par outstanding represents transactions the Company has insured that are (3) insured directly by another monoline financial guaranty insurer and where the Company's obligation to pay under its insurance of such transactions arises only if both the underlying insured obligation and the primary financial guarantor insurer default. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer.

## Commutations

During Third Quarter 2018, the Company entered into commutation agreements to reassume portions of its outstanding portfolio previously ceded to one of its unaffiliated reinsurers. The reassumed exposures represented approximately 12% of the Company's total portfolio ceded to such reinsurer on July 1, 2018 and were split between U.S. public finance exposures and international public and project finance exposures. During the second quarter of 2018, in connection with AGC's reinsurance of substantially all of SGI's insured portfolio described above, the Company also entered into a commutation agreement to reassume a book of business it had ceded to SGI (but excluding certain outstanding cessions to SGI with ceded U.S. statutory loss reserves). See Note 2, Assumption of Insured Portfolio and Business Combinations for additional information on the SGI Transaction. During the first quarter of 2018, the Company entered into a commutation agreement to reassume U.S. RMBS transactions previously ceded to one of its unaffiliated reinsurers. During Third Quarter 2017, the Company entered into two commutation

agreements. In one case, it reassumed the entire portfolio previously ceded to one of its unaffiliated reinsurers under quota share reinsurance, consisting predominantly of U.S. public finance and international public and project finance exposures. In the other case, it reassumed a portion of the portfolio previously ceded to one of its other unaffiliated reinsurers. During the first quarter of 2017, the Company entered into a commutation agreement to reassume the entire portfolio previously ceded to one of its unaffiliated reinsurers, consisting predominantly (over 97%) of U.S. public finance and international public and project finance exposures.

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The table below summarizes the effect of commutations.

## Commutations of Ceded Reinsurance Contracts

|   | Third<br>Quarter<br>2018 | Nine<br>Months<br>2018 | 2017      |
|---|--------------------------|------------------------|-----------|
|   | (in millions)            |                        |           |
| Increase (decrease) in net unearned premium reserve | \$4                      | \$ 62                  | \$ 80     |
| Increase (decrease) in net par outstanding          | 2243,455                 | 1,457                  | 4,628     |
| Commutation gains (losses)                          | 1                        | 255                    | (16 ) 328 |

## Excess of Loss Reinsurance Facility

Effective January 1, 2018, AGC, AGM and MAC entered into a \$400 million aggregate excess of loss reinsurance facility of which \$180 million was placed with an unaffiliated reinsurer. This facility replaces a similar \$400 million aggregate excess of loss reinsurance facility, of which \$360 million was placed with unaffiliated reinsurers, that AGC, AGM and MAC had entered into effective January 1, 2016 and which terminated on December 31, 2017. The new facility covers losses occurring either from January 1, 2018 through December 31, 2024, or January 1, 2019 through December 31, 2025, at the option of AGC, AGM and MAC. It terminates on January 1, 2020, unless AGC, AGM and MAC choose to extend it. The new facility covers certain U.S. public finance exposures insured or reinsured by AGC, AGM and MAC as of September 30, 2017, excluding exposures that were rated non-investment grade as of December 31, 2017 by Moody's or S&P or internally by AGC, AGM or MAC and is subject to certain per credit limits. Among the exposures excluded are those associated with the Commonwealth of Puerto Rico and its related authorities and public corporations. The new facility attaches when AGC's, AGM's and MAC's net losses (net of AGC's and AGM's reinsurance (including from affiliates) and net of recoveries) exceed \$0.8 billion in the aggregate. The new facility covers a portion of the next \$400 million of losses, with the reinsurer assuming \$180 million of the \$400 million of losses and AGC, AGM and MAC jointly retaining the remaining \$220 million. The reinsurer is required to be rated at least AA- or to post collateral sufficient to provide AGC, AGM and MAC with the same reinsurance credit as reinsurers rated AA-. AGC, AGM and MAC are obligated to pay the reinsurer its share of recoveries relating to losses during the coverage period in the covered portfolio. AGC, AGM and MAC paid approximately \$3.2 million of premiums in 2018 for the term January 1, 2018 through December 31, 2018 and deposited approximately \$3.2 million in cash into a trust account for the benefit of the reinsurer to be used to pay the premiums for 2019. The main differences between the new facility and the prior facility that terminated on December 31, 2017 are the reinsurance attachment point (\$0.8 billion versus \$1.25 billion), the total reinsurance coverage (\$180 million part of \$400 million versus \$360 million part of \$400 million) and the annual premium (\$3.2 million versus \$9 million).

## Assumed and Ceded Non-Financial Guaranty Business

As described in Note 4, Outstanding Exposure, Non-Financial Guaranty Insurance, the Company, through AGRO, assumes non-financial guaranty business from third party insurers (Assumed Non-Financial Guaranty Business). It also retrocedes some of this business to third party reinsurers. A downgrade of AGRO's financial strength rating by S&P below "A" would require AGRO to post, as of September 30, 2018, an estimated \$3 million of collateral in respect of certain of its Assumed Non-Financial Guaranty Business. A further downgrade of AGRO's S&P rating below A- would give the company ceding such business the right to recapture the business for AGRO's collateral amount, and, if also accompanied by a downgrade of AGRO's financial strength rating by A.M. Best Company, Inc. below A-, would also require AGRO to post, as of September 30, 2018, an estimated \$8 million of collateral in respect of a different portion of AGRO's Assumed Non-Financial Guaranty Business. AGRO's ceded contracts generally have equivalent provisions requiring the assuming reinsurer to post collateral and/or allowing AGRO to recapture the ceded business

upon certain triggering events, such as reinsurer rating downgrades.

14. Commitments and Contingencies

Legal Proceedings

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

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In addition, in the ordinary course of their respective businesses, certain of AGL's subsidiaries assert claims in legal proceedings against third parties to recover losses paid in prior periods or prevent losses in the future. For example, the Company has commenced a number of legal actions in the Federal District Court for Puerto Rico to enforce its rights with respect to the obligations it insures of Puerto Rico and various of its related authorities and public corporations. See "Exposure to Puerto Rico" section of Note 4, Outstanding Exposure, for a description of such actions. See "Recovery Litigation" section of Note 5, Expected Loss to be Paid, for a description of recovery litigation unrelated to Puerto Rico. The amounts, if any, the Company will recover in these and other proceedings to recover losses are uncertain, and recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or year could be material to the Company's results of operations in that particular quarter or year.

The Company also receives subpoenas duces tecum and interrogatories from regulators from time to time.

Litigation

On November 28, 2011, Lehman Brothers International (Europe) (in administration) (LBIE) sued AG Financial Products Inc. (AGFP), an affiliate of AGC which in the past had provided credit protection to counterparties under CDS. AGC acts as the credit support provider of AGFP under these CDS. LBIE's complaint, which was filed in the Supreme Court of the State of New York, asserted a claim for breach of the implied covenant of good faith and fair dealing based on AGFP's termination of nine credit derivative transactions between LBIE and AGFP and asserted claims for breach of contract and breach of the implied covenant of good faith and fair dealing based on AGFP's termination of 28 other credit derivative transactions between LBIE and AGFP and AGFP's calculation of the termination payment in connection with those 28 other credit derivative transactions. Following defaults by LBIE, AGFP properly terminated the transactions in question in compliance with the agreement between AGFP and LBIE, and calculated the termination payment properly. AGFP calculated that LBIE owes AGFP approximately \$29 million in connection with the termination of the credit derivative transactions, whereas LBIE asserted in the complaint that AGFP owes LBIE a termination payment of approximately \$1.4 billion. AGFP filed a motion to dismiss the claims for breach of the implied covenant of good faith in LBIE's complaint, and on March 15, 2013, the court granted AGFP's motion to dismiss in respect of the count relating to the nine credit derivative transactions and narrowed LBIE's claim with respect to the 28 other credit derivative transactions. LBIE's administrators disclosed in an April 10, 2015 report to LBIE's unsecured creditors that LBIE's valuation expert has calculated LBIE's claim for damages in aggregate for the 28 transactions to range between a minimum of approximately \$200 million and a maximum of approximately \$500 million, depending on what adjustment, if any, is made for AGFP's credit risk and excluding any applicable interest. AGFP filed a motion for summary judgment on the remaining causes of action asserted by LBIE and on AGFP's counterclaims, and on July 2, 2018, the court granted in part and denied in part AGFP's motion. The court dismissed, in its entirety, LBIE's remaining claim for breach of the implied covenant of good faith and fair dealing and also dismissed LBIE's claim for breach of contract solely to the extent that it is based upon AGFP's conduct in connection with the auction. With respect to LBIE's claim for breach of contract, the court held that there are triable issues of fact regarding whether AGFP calculated its loss reasonably and in good faith. On October 1, 2018, AGFP filed an appeal with the Appellate Division of the Supreme Court of the State of New York, First Judicial Department, seeking reversal of the portions of the lower court's ruling denying AGFP's motion for summary judgment with respect to LBIE's sole remaining claim for breach of contract.

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## 15. Long-Term Debt and Credit Facilities

The principal and carrying values of the Company's long-term debt are presented in the table below.

## Principal and Carrying Amounts of Debt

|  | As of<br>September 30,<br>2018 |                   | As of<br>December 31,<br>2017 |                   |
|--|--------------------------------|-------------------|-------------------------------|-------------------|
|  | Principal                      | Carrying<br>Value | Principal                     | Carrying<br>Value |
|  | (in millions)                  |                   |                               |                   |
| AGUS:  |                                |                   |                               |                   |
| 7% Senior Notes (1)                                  | \$200                          | \$197             | \$200                         | \$197             |
| 5% Senior Notes (1)                                  | 500                            | 497               | 500                           | 496               |
| Series A Enhanced Junior Subordinated Debentures (2) | 150                            | 150               | 150                           | 150               |
| Total AGUS   | 850                            | 844               | 850                           | 843               |
| AGMH(3):   |                                |                   |                               |                   |
| 67/8% QUIBS (1)                                      | 100                            | 70                | 100                           | 70                |
| 6.25% Notes (1)                                      | 230                            | 143               | 230                           | 142               |
| 5.6% Notes (1)                                       | 100                            | 57                | 100                           | 57                |
| Junior Subordinated Debentures (2)                   | 300                            | 196               | 300                           | 192               |
| Total AGMH   | 730                            | 466               | 730                           | 461               |
| AGM:   |                                |                   |                               |                   |
| AGM Notes Payable                                    | 5                              | 5                 | 6                             | 6                 |
| Total AGM  | 5                              | 5                 | 6                             | 6                 |
| Purchased debt                                       | (100 )                         | (66 )             | (28 )                         | (18 )             |
| Total  | \$1,485                        | \$1,249           | \$1,558                       | \$1,292           |

(1) AGL fully and unconditionally guarantees these obligations.

(2) Guaranteed by AGL on a junior subordinated basis.

Carrying amounts are different than principal amounts due primarily to fair value adjustments at the date of the (3) AGMH acquisition, which are accreted or amortized into interest expense over the remaining terms of these obligations.

The following table presents the principal amounts of AGMH's outstanding Junior Subordinated Debentures that AGUS purchased and the loss on extinguishment of debt recognized by the Company.

AGUS's Purchase  
of AGMH's Junior Subordinated Debentures

|                                    | Third<br>Quarter<br>2018 |      | Nine<br>Months<br>2017 |      |
|------------------------------------|--------------------------|------|------------------------|------|
|                                    | 2018                     | 2017 | 2018                   | 2017 |
|                                    | (in millions)            |      |                        |      |
| Principal amount repurchased       | \$25                     | \$6  | \$72                   | \$28 |
| Loss on extinguishment of debt (1) | 9                        | 2    | 26                     | 9    |



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Included in other income in the condensed consolidated statements of operations. The loss represents the difference (1) between the amount paid to purchase AGMH's debt and the carrying value of the debt, which includes the unamortized fair value adjustments that were recorded upon the acquisition of AGMH in 2009.

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Intercompany Credit Facility and Intercompany Debt

On October 25, 2013, AGL, as borrower, and AGUS, as lender, entered into a revolving credit facility pursuant to which AGL may, from time to time, borrow for general corporate purposes. Under the credit facility, AGUS committed to lend a principal amount not exceeding \$225 million in the aggregate. In September 2018, AGL and AGUS amended the revolving credit facility to extend the commitment until October 25, 2023 (the loan commitment termination date). The unpaid principal amount of each loan will bear interest at a fixed rate equal to 100% of the then applicable interest rate as determined under Section 1274(d) of the Code, and interest on all loans will be computed for the actual number of days elapsed on the basis of a year consisting of 360 days. Accrued interest on all loans will be paid on the last day of each June and December, beginning on December 31, 2013, and at maturity. AGL must repay the then unpaid principal amounts of the loans by the third anniversary of the loan commitment termination date. No amounts are currently outstanding under the credit facility.

In addition, in 2012 AGUS borrowed \$90 million from its affiliate AGRO to fund the acquisition of MAC. In 2016, the parties agreed to extend the maturity date of the loan from May 2017 to November 2019. During 2017, AGUS repaid \$10 million in outstanding principal as well as accrued and unpaid interest. As of September 30, 2018, \$60 million remained outstanding.

Committed Capital Securities

Each of AGC and AGM have entered into put agreements with four separate custodial trusts allowing AGC and AGM, respectively, to issue an aggregate of \$200 million of non-cumulative redeemable perpetual preferred securities to the trusts in exchange for cash. Each custodial trust was created for the primary purpose of issuing \$50 million face amount of CCS, investing the proceeds in high-quality assets and entering into put options with AGC or AGM, as applicable. The Company does not consider itself to be the primary beneficiary of the trusts and the trusts are not consolidated in Assured Guaranty's financial statements.

The trusts provide AGC and AGM access to new equity capital at their respective sole discretion through the exercise of the put options. Upon AGC's or AGM's exercise of its put option, the relevant trust will liquidate its portfolio of eligible assets and use the proceeds to purchase the AGC or AGM preferred stock, as applicable. AGC or AGM may use the proceeds from its sale of preferred stock to the trusts for any purpose, including the payment of claims. The put agreements have no scheduled termination date or maturity. However, each put agreement will terminate if (subject to certain grace periods) specified events occur. Both AGC and AGM continue to have the ability to exercise their respective put options and cause the related trusts to purchase their preferred stock.

Prior to 2008 or 2007, the amounts paid on the CCS were established through an auction process. All of those auctions failed in 2008 or 2007, and the rates paid on the CCS increased to their respective maximums. The annualized rate on the AGC CCS is one-month LIBOR plus 250 basis points, and the annualized rate on the AGM CPS is one-month LIBOR plus 200 basis points.

See Note 7, Fair Value Measurement, –Other Assets–Committed Capital Securities, for a fair value measurement discussion.

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## 16. Earnings Per Share

## Computation of Earnings Per Share

|  | Third<br>Quarter                           |        | Nine<br>Months |        |
|--|--|--------|----------------|--------|
|  | 2018                                       | 2017   | 2018           | 2017   |
|  | (in millions, except per<br>share amounts) |        |                |        |
| Basic Earnings Per Share (EPS):  |  |        |                |        |
| Net income (loss) attributable to AGL  | \$161                                      | \$208  | \$433          | \$678  |
| Less: Distributed and undistributed income (loss) available to nonvested shareholders                          | 1  | 0      | 1              | 1      |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries, basic    | \$160                                      | \$208  | \$432          | \$677  |
| Basic shares   | 108.0                                      | 118.7  | 111.6          | 121.8  |
| Basic EPS  | \$1.48                                     | \$1.75 | \$3.87         | \$5.56 |
| Diluted EPS:   |  |        |                |        |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries, basic    | \$160                                      | \$208  | \$432          | \$677  |
| Plus: Re-allocation of undistributed income (loss) available to nonvested shareholders of AGL and subsidiaries | 0  | 0      | 0              | 0      |
| Distributed and undistributed income (loss) available to common shareholders of AGL and subsidiaries, diluted  | \$160                                      | \$208  | \$432          | \$677  |
| Basic shares   | 108.0                                      | 118.7  | 111.6          | 121.8  |
| Dilutive securities:   |  |        |                |        |
| Options and restricted stock awards  | 1.3  | 2.0    | 1.3            | 1.7    |
| Diluted shares   | 109.3                                      | 120.7  | 112.9          | 123.5  |
| Diluted EPS  | \$1.47                                     | \$1.72 | \$3.83         | \$5.48 |
| Potentially dilutive securities excluded from computation of EPS because of antidilutive effect                | 0.0  | —      | 0.1            | 0.1    |

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## 17. Shareholders' Equity

## Other Comprehensive Income

The following tables present the changes in each component of AOCI and the effect of reclassifications out of AOCI on the respective line items in net income.

Changes in Accumulated Other Comprehensive Income by Component  
Third Quarter 2018

|  | Net Unrealized<br>Gains (Losses)<br>on FG<br>Investments<br>with<br>no OTTI | Net Unrealized<br>Gains (Losses)<br>on<br>Investments<br>with<br>OTTI | Net<br>Unrealized<br>Gains<br>(Losses)<br>on FG<br>VIEs' Liabilities<br>with<br>Recourse<br>due to<br>ISCR | Cumulative<br>Translation<br>Adjustment | Cash Flow<br>Hedge | Total<br>AOCI |
|--|---|---|--|---|--------------------|---------------|
|  | (in millions)   |   |  |   |                    |               |
| Balance, June 30, 2018                                     | \$83  | \$ 124  | \$ (31 )   | \$ (32 )                                | \$ 8               | \$152         |
| Other comprehensive income (loss) before reclassifications | (59 )   | (16 )   | (5 )   | (3 )                                    | —                  | (83 )         |
| Less: Amounts reclassified from AOCI to:                   |   |   |  |   |                    |               |
| Net realized investment gains (losses)                     | 1   | (8 )  | —  | —                                       | —                  | (7 )          |
| Fair value gains (losses) on FG VIEs                       | —   | —   | (2 )   | —                                       | —                  | (2 )          |
| Total before tax   | 1   | (8 )  | (2 )   | —                                       | —                  | (9 )          |
| Tax (provision) benefit                                    | (1 )  | 1   | 0  | —                                       | —                  | 0             |
| Total amount reclassified from AOCI, net of tax            | 0   | (7 )  | (2 )   | —                                       | —                  | (9 )          |
| Net current period other comprehensive income (loss)       | (59 )   | (9 )  | (3 )   | (3 )                                    | —                  | (74 )         |
| Balance, September 30, 2018                                | \$24  | \$ 115  | \$ (34 )   | \$ (35 )                                | \$ 8               | \$78          |

Changes in Accumulated Other Comprehensive Income by Component  
Third Quarter 2017

|  | Net Unrealized<br>Gains (Losses)<br>on FG<br>Investments<br>with<br>no OTTI | Net Unrealized<br>Gains (Losses)<br>on<br>Investments<br>with<br>OTTI | Net<br>Unrealized<br>Gains<br>(Losses)<br>on FG<br>VIEs' Liabilities<br>with<br>Recourse<br>due to<br>ISCR | Cumulative<br>Translation<br>Adjustment | Cash Flow<br>Hedge | Total<br>AOCI |
|--|---|---|--|---|--------------------|---------------|
|  | (in millions)   |   |  |   |                    |               |
| Balance, June 30, 2017                                     | \$228   | \$ 107  | \$ (27 )   | \$ 7                                    | \$ 7               | \$315         |
| Other comprehensive income (loss) before reclassifications | 27  | (15 )   | 3  | —                                       | —                  | 15            |
| Less: Amounts reclassified from AOCI to:                   |   |   |  |   |                    |               |
| Net realized investment gains (losses)                     | 24  | (17 )   | —  | —                                       | —                  | 7             |
| Total before tax   | 24  | (17 )   | —  | —                                       | —                  | 7             |

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|  |       |     |     |    |     |    |    |   |       |
|--|-------|-----|-----|----|-----|----|----|---|-------|
| Tax (provision) benefit                              | (9    | )   | 6   | —  | 0   | (3 | )  |   |       |
| Total amount reclassified from AOCI, net of tax      | 15    | (11 | )   | —  | 0   | 4  |    |   |       |
| Net current period other comprehensive income (loss) | 12    | (4  | )   | 3  | 0   | 11 |    |   |       |
| Balance, September 30, 2017                          | \$240 | \$  | 103 | \$ | (24 | )  | \$ | 7 | \$326 |

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Table of ContentsChanges in Accumulated Other Comprehensive Income by Component  
Nine Months 2018

|  | Net Unrealized Gains (Losses) on Investments with no OTTI |           | Net Unrealized Gains (Losses) on FG VIEs' Liabilities with Recourse due to ISCR |          | Cumulative Translation Adjustment | Cash Flow Hedge | Total AOCI |
|--|---|-----------|---|----------|-----------------------------------|-----------------|------------|
|  | with Investments  | with OTTI | with  | with     |                                   |                 |            |
|  | (in millions)   |           |   |          |                                   |                 |            |
| Balance, December 31, 2017                                 | \$273   | \$ 120    | \$ —  | \$ (29 ) | \$ 8                              |                 | \$372      |
| Effect of adoption of ASU 2016-01                          | 1   | —         | (33 )   | —        | —                                 |                 | (32 )      |
| Other comprehensive income (loss) before reclassifications | (245 )  | (21 )     | (6 )  | (6 )     | —                                 |                 | (278 )     |
| Less: Amounts reclassified from AOCI to:                   |   |           |   |          |                                   |                 |            |
| Net realized investment gains (losses)                     | 6   | (19 )     | —   | —        | —                                 |                 | (13 )      |
| Fair value gains (losses) on FG VIEs                       | —   | —         | (6 )  | —        | —                                 |                 | (6 )       |
| Total before tax   | 6   | (19 )     | (6 )  | —        | —                                 |                 | (19 )      |
| Tax (provision) benefit                                    | (1 )  | 3         | 1   | —        | —                                 |                 | 3          |
| Total amount reclassified from AOCI, net of tax            | 5   | (16 )     | (5 )  | —        | —                                 |                 | (16 )      |
| Net current period other comprehensive income (loss)       | (250 )  | (5 )      | (1 )  | (6 )     | —                                 |                 | (262 )     |
| Balance, September 30, 2018                                | \$24  | \$ 115    | \$ (34 )  | \$ (35 ) | \$ 8                              |                 | \$78       |

Changes in Accumulated Other Comprehensive Income by Component  
Nine Months 2017

|  | Net Unrealized Gains (Losses) on Investments with no OTTI |           | Net Unrealized Gains (Losses) on Investments with OTTI |      | Cumulative Translation Adjustment | Cash Flow Hedge | Total AOCI |
|--|---|-----------|--|------|-----------------------------------|-----------------|------------|
|  | with Investments  | with OTTI | with   | with |                                   |                 |            |
|  | (in millions)   |           |  |      |                                   |                 |            |
| Balance, December 31, 2016                                 | \$171   | \$ 10     | \$ (39 )   | \$ 7 |                                   |                 | \$149      |
| Other comprehensive income (loss) before reclassifications | 133   | 81        | 15   | —    |                                   |                 | 229        |
| Less: Amounts reclassified from AOCI to:                   |   |           |  |      |                                   |                 |            |
| Net realized investment gains (losses)                     | 71  | (18 )     | —  | —    | —                                 |                 | 53         |
| Net investment income                                      | 28  | —         | —  | —    | —                                 |                 | 28         |
| Total before tax   | 99  | (18 )     | —  | —    | —                                 |                 | 81         |
| Tax (provision) benefit                                    | (35 )   | 6         | —  | 0    | 0                                 |                 | (29 )      |
| Total amount reclassified from AOCI, net of tax            | 64  | (12 )     | —  | 0    | 0                                 |                 | 52         |
| Net current period other comprehensive income (loss)       | 69  | 93        | 15   | 0    | 0                                 |                 | 177        |
| Balance, September 30, 2017                                | \$240   | \$ 103    | \$ (24 )   | \$ 7 |                                   |                 | \$326      |



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## Share Repurchases

## Share Repurchases

| Period   | Number of<br>Shares<br>Repurchased | Total<br>Payments<br>(in<br>millions) | Average<br>Price<br>Paid Per<br>Share |
|--|------------------------------------|---------------------------------------|---------------------------------------|
| 2017 (January 1 - March 31)                        | 5,430,041                          | \$ 216                                | \$ 39.83                              |
| 2017 (April 1 - June 30, 2017)                     | 3,456,711                          | 135                                   | 39.05                                 |
| 2017 (July 1 - September 30, 2017)                 | 1,847,901                          | 80                                    | 43.29                                 |
| 2017 (October 1 - December 31, 2017)               | 1,934,990                          | 70                                    | 36.18                                 |
| Total 2017   | 12,669,643                         | \$ 501                                | \$ 39.57                              |
| 2018 (January 1 - March 31)                        | 2,787,936                          | 98                                    | 35.20                                 |
| 2018 (April 1 - June 30)                           | 4,163,190                          | 152                                   | 36.48                                 |
| 2018 (July 1 - September 30)                       | 3,299,049                          | 130                                   | 39.41                                 |
| 2018 (October 1 through November 9, 2018)          | 1,183,469                          | 49                                    | 41.29                                 |
| Total 2018   | 11,433,644                         | \$ 429                                | \$ 37.51                              |
| Cumulative repurchases since the beginning of 2013 | 92,746,494                         | \$ 2,645                              | \$ 28.52                              |

The Board of Directors (the Board) most recently authorized share repurchases on August 1, 2018, for an additional \$250 million. As of November 9, 2018, the Company was authorized to purchase \$169 million of its common shares. The Company expects to repurchase shares from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program are at the discretion of management and will depend on a variety of factors, including funds available at the parent company, other potential uses for such funds, market conditions, the Company's capital position, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board at any time. It does not have an expiration date.

## Dividends

## Dividends

|                              | Third Quarter                           |          | Nine Months |          |
|------------------------------|---|----------|-------------|----------|
|                              | 2018                                    | 2017     | 2018        | 2017     |
|                              | (in millions, except per share amounts) |          |             |          |
| Dividends declared per share | \$0.16                                  | \$0.1425 | \$0.48      | \$0.4275 |
| Dividends declared           | 17                                      | 17       | 54          | 53       |

## Deferred Compensation

The Company used a portion of its share repurchase program to repurchase 297,131 common shares from its Chief Executive Officer and 23,062 common shares from its then General Counsel on January 6, 2017. The shares were purchased at the closing price of a common share of the Company on the New York Stock Exchange on January 6, 2017. Separately, these officers also received 297,131 and 23,062 common shares, respectively, on January 6, 2017 in settlement of 297,131 share units and 23,062 share units held by them in the employer stock fund of the Assured



Guaranty Ltd. Supplemental Employee Retirement Plan (the AGL SERP). The distribution of shares occurred in January 2017 pursuant to the terms of an amendment adopted in 2011 to the AGL SERP. Such amendment was adopted to comply with requirements of Section 409A of the Code and Section 457A of the Code, which required all grandfathered amounts (within the meaning of Section 457A of the Code), including the units in the employer stock fund in the AGL SERP, to be included in the income of the applicable participant no later than 2017.

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## 18. Subsidiary Information

The following tables present the condensed consolidating financial information for AGUS and AGMH, 100%-owned subsidiaries of AGL, which have issued publicly traded debt securities (see Note 15, Long Term Debt and Credit Facilities). The information for AGL, AGUS and AGMH presents their subsidiaries on the equity method of accounting. The following tables reflect transfers of businesses between entities within the consolidated group consistently for all prior periods presented.

## CONDENSED CONSOLIDATING BALANCE SHEET

AS OF SEPTEMBER 30, 2018

(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>ASSETS</b>                                     |                                      |                  |                  |                   |                              |  |
| Total investment portfolio and cash               | \$ 47                                | \$ 257           | \$ 104           | \$ 11,098         | \$ (399)                     | ) \$ 11,107                                |
| Investment in subsidiaries                        | 6,448                                | 5,929            | 3,967            | 219               | (16,563)                     | ) —  |
| Premiums receivable, net of commissions payable   | —                                    | —                | —                | 1,078             | (162)                        | ) 916                                      |
| Ceded unearned premium reserve                    | —                                    | —                | —                | 959               | (898)                        | ) 61                                       |
| Deferred acquisition costs                        | —                                    | —                | —                | 142               | (39)                         | ) 103                                      |
| Deferred tax asset, net                           | —                                    | —                | —                | 148               | (77)                         | ) 71                                       |
| Intercompany receivable                           | —                                    | —                | —                | 60                | (60)                         | ) —  |
| FG VIEs' assets, at fair value                    | —                                    | —                | —                | 596               | —                            | ) 596                                      |
| Dividends receivable from affiliate               | 78                                   | —                | —                | —                 | (78)                         | ) —  |
| Other   | 25                                   | 109              | 56               | 1,380             | (685)                        | ) 885                                      |
| <b>TOTAL ASSETS</b>                               | <b>\$ 6,598</b>                      | <b>\$ 6,295</b>  | <b>\$ 4,127</b>  | <b>\$ 15,680</b>  | <b>\$ (18,961)</b>           | <b>) \$ 13,739</b>                         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |                                      |                  |                  |                   |                              |  |
| Unearned premium reserves                         | \$ —                                 | \$ —             | \$ —             | \$ 4,478          | \$ (940)                     | ) \$ 3,538                                 |
| Loss and LAE reserve                              | —                                    | —                | —                | 1,429             | (282)                        | ) 1,147                                    |
| Long-term debt                                    | —                                    | 844              | 466              | 5                 | (66)                         | ) 1,249                                    |
| Intercompany payable                              | —                                    | 60               | —                | 300               | (360)                        | ) —  |
| Credit derivative liabilities                     | —                                    | —                | —                | 268               | (29)                         | ) 239                                      |
| Deferred tax liabilities, net                     | —                                    | 30               | 51               | —                 | (81)                         | ) —  |
| FG VIEs' liabilities, at fair value               | —                                    | —                | —                | 649               | —                            | ) 649                                      |
| Dividends payable to affiliate                    | —                                    | 51               | —                | 27                | (78)                         | ) —  |
| Other   | 15                                   | 31               | 22               | 779               | (513)                        | ) 334                                      |
| <b>TOTAL LIABILITIES</b>                          | <b>15</b>                            | <b>1,016</b>     | <b>539</b>       | <b>7,935</b>      | <b>(2,349)</b>               | <b>) 7,156</b>                             |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 |                                      |                  |                  |                   |                              |  |
| <b>ATTRIBUTABLE TO ASSURED GUARANTY LTD.</b>      | <b>6,583</b>                         | <b>5,279</b>     | <b>3,588</b>     | <b>7,526</b>      | <b>(16,393)</b>              | <b>) 6,583</b>                             |
| Noncontrolling interest                           | —                                    | —                | —                | 219               | (219)                        | ) —  |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 | <b>6,583</b>                         | <b>5,279</b>     | <b>3,588</b>     | <b>7,745</b>      | <b>(16,612)</b>              | <b>) 6,583</b>                             |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 6,598</b>                      | <b>\$ 6,295</b>  | <b>\$ 4,127</b>  | <b>\$ 15,680</b>  | <b>\$ (18,961)</b>           | <b>) \$ 13,739</b>                         |

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## CONDENSED CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2017

(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>ASSETS</b>                                     |                                      |                  |                  |                   |                              |  |
| Total investment portfolio and cash               | \$ 36                                | \$ 319           | \$ 28            | \$ 11,484         | \$ (328)                     | ) \$ 11,539                                |
| Investment in subsidiaries                        | 6,794                                | 6,126            | 4,048            | 216               | (17,184)                     | ) —  |
| Premiums receivable, net of commissions payable   | —                                    | —                | —                | 1,074             | (159)                        | ) 915                                      |
| Ceded unearned premium reserve                    | —                                    | —                | —                | 1,002             | (883)                        | ) 119                                      |
| Deferred acquisition costs                        | —                                    | —                | —                | 144               | (43)                         | ) 101                                      |
| Deferred tax asset, net                           | —                                    | 59               | —                | 93                | (54)                         | ) 98                                       |
| Intercompany receivable                           | —                                    | —                | —                | 60                | (60)                         | ) —  |
| FG VIEs' assets, at fair value                    | —                                    | —                | —                | 700               | —                            | ) 700                                      |
| Other   | 26                                   | 0                | 40               | 1,643             | (748)                        | ) 961                                      |
| <b>TOTAL ASSETS</b>                               | <b>\$ 6,856</b>                      | <b>\$ 6,504</b>  | <b>\$ 4,116</b>  | <b>\$ 16,416</b>  | <b>\$ (19,459)</b>           | <b>) \$ 14,433</b>                         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |                                      |                  |                  |                   |                              |  |
| Unearned premium reserves                         | \$ —                                 | \$ —             | \$ —             | \$ 4,423          | \$ (948)                     | ) \$ 3,475                                 |
| Loss and LAE reserve                              | —                                    | —                | —                | 1,793             | (349)                        | ) 1,444                                    |
| Long-term debt                                    | —                                    | 843              | 461              | 6                 | (18)                         | ) 1,292                                    |
| Intercompany payable                              | —                                    | 60               | —                | 300               | (360)                        | ) —  |
| Credit derivative liabilities                     | —                                    | —                | —                | 308               | (37)                         | ) 271                                      |
| Deferred tax liabilities, net                     | —                                    | —                | 51               | —                 | (51)                         | ) —  |
| FG VIEs' liabilities, at fair value               | —                                    | —                | —                | 757               | —                            | ) 757                                      |
| Other   | 17                                   | 59               | 20               | 740               | (481)                        | ) 355                                      |
| <b>TOTAL LIABILITIES</b>                          | <b>17</b>                            | <b>962</b>       | <b>532</b>       | <b>8,327</b>      | <b>(2,244)</b>               | <b>) 7,594</b>                             |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 |                                      |                  |                  |                   |                              |  |
| <b>ATTRIBUTABLE TO ASSURED GUARANTY LTD.</b>      | <b>6,839</b>                         | <b>5,542</b>     | <b>3,584</b>     | <b>7,873</b>      | <b>(16,999)</b>              | <b>) 6,839</b>                             |
| Noncontrolling interest                           | —                                    | —                | —                | 216               | (216)                        | ) —  |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 | <b>6,839</b>                         | <b>5,542</b>     | <b>3,584</b>     | <b>8,089</b>      | <b>(17,215)</b>              | <b>) 6,839</b>                             |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 6,856</b>                      | <b>\$ 6,504</b>  | <b>\$ 4,116</b>  | <b>\$ 16,416</b>  | <b>\$ (19,459)</b>           | <b>) \$ 14,433</b>                         |

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
AND COMPREHENSIVE INCOME  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018  
(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>REVENUES</b>   |                                      |                  |                  |                   |                              |  |
| Net earned premiums   | \$ —                                 | \$ —             | \$ —             | \$ 146            | \$ (4 )                      | \$ 142                                     |
| Net investment income   | 0                                    | 2                | 0                | 100               | (4 )                         | 98   |
| Net realized investment gains (losses)  | —                                    | 0                | —                | (7 )              | 0                            | (7 )                                       |
| Net change in fair value of credit derivatives  | —                                    | —                | —                | 21                | 0                            | 21   |
| Other   | 3                                    | 0                | —                | 72                | (55 )                        | 20   |
| <b>TOTAL REVENUES</b>   | <b>3</b>                             | <b>2</b>         | <b>0</b>         | <b>332</b>        | <b>(63 )</b>                 | <b>274</b>                                 |
| <b>EXPENSES</b>   |                                      |                  |                  |                   |                              |  |
| Loss and LAE  | —                                    | —                | —                | 18                | (1 )                         | 17   |
| Amortization of deferred acquisition costs  | —                                    | —                | —                | 5                 | (2 )                         | 3  |
| Interest expense  | —                                    | 13               | 13               | 2                 | (5 )                         | 23   |
| Other operating expenses  | 10                                   | 6                | (1 )             | 93                | (52 )                        | 56   |
| <b>TOTAL EXPENSES</b>   | <b>10</b>                            | <b>19</b>        | <b>12</b>        | <b>118</b>        | <b>(60 )</b>                 | <b>99</b>                                  |
| <b>INCOME (LOSS) BEFORE INCOME TAXES AND<br/>EQUITY IN NET EARNINGS OF SUBSIDIARIES</b> | <b>(7 )</b>                          | <b>(17 )</b>     | <b>(12 )</b>     | <b>214</b>        | <b>(3 )</b>                  | <b>175</b>                                 |
| Total (provision) benefit for income taxes  | —                                    | 45               | 3                | (58 )             | (4 )                         | (14 )                                      |
| Equity in net earnings of subsidiaries  | 168                                  | 111              | 108              | 7                 | (394 )                       | —  |
| <b>NET INCOME (LOSS)</b>  | <b>\$ 161</b>                        | <b>\$ 139</b>    | <b>\$ 99</b>     | <b>\$ 163</b>     | <b>\$ (401 )</b>             | <b>\$ 161</b>                              |
| Less: noncontrolling interest   | —                                    | —                | —                | 7                 | (7 )                         | —  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO<br/>ASSURED GUARANTY LTD.</b>                      | <b>\$ 161</b>                        | <b>\$ 139</b>    | <b>\$ 99</b>     | <b>\$ 156</b>     | <b>\$ (394 )</b>             | <b>\$ 161</b>                              |
| <br><b>COMPREHENSIVE INCOME (LOSS)</b>  | <br><b>\$ 87</b>                     | <br><b>\$ 76</b> | <br><b>\$ 61</b> | <br><b>\$ 92</b>  | <br><b>\$ (229 )</b>         | <br><b>\$ 87</b>                           |

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
AND COMPREHENSIVE INCOME  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017  
(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>REVENUES</b>   |                                      |                  |                  |                   |                              |  |
| Net earned premiums   | \$ —                                 | \$—              | \$—              | \$ 190            | \$ (4 )                      | \$ 186                                     |
| Net investment income   | 0                                    | 0                | 0                | 101               | (2 )                         | 99   |
| Net realized investment gains (losses)  | —                                    | 0                | 0                | (9 )              | 16                           | 7  |
| Net change in fair value of credit derivatives  | —                                    | —                | —                | 58                | 0                            | 58   |
| Other   | 3                                    | —                | —                | 302               | (32 )                        | 273  |
| <b>TOTAL REVENUES</b>   | <b>3</b>                             | <b>0</b>         | <b>0</b>         | <b>642</b>        | <b>(22 )</b>                 | <b>623</b>                                 |
| <b>EXPENSES</b>   |                                      |                  |                  |                   |                              |  |
| Loss and LAE  | —                                    | —                | —                | 250               | (27 )                        | 223  |
| Amortization of deferred acquisition costs  | —                                    | —                | —                | 8                 | (3 )                         | 5  |
| Interest expense  | —                                    | 12               | 13               | 3                 | (4 )                         | 24   |
| Other operating expenses  | 10                                   | 1                | 0                | 91                | (44 )                        | 58   |
| <b>TOTAL EXPENSES</b>   | <b>10</b>                            | <b>13</b>        | <b>13</b>        | <b>352</b>        | <b>(78 )</b>                 | <b>310</b>                                 |
| <b>INCOME (LOSS) BEFORE INCOME TAXES AND<br/>EQUITY IN NET EARNINGS OF SUBSIDIARIES</b> | <b>(7 )</b>                          | <b>(13 )</b>     | <b>(13 )</b>     | <b>290</b>        | <b>56</b>                    | <b>313</b>                                 |
| Total (provision) benefit for income taxes  | —                                    | 4                | 4                | (94 )             | (19 )                        | (105 )                                     |
| Equity in net earnings of subsidiaries  | 215                                  | 237              | 178              | 8                 | (638 )                       | —  |
| <b>NET INCOME (LOSS)</b>  | <b>\$ 208</b>                        | <b>\$ 228</b>    | <b>\$ 169</b>    | <b>\$ 204</b>     | <b>\$ (601 )</b>             | <b>\$ 208</b>                              |
| Less: noncontrolling interest   | —                                    | —                | —                | 8                 | (8 )                         | —  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO<br/>ASSURED GUARANTY LTD.</b>                      | <b>\$ 208</b>                        | <b>\$ 228</b>    | <b>\$ 169</b>    | <b>\$ 196</b>     | <b>\$ (593 )</b>             | <b>\$ 208</b>                              |
| <br>  |                                      |                  |                  |                   |                              |  |
| <b>COMPREHENSIVE INCOME (LOSS)</b>  | <b>\$ 219</b>                        | <b>\$ 237</b>    | <b>\$ 178</b>    | <b>\$ 274</b>     | <b>\$ (689 )</b>             | <b>\$ 219</b>                              |

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
AND COMPREHENSIVE INCOME  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018  
(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>REVENUES</b>   |                                      |                  |                  |                   |                              |  |
| Net earned premiums   | \$ —                                 | \$ —             | \$ —             | \$ 434            | \$ (11 )                     | \$ 423                                     |
| Net investment income   | 0                                    | 6                | 0                | 302               | (10 )                        | 298  |
| Net realized investment gains (losses)  | —                                    | 0                | 0                | (14 )             | 0                            | (14 )                                      |
| Net change in fair value of credit derivatives  | —                                    | —                | —                | 103               | 0                            | 103  |
| Other   | 9                                    | 0                | —                | 136               | (167 )                       | (22 )                                      |
| <b>TOTAL REVENUES</b>   | <b>9</b>                             | <b>6</b>         | <b>0</b>         | <b>961</b>        | <b>(188 )</b>                | <b>788</b>                                 |
| <b>EXPENSES</b>   |                                      |                  |                  |                   |                              |  |
| Loss and LAE  | —                                    | —                | —                | 48                | (5 )                         | 43   |
| Amortization of deferred acquisition costs  | —                                    | —                | —                | 16                | (4 )                         | 12   |
| Interest expense  | —                                    | 37               | 40               | 7                 | (13 )                        | 71   |
| Other operating expenses  | 30                                   | 9                | 0                | 293               | (149 )                       | 183  |
| <b>TOTAL EXPENSES</b>   | <b>30</b>                            | <b>46</b>        | <b>40</b>        | <b>364</b>        | <b>(171 )</b>                | <b>309</b>                                 |
| <b>INCOME (LOSS) BEFORE INCOME TAXES AND<br/>EQUITY IN NET EARNINGS OF SUBSIDIARIES</b> | <b>(21 )</b>                         | <b>(40 )</b>     | <b>(40 )</b>     | <b>597</b>        | <b>(17 )</b>                 | <b>479</b>                                 |
| Total (provision) benefit for income taxes  | —                                    | 50               | 9                | (103 )            | (2 )                         | (46 )                                      |
| Equity in net earnings of subsidiaries  | 454                                  | 336              | 219              | 20                | (1,029 )                     | —  |
| <b>NET INCOME (LOSS)</b>  | <b>\$ 433</b>                        | <b>\$ 346</b>    | <b>\$ 188</b>    | <b>\$ 514</b>     | <b>\$ (1,048 )</b>           | <b>\$ 433</b>                              |
| Less: noncontrolling interest   | —                                    | —                | —                | 20                | (20 )                        | —  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO<br/>ASSURED GUARANTY LTD.</b>                      | <b>\$ 433</b>                        | <b>\$ 346</b>    | <b>\$ 188</b>    | <b>\$ 494</b>     | <b>\$ (1,028 )</b>           | <b>\$ 433</b>                              |
| <br>  |                                      |                  |                  |                   |                              |  |
| <b>COMPREHENSIVE INCOME (LOSS)</b>  | <b>\$ 171</b>                        | <b>\$ 150</b>    | <b>\$ 54</b>     | <b>\$ 255</b>     | <b>\$ (459 )</b>             | <b>\$ 171</b>                              |

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CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS  
AND COMPREHENSIVE INCOME  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017  
(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| <b>REVENUES</b>   |                                      |                  |                  |                   |                              |  |
| Net earned premiums   | \$ —                                 | \$ —             | \$ —             | \$ 523            | \$ (11 )                     | \$ 512                                     |
| Net investment income   | 0                                    | 1                | 0                | 325               | (4 )                         | 322  |
| Net realized investment gains (losses)  | —                                    | 0                | 0                | 53                | 1                            | 54   |
| Net change in fair value of credit derivatives                                      | —                                    | —                | —                | 106               | 0                            | 106  |
| Bargain purchase gain and settlement of pre-existing relationships                  | —                                    | —                | —                | 58                | 0                            | 58   |
| Other   | 8                                    | —                | —                | 527               | (129 )                       | 406  |
| <b>TOTAL REVENUES</b>   | <b>8</b>                             | <b>1</b>         | <b>0</b>         | <b>1,592</b>      | <b>(143 )</b>                | <b>1,458</b>                               |
| <b>EXPENSES</b>   |                                      |                  |                  |                   |                              |  |
| Loss and LAE  | —                                    | —                | —                | 301               | 53                           | 354  |
| Amortization of deferred acquisition costs  | —                                    | —                | —                | 19                | (6 )                         | 13   |
| Interest expense  | —                                    | 36               | 40               | 8                 | (11 )                        | 73   |
| Other operating expenses  | 30                                   | 8                | 1                | 286               | (142 )                       | 183  |
| <b>TOTAL EXPENSES</b>   | <b>30</b>                            | <b>44</b>        | <b>41</b>        | <b>614</b>        | <b>(106 )</b>                | <b>623</b>                                 |
| <b>INCOME (LOSS) BEFORE INCOME TAXES AND EQUITY IN NET EARNINGS OF SUBSIDIARIES</b> | <b>(22 )</b>                         | <b>(43 )</b>     | <b>(41 )</b>     | <b>978</b>        | <b>(37 )</b>                 | <b>835</b>                                 |
| Total (provision) benefit for income taxes  | —                                    | 13               | 15               | (194 )            | 9                            | (157 )                                     |
| Equity in net earnings of subsidiaries  | 700                                  | 574              | 422              | 22                | (1,718 )                     | —  |
| <b>NET INCOME (LOSS)</b>  | <b>\$ 678</b>                        | <b>\$ 544</b>    | <b>\$ 396</b>    | <b>\$ 806</b>     | <b>\$ (1,746 )</b>           | <b>\$ 678</b>                              |
| Less: noncontrolling interest   | —                                    | —                | —                | 22                | (22 )                        | —  |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO ASSURED GUARANTY LTD.</b>                      | <b>\$ 678</b>                        | <b>\$ 544</b>    | <b>\$ 396</b>    | <b>\$ 784</b>     | <b>\$ (1,724 )</b>           | <b>\$ 678</b>                              |
| <br>  |                                      |                  |                  |                   |                              |  |
| <b>COMPREHENSIVE INCOME (LOSS)</b>  | <b>\$ 855</b>                        | <b>\$ 705</b>    | <b>\$ 484</b>    | <b>\$ 1,004</b>   | <b>\$ (2,193 )</b>           | <b>\$ 855</b>                              |

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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018  
(in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| Net cash flows provided by (used in) operating activities | \$ 454                               | \$ 101           | \$ 126           | \$ 448            | \$ (777 )                    | \$ 352                                     |
| Cash flows from investing activities                      |                                      |                  |                  |                   |                              |  |
| Fixed-maturity securities:                                |                                      |                  |                  |                   |                              |  |
| Purchases   | —                                    | (76 )            | (12 )            | (1,462)           | 72                           | (1,478 )                                   |
| Sales   | —                                    | 31               | 8                | 869               | —                            | 908  |
| Maturities  | —                                    | 28               | 0                | 718               | —                            | 746  |
| Sales (purchases) of short-term investments, net          | (11 )                                | 60               | (74 )            | (66 )             | —                            | (91 )                                      |
| Net proceeds from FG VIEs' assets                         | —                                    | —                | —                | 90                | —                            | 90   |
| Return of capital from subsidiary                         | —                                    | 200              | —                | —                 | (200 )                       | —  |
| Other   | —                                    | (15 )            | —                | 34                | —                            | 19   |
| Net cash flows provided by (used in) investing activities | (11 )                                | 228              | (78 )            | 183               | (128 )                       | 194  |
| Cash flows from financing activities                      |                                      |                  |                  |                   |                              |  |
| Return of capital   | —                                    | —                | —                | —                 | —                            | —  |
| Capital contribution                                      | —                                    | —                | —                | —                 | —                            | —  |
| Dividends paid  | (55 )                                | (362 )           | (50 )            | (365 )            | 777                          | (55 )                                      |
| Repurchases of common stock                               | (380 )                               | —                | —                | (200 )            | 200                          | (380 )                                     |
| Repurchases of common stock to pay withholding taxes      | (13 )                                | —                | —                | —                 | —                            | (13 )                                      |
| Net paydowns of FG VIEs' liabilities                      | —                                    | —                | —                | (90 )             | —                            | (90 )                                      |
| Paydown of long-term debt                                 | —                                    | —                | —                | (1 )              | (72 )                        | (73 )                                      |
| Proceeds from options exercises                           | 5                                    | —                | —                | —                 | —                            | 5  |
| Net cash flows provided by (used in) financing activities | (443 )                               | (362 )           | (50 )            | (656 )            | 905                          | (606 )                                     |
| Effect of exchange rate changes                           | —                                    | 0                | —                | (2 )              | —                            | (2 )                                       |
| Increase (decrease) in cash and restricted cash           | 0                                    | (33 )            | (2 )             | (27 )             | —                            | (62 )                                      |
| Cash and restricted cash at beginning of period           | 0                                    | 33               | 2                | 109               | —                            | 144  |
| Cash and restricted cash at end of period                 | \$ 0                                 | \$ 0             | \$ 0             | \$ 82             | \$ —                         | \$ 82                                      |



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CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS  
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017  
 (in millions)

|   | Assured<br>Guaranty Ltd.<br>(Parent) | AGUS<br>(Issuer) | AGMH<br>(Issuer) | Other<br>Entities | Consolidating<br>Adjustments | Assured<br>Guaranty Ltd.<br>(Consolidated) |
|---|--------------------------------------|------------------|------------------|-------------------|------------------------------|--|
| Net cash flows provided by (used in) operating activities | \$ 503                               | \$ 175           | \$ 105           | \$ 469            | \$ (898 )                    | \$ 354                                     |
| Cash flows from investing activities                      |                                      |                  |                  |                   |                              |  |
| Fixed-maturity securities:                                |                                      |                  |                  |                   |                              |  |
| Purchases   | —                                    | (75 )            | (15 )            | (1,552)           | 27                           | (1,615 )                                   |
| Sales   | —                                    | 112              | 12               | 1,004             | —                            | 1,128                                      |
| Maturities  | —                                    | 7                | 0                | 682               | —                            | 689  |
| Sales (purchases) of short-term investments, net          | (11 )                                | 218              | 3                | (450 )            | —                            | (240 )                                     |
| Net proceeds from FG VIEs' assets                         | —                                    | —                | —                | 117               | —                            | 117  |
| Investment in subsidiaries                                | —                                    | (28 )            | —                | (69 )             | 97                           | —  |
| Proceeds from sale of subsidiaries                        | —                                    | —                | —                | 139               | (139 )                       | —  |
| Acquisition of MBIA UK, net of cash acquired              | —                                    | —                | —                | 95                | —                            | 95   |
| Other   | —                                    | —                | —                | 58                | —                            | 58   |
| Net cash flows provided by (used in) investing activities | (11 )                                | 234              | —                | 24                | (15 )                        | 232  |
| Cash flows from financing activities                      |                                      |                  |                  |                   |                              |  |
| Return of capital   | —                                    | —                | —                | (70 )             | 70                           | —  |
| Capital contribution                                      | —                                    | —                | 25               | 3                 | (28 )                        | —  |
| Dividends paid  | (53 )                                | (390 )           | (128 )           | (380 )            | 898                          | (53 )                                      |
| Repurchases of common stock                               | (431 )                               | —                | —                | —                 | —                            | (431 )                                     |
| Repurchases of common stock to pay withholding taxes      | (13 )                                | —                | —                | —                 | —                            | (13 )                                      |
| Net paydowns of FG VIEs' liabilities                      | —                                    | —                | —                | (124 )            | —                            | (124 )                                     |
| Paydown of long-term debt                                 | —                                    | —                | —                | (2 )              | (27 )                        | (29 )                                      |
| Proceeds from options exercises                           | 5                                    | —                | —                | —                 | —                            | 5  |
| Net cash flows provided by (used in) financing activities | (492 )                               | (390 )           | (103 )           | (573 )            | 913                          | (645 )                                     |
| Effect of exchange rate changes                           | —                                    | —                | —                | 4                 | —                            | 4  |
| Increase (decrease) in cash and restricted cash           | 0                                    | 19               | 2                | (76 )             | —                            | (55 )                                      |
| Cash and restricted cash at beginning of period           | 0                                    | 1                | 0                | 126               | —                            | 127  |
| Cash and restricted cash at end of period                 | \$ 0                                 | \$ 20            | \$ 2             | \$ 50             | \$ —                         | \$ 72                                      |

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ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
2. OPERATIONS

Forward Looking Statements

This Form 10-Q contains information that includes or is based upon forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward looking statements give the expectations or forecasts of future events of Assured Guaranty Ltd. (AGL) and its subsidiaries (collectively with AGL, Assured Guaranty or the Company). These statements can be identified by the fact that they do not relate strictly to historical or current facts and relate to future operating or financial performance.

Any or all of Assured Guaranty's forward looking statements herein are based on current expectations and the current economic environment and may turn out to be incorrect. Assured Guaranty's actual results may vary materially. Among factors that could cause actual results to differ adversely are:

• reduction in the amount of available insurance opportunities and/or in the demand for Assured Guaranty's insurance;

• rating agency action, including a ratings downgrade, a change in outlook, the placement of ratings on watch for downgrade, or a change in rating criteria, at any time, of AGL or any of its subsidiaries, and/or of any securities AGL or any of its subsidiaries have issued, and/or of transactions that AGL's subsidiaries have insured;

• developments in the world's financial and capital markets that adversely affect obligors' payment rates or Assured Guaranty's loss experience;

• the possibility that budget or pension shortfalls or other factors will result in credit losses or impairments on obligations of state, territorial and local governments and their related authorities and public corporations that Assured Guaranty insures or reinsures;

• the failure of Assured Guaranty to realize loss recoveries that are assumed in its expected loss estimates;

• increased competition, including from new entrants into the financial guaranty industry;

• rating agency action on obligors, including sovereign debtors, resulting in a reduction in the value of securities in Assured Guaranty's investment portfolio and in collateral posted by and to Assured Guaranty;

• the inability of Assured Guaranty to access external sources of capital on acceptable terms;

• changes in the world's credit markets, segments thereof, interest rates or general economic conditions;

• the impact of market volatility on the mark-to-market of Assured Guaranty's contracts written in credit default swap (CDS) form;

• changes in applicable accounting policies or practices;

• changes in applicable laws or regulations, including insurance, bankruptcy and tax laws, or other governmental actions;

• the impact of changes in the world's economy and credit and currency markets and in applicable laws or regulations relating to the decision of the United Kingdom (U.K.) to exit the European Union (EU);

the possibility that acquisitions or alternative investments made by Assured Guaranty do not result in the benefits anticipated or subject Assured Guaranty to unanticipated consequences;

deterioration in the financial condition of Assured Guaranty's reinsurers, the amount and timing of reinsurance recoverables actually received and the risk that reinsurers may dispute amounts owed to Assured Guaranty under its reinsurance agreements;

difficulties with the execution of Assured Guaranty's business strategy;

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- loss of key personnel;
- the effects of mergers, acquisitions and divestitures;
- natural or man-made catastrophes;
- other risk factors identified in AGL's filings with the U.S. Securities and Exchange Commission (the SEC);
- other risks and uncertainties that have not been identified at this time; and
- management's response to these factors.

The foregoing review of important factors should not be construed as exhaustive, and should be read in conjunction with the other cautionary statements that are included in this Form 10-Q, as well as the risk factors included in AGL's 2017 Annual Report on Form 10-K. The Company undertakes no obligation to update publicly or review any forward looking statement, whether as a result of new information, future developments or otherwise, except as required by law. Investors are advised, however, to consult any further disclosures the Company makes on related subjects in the Company's reports filed with the SEC.

If one or more of these or other risks or uncertainties materialize, or if the Company's underlying assumptions prove to be incorrect, actual results may vary materially from what the Company projected. Any forward looking statements in this Form 10-Q reflect the Company's current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to its operations, results of operations, growth strategy and liquidity.

For these statements, the Company claims the protection of the safe harbor for forward looking statements contained in Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act).

Available Information

The Company maintains an Internet web site at [www.assuredguaranty.com](http://www.assuredguaranty.com). The Company makes available, free of charge, on its web site (under [www.assuredguaranty.com/sec-filings](http://www.assuredguaranty.com/sec-filings)) the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 (a) or 15 (d) of the Exchange Act as soon as reasonably practicable after the Company files such material with, or furnishes it to, the SEC. The Company also makes available, free of charge, through its web site (under [www.assuredguaranty.com/governance](http://www.assuredguaranty.com/governance)) links to the Company's Corporate Governance Guidelines, its Code of Conduct, AGL's Bye-Laws and the charters for its Board committees.

The Company routinely posts important information for investors on its web site (under [www.assuredguaranty.com/company-statements](http://www.assuredguaranty.com/company-statements) and, more generally, under the Investor Information tab at [www.assuredguaranty.com/investor-information](http://www.assuredguaranty.com/investor-information) and Businesses tab at [www.assuredguaranty.com/businesses](http://www.assuredguaranty.com/businesses)). The Company uses this web site as a means of disclosing material information and for complying with its disclosure obligations under SEC Regulation FD (Fair Disclosure). Accordingly, investors should monitor the Company Statements, Investor Information and Businesses portions of the Company's web site, in addition to following the Company's press releases, SEC filings, public conference calls, presentations and webcasts.

The information contained on, or that may be accessed through, the Company's web site is not incorporated by reference into, and is not a part of, this report.

Executive Summary

This executive summary of management's discussion and analysis highlights selected information and may not contain all of the information that is important to readers of this Quarterly Report. For a more detailed description of events, trends and uncertainties, as well as the capital, liquidity, credit, operational and market risks and the critical accounting policies and estimates affecting the Company, this Quarterly Report should be read in its entirety and in addition to AGL's 2017 Annual Report on Form 10-K.

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Economic Environment

The positive economic momentum in the United States (U.S.) since the beginning of 2016 continued through September 30, 2018. According to the U.S. Bureau of Labor Statistics (BLS), after revisions, job gains averaged 190,000 per month over the three-month period ended September 30, 2018 (Third Quarter 2018). Additionally, the BLS estimated that, at the end of the quarter, the unemployment rate stood at 3.7%, nearly a fifty-year low.

Real gross domestic product (GDP) increased at an annual rate of 3.5% in Third Quarter 2018, according to the “advance” estimate released by the Bureau of Economic Analysis (BEA). In the second quarter of 2018, real GDP increased at an annual rate of 4.2% according to the BEA.

The S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index, covering all nine U.S. census divisions, reported a 5.8% annual gain in August, the latest data available. The 20-City Composite posted a 5.5% year-over-year gain.

At the September 2018 Federal Open Market Committee (FOMC) meeting, the FOMC raised the target range for the federal funds rate to between 2.00% and 2.25%, citing sustained expansion of economic activity and strong labor market conditions. The FOMC stated it expected future gradual increases in the target range for the federal funds rate.

The U.S. equity markets overall returned to positive performance in Third Quarter 2018. For the quarter, the S&P 500 Index, the Dow Jones Industrial Average (DJIA), and the NASDAQ Composite, along with other domestic indices such as the Russell 1000 Growth Index, finished appreciably higher.

Average municipal interest rates remained above the historic lows experienced in 2016, during which the 30-year AAA Municipal Market Data’s (MMD’s) rates were at times below 2%. The 30-year AAA MMD rate started the quarter at 2.94%, reaching a high of 3.26% on September 25 and September 26, 2018, and finished the quarter at 3.19%. While average municipal interest rates have risen above the historic lows experienced in 2016, at quarter end U.S. municipal credit spreads remained at relatively tight levels as demonstrated by the 49 basis point margin of A versus AAA General Obligation bonds as reported by Thomson Reuters versus an average rate of 68 basis points over the last ten years.

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## Financial Performance of Assured Guaranty

## Financial Results

|   | Third Quarter                           |           | Nine Months  |           |
|---|---|-----------|--------------|-----------|
|   | 2018                                    | 2017      | 2018         | 2017      |
|   | (in millions)                           |           |              |           |
| Net income (loss)   | \$ 161                                  | \$ 208    | \$ 433       | \$ 678    |
| Non-GAAP operating income (1)   | 161                                     | 156       | 390          | 570       |
| Gain (loss) related to the effect of consolidating financial guaranty variable interest entities (FG VIE consolidation) included in non-GAAP operating income | (2 )                                    | (1 )      | (1 )         | 9         |
| Net income (loss) per diluted share   | \$ 1.47                                 | \$ 1.72   | \$ 3.83      | \$ 5.48   |
| Non-GAAP operating income per share (1)   | 1.47                                    | 1.29      | 3.45         | 4.62      |
| Gain (loss) related to FG VIE consolidation included in non-GAAP operating income per share   | (0.02 )                                 | (0.01 )   | (0.01 )      | 0.08      |
| Diluted shares  | 109.3                                   | 120.7     | 112.9        | 123.5     |
| Gross written premiums (GWP)  | \$ 50                                   | \$ 45     | \$ 516       | \$ 235    |
| Present value of new business production (PVP) (1)  | 52                                      | 43        | 567          | 212       |
| Gross par written   | 3,001                                   | 3,417     | 19,774       | 13,248    |
|   | As of                                   |           | As of        |           |
|   | September 30,                           |           | December 31, |           |
|   | 2018                                    |           | 2017         |           |
|   | Amount                                  | Per Share | Amount       | Per Share |
|   | (in millions, except per share amounts) |           |              |           |
| Shareholders' equity  | \$ 6,583                                | \$ 61.73  | \$ 6,839     | \$ 58.95  |
| Non-GAAP operating shareholders' equity (1)   | 6,420                                   | 60.20     | 6,521        | 56.20     |
| Non-GAAP adjusted book value (1)  | 9,012                                   | 84.51     | 9,020        | 77.74     |
| Gain (loss) related to FG VIE consolidation included in non-GAAP operating shareholders' equity   | 3                                       | 0.03      | 5            | 0.03      |
| Gain (loss) related to FG VIE consolidation included in non-GAAP adjusted book value  | (14 )                                   | (0.14 )   | (14 )        | (0.12 )   |
| Common shares outstanding (2)   | 106.6                                   |           | 116.0        |           |

See “—Non-GAAP Financial Measures” for a definition of the financial measures that were not determined in (1) accordance with accounting principles generally accepted in the United States of America (GAAP) and a reconciliation of the non-GAAP financial measure to the most directly comparable GAAP measure, if available. See “—Non-GAAP Financial Measures” for additional details.

(2) See "Key Business Strategies – Capital Management" below for information on common share repurchases.

Several primary drivers of volatility in net income or loss are not necessarily indicative of credit impairment or improvement, or ultimate economic gains or losses: changes in credit spreads of insured credit derivative obligations,

changes in fair value of assets and liabilities of financial guaranty variable interest entities (FG VIEs) and committed capital securities (CCS), changes in fair value of credit derivatives related to the Company's own credit spreads, and changes in risk-free rates used to discount expected losses. Changes in the Company's and/or collateral credit spreads generally have the most significant effect on the fair value of credit derivatives and FG VIEs' assets and liabilities. Effective January 1, 2018, the change in fair value of FG VIEs' liabilities with recourse attributed to changes in Assured Guaranty Corp.'s (AGC) and Assured Guaranty Municipal Corp.'s (AGM) own credit spreads, or instrument specific credit risk (ISCR), is recorded in other comprehensive income (OCI). In addition to non-economic factors, other factors such as: changes in expected claims and recoveries, the amount and timing of the refunding and/or termination of insured obligations, realized gains and losses on the investment portfolio (including other-than-temporary impairments (OTTI)), the effects of large settlements, commutations, acquisitions,



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the effects of the Company's various loss mitigation strategies, and changes in laws and regulations, among others, may also have a significant effect on reported net income or loss in a given reporting period.

### Third Quarter 2018

Net income for Third Quarter 2018 was \$161 million compared with \$208 million for the three-month period ended September 30, 2017 (Third Quarter 2017). The Company's reassumption of previously ceded books of business generated \$255 million in pretax commutation gains in Third Quarter 2017. Excluding commutation gains, net income increased due primarily to lower loss and loss adjustment expense (LAE), a fair value gain on the sale of an equity security and a lower effective tax rate, offset in part by lower premium accelerations, lower fair value gains on credit derivatives and foreign exchange remeasurement losses in Third Quarter 2018.

Non-GAAP operating income was \$161 million in Third Quarter 2018, compared with \$156 million in Third Quarter 2017. Non-GAAP operating income in Third Quarter 2018 was higher primarily due to lower loss and LAE, a fair value gain on the sale of an equity security and a lower effective tax rate, offset in part by lower commutation gains and lower premium accelerations in Third Quarter 2018.

### Nine Months 2018

Net income for the nine-month period ended September 30, 2018 (Nine Months 2018) was \$433 million compared with \$678 million for the nine-month period ended September 30, 2017 (Nine Months 2017). Net income for Nine Months 2017 was higher due primarily to significant gains attributable to commutation gains (as described above) and the acquisition (MBIA UK Acquisition) of MBIA UK Insurance Limited (MBIA UK). Excluding the commutation and MBIAUK Acquisition gains in Nine Months 2017, net income increased due mainly to lower loss and LAE and a lower effective tax rate, offset in part by foreign exchange remeasurement losses in Nine Months 2018 compared with gains in Nine Months 2017, and lower net earned premiums.

The Company reported non-GAAP operating income of \$390 million in Nine Months 2018, compared with \$570 million in Nine Months 2017. Excluding the commutation and MBIA UK Acquisition gains in 2017, non-GAAP operating income increased due mainly to lower loss and LAE and a lower effective tax rate in Nine Months 2018, offset in part by lower net earned premiums.

Shareholders' equity decreased since December 31, 2017 due primarily to share repurchases and unrealized losses on available for sale investment securities, partially offset by net income. Non-GAAP operating shareholders' equity decreased in Nine Months 2018 due primarily to share repurchases partially offset by positive non-GAAP operating income. Non-GAAP adjusted book value decreased in Nine Months 2018 due primarily to share repurchases and dividends, partially offset by the effect of the Syncora Guarantee Inc. (SGI) Transaction and new direct business production.

Shareholders' equity per share, non-GAAP operating shareholders' equity per share and non-GAAP adjusted book value per share all increased in Nine Months 2018, and benefited from the repurchase of an additional 10.3 million shares in Nine Months 2018 under the share repurchase program that began in 2013. See "Accretive Effect of Cumulative Repurchases" table below.

### Key Business Strategies

The Company continually evaluates its business strategies. Currently, the Company is pursuing the following business strategies, each described in more detail below:

• New business production  
• Capital management  
• Alternative strategies  
• Loss mitigation

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## New Business Production

The Company believes high-profile defaults by municipal obligors, such as Puerto Rico, Detroit, Michigan and Stockton, California have led to increased awareness of the value of bond insurance and stimulated demand for the product. The Company believes there will be continued demand for its insurance in this market because, for those exposures that the Company guarantees, it undertakes the tasks of credit selection, analysis, negotiation of terms, surveillance and, if necessary, loss mitigation. The Company believes that its insurance:

- encourages retail investors, who typically have fewer resources than the Company for analyzing municipal bonds, to purchase such bonds;
- enables institutional investors to operate more efficiently; and
- allows smaller, less well-known issuers to gain market access on a more cost-effective basis.

On the other hand, the persistently low interest rate environment and relatively tight U.S. municipal credit spreads have dampened demand for bond insurance, and provisions in legislation known as the 2017 Tax Cuts and Jobs Act (Tax Act), such as the termination of the tax-exempt status of advance refunding bonds and the reduction in corporate tax rates, could result in a reduction of supply and make municipal obligations less attractive to certain institutional investors.

## U.S. Municipal Market Data and Bond Insurance Penetration Rates (1)

Based on Sale Date

|   | Nine<br>Months<br>2018   | Nine<br>Months<br>2017 | Year Ended<br>December 31,<br>2017 |        |
|---|--|------------------------|------------------------------------|--------|
|   | (dollars<br>in billions, except number of issues and<br>percent) |                        |                                    |        |
| Par:  |  |                        |                                    |        |
| New municipal bonds issued                  | \$ 239.2   | \$ 271.6               | \$                                 | 409.5  |
| Total insured                               | \$ 13.3  | \$ 16.8                | \$                                 | 23.0   |
| Insured by Assured Guaranty                 | \$ 7.5   | \$ 9.8                 | \$                                 | 13.5   |
| Number of issues:                           |  |                        |                                    |        |
| New municipal bonds issued                  | 6,398  | 7,583                  |                                    | 10,589 |
| Total insured                               | 928  | 1,242                  |                                    | 1,637  |
| Insured by Assured Guaranty                 | 442  | 634                    |                                    | 833    |
| Bond insurance market penetration based on: |  |                        |                                    |        |
| Par   | 5.6  | % 6.2                  | % 5.6                              | %      |
| Number of issues                            | 14.5   | % 16.4                 | % 15.5                             | %      |
| Single A par sold                           | 17.4   | % 26.9                 | % 23.3                             | %      |
| Single A transactions sold                  | 53.0   | % 59.5                 | % 57.3                             | %      |
| \$25 million and under par sold             | 17.7   | % 20.0                 | % 18.7                             | %      |
| \$25 million and under transactions sold    | 17.1   | % 19.0                 | % 18.3                             | %      |

(1) Source: Thomson Reuters.



Table of ContentsGross Written Premiums and  
New Business Production

|                                 | Third Quarter |         | Nine Months |          |
|---------------------------------|---------------|---------|-------------|----------|
|                                 | 2018          | 2017    | 2018        | 2017     |
|                                 | (in millions) |         |             |          |
| <b>GWP</b>                      |               |         |             |          |
| Public Finance—U.S.             | \$24          | \$37    | \$227       | \$132    |
| Public Finance—non-U.S.         | 17            | 8       | 111         | 92       |
| Structured Finance—U.S.         | 9             | 1       | 168         | 3        |
| Structured Finance—non-U.S.     | 0             | (1)     | 10          | 8        |
| Total GWP                       | \$50          | \$45    | \$516       | \$235    |
| <b>PVP (1):</b>                 |               |         |             |          |
| Public Finance—U.S.             | \$33          | \$39    | \$302       | \$137    |
| Public Finance—non-U.S.         | 12            | 4       | 91          | 58       |
| Structured Finance—U.S. (2)     | 7             | 0       | 165         | 5        |
| Structured Finance—non-U.S. (3) | —             | —       | 9           | 12       |
| Total PVP                       | \$52          | \$43    | \$567       | \$212    |
| <b>Gross Par Written (1):</b>   |               |         |             |          |
| Public Finance—U.S.             | \$2,338       | \$3,328 | \$15,017    | \$11,590 |
| Public Finance—non-U.S.         | 189           | 89      | 3,721       | 1,260    |
| Structured Finance—U.S. (2)     | 473           | —       | 877         | 243      |
| Structured Finance—non-U.S. (3) | —             | —       | 159         | 155      |
| Total gross par written         | \$3,001       | \$3,417 | \$19,774    | \$13,248 |

(1) PVP and Gross Par Written in the table above are based on "close date," when the transaction settles. See "— Non-GAAP Financial Measures – PVP or Present Value of New Business Production."

(2) Includes capital relief triple-X excess of loss life reinsurance transactions.

(3) Relates to aircraft residual value insurance (RVI) policies.

## Third Quarter 2018

Financial guaranty GWP includes amounts collected upfront on new business written, the present value of future premiums on new business written (discounted at risk free rates), as well as the effects of changes in the estimated lives of transactions in the inforce book of business. Non-financial guaranty GWP is recorded over time as installments are received. Non-GAAP PVP includes upfront premiums on new business and future expected installments at the time of issuance, discounted at 6% for all contracts.

Variances in GWP between Third Quarter 2018 and Third Quarter 2017 are due to the volume of new business written and, to a lesser extent, changes in expected lives.

In the U.S. public finance sector, Assured Guaranty once again guaranteed the majority of insured par issued in Third Quarter 2018 while maintaining a BBB+ average rating on new business written.

Outside the U.S. the Company closed three new transactions during the quarter: a guarantee of an accommodation project for Durham University; a restructuring of an existing guarantee with a bank; and the Company's first

post-financial crisis transaction in Australia, a guarantee of a bond issue for the Port of Brisbane. This is the twelfth consecutive quarter that the Company generated PVP outside the United States. Quarterly business activity in the international infrastructure sector is influenced by typically long lead times and therefore may vary from quarter to quarter.

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In structured finance, the Company continued to execute transactions in the aviation and commercial real estate markets, and guaranteed a collateralized loan obligation (CLO) for the first time since 2008.

Structured finance transactions tend to have long lead times and may vary from period to period. In general, the Company believes that structured finance opportunities may increase in the future as the global economy continues to recover, interest rates rise, more issuers return to the capital markets for financings and institutional investors again utilize financial guaranties. The Company considers its involvement in both structured finance and international infrastructure transactions to be beneficial because such transactions diversify both the Company's business opportunities and its risk profile beyond U.S. public finance.

## Nine Months 2018

In Nine Months 2018, GWP increased to \$516 million from \$235 million in Nine Months 2017, and PVP increased to \$567 million from \$212 million, due to the SGI assumption. The reinsured portfolio from SGI consisted predominantly of public finance and infrastructure obligations that met AGC's underwriting criteria. On June 1, 2018, as consideration, SGI paid \$363 million and assigned to Assured Guaranty estimated financial guaranty and derivative installments with a present value of \$48 million (discounted at 6%, the rate used for non-GAAP PVP), for a total of \$411 million, of which \$391 million was attributable to the newly reinsured book of business. The average rating on new business written was A- for Nine Months 2018.

On a GAAP basis, the SGI Transaction generated GWP of \$330 million, plus \$86 million in expected future credit derivative gains, and included transactions with \$131 million in expected losses (discounted at the risk free rate). See Part I, Item 1, Financial Statements, Note 2, Assumption of Insured Portfolio and Business Combinations, for additional information.

On a non-GAAP basis, the SGI Transaction generated PVP of \$391 million, and included transactions with \$83 million in expected losses (assuming a 6% discount rate consistent with the non-GAAP PVP discount rate).

The components of the assumed SGI insured portfolio are presented below.

## Assumed SGI Insured Portfolio

As of June 1, 2018

|                             | GWP PVP (1)           |                       |                       | Total  | Gross<br>Par<br>Written<br>(1) |
|-----------------------------|-----------------------|-----------------------|-----------------------|--------|--------------------------------|
|                             | Financial<br>Guaranty | Financial<br>Guaranty | Credit<br>Derivatives |        |                                |
|                             | (in millions)         |                       |                       |        |                                |
| Public Finance—U.S.         | \$ 123                | \$ 118                | \$ 67                 | \$ 185 | \$ 7,559                       |
| Public Finance—non-U.S.     | 50                    | 38                    | 12                    | 50     | 3,345                          |
| Structured Finance—U.S.     | 157                   | 156                   | —                     | 156    | 349                            |
| Structured Finance—non-U.S. | 0                     | —                     | —                     | 0      | 19                             |
| Total                       | \$ 330                | \$ 312                | \$ 79                 | \$ 391 | \$ 11,272                      |

(1) See “– Non-GAAP Financial Measures – PVP or Present Value of New Business Production.”

Excluding the SGI assumption, the Company generated U.S. public finance PVP of \$117 million in Nine Months 2018. Nine Months 2017 included one large structured infrastructure financing which accounts for substantially all of

the variance in year-to-date PVP (excluding the SGI Transaction).

Excluding the SGI assumption, the Company generated non-U.S. public finance PVP of \$41 million in Nine Months 2018 compared with \$58 million in Nine Months 2017. The higher PVP in 2017 was due mainly to several large transactions.

In Nine Months 2018, excluding the SGI assumption, the Company executed transactions in the aviation and commercial real estate markets, and guaranteed a CLO for the first time since 2008.



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## Capital Management

In recent years, the Company has developed strategies to manage capital within the Assured Guaranty group more efficiently.

From 2013 through November 9, 2018, the Company has repurchased 92.7 million common shares for approximately \$2,645 million. The Board of Directors authorized, on August 1, 2018, an additional \$250 million of share repurchases. As of November 9, 2018 the Company was authorized to purchase \$169 million of its common shares. The Company expects the repurchases to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program are at the discretion of management and will depend on a variety of factors, including free funds available at the parent company, other potential uses for such free funds, market conditions, the Company's capital position, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time. It does not have an expiration date. See Part I, Item 1, Financial Statements, Note 17, Shareholders' Equity, for additional information about the Company's repurchases of its common shares.

## Summary of Share Repurchases

|  | Amount of                            | Number of | Average         |
|--|--------------------------------------|-----------|-----------------|
|  | Shares                               | Shares    | price per share |
|  | (in millions, except per share data) |           |                 |
| 2013   | \$264                                | 12.51     | \$ 21.12        |
| 2014   | 590                                  | 24.41     | 24.17           |
| 2015   | 555                                  | 21.00     | 26.43           |
| 2016   | 306                                  | 10.72     | 28.53           |
| 2017   | 501                                  | 12.67     | 39.57           |
| 2018 (First Quarter)                               | 98                                   | 2.79      | 35.20           |
| 2018 (Second Quarter)                              | 152                                  | 4.16      | 36.48           |
| 2018 (Third Quarter)                               | 130                                  | 3.30      | 39.41           |
| 2018 (October 1 through November 9, 2018)          | 49                                   | 1.18      | 41.29           |
| Cumulative repurchases since the beginning of 2013 | \$2,645                              | 92.74     | \$ 28.52        |

## Accretive Effect of Cumulative Repurchases (1)

|   | Third Quarter | Nine Months | As of              |
|---|---------------|-------------|--------------------|
|   | 2018          | 2018        | September 30, 2018 |
|   | (per share)   |             |                    |
| Net income                              | \$0.58        | \$ 1.41     |                    |
| Non-GAAP operating income               | 0.57          | 1.24        |                    |
| Shareholders' equity                    |               |             | \$ 15.23           |
| Non-GAAP operating shareholders' equity |               |             | 14.54              |
| Non-GAAP adjusted book value            |               |             | 25.68              |

(1) Cumulative repurchases since the beginning of 2013.

On December 21, 2017, the Maryland Insurance Administration approved, and in January 2018 AGC repurchased, \$200 million in shares of its common stock from its direct parent, Assured Guaranty US Holdings Inc. (AGUS).

The Company also considers the appropriate mix of debt and equity in its capital structure, and may repurchase some of its debt from time to time. For example, in Third Quarter 2018 and Nine Months 2018, AGUS purchased \$25 million and \$72 million, respectively, of Assured Guaranty Municipal Holdings Inc.'s (AGMH) outstanding Junior Subordinated Debentures, which resulted in a loss on extinguishment of debt of \$9 million in Third Quarter 2018 and \$26 million in Nine

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Months 2018. The Company may choose to make additional purchases of this or other Company debt in the future. Since June 2017, the Company has repurchased \$100 million of its debt principal outstanding.

In order to reduce leverage, and possibly rating agency capital charges, the Company has mutually agreed with beneficiaries to terminate selected financial guaranty insurance and credit derivative contracts. In particular, the Company has targeted investment grade securities for which claims are not expected but which carry a disproportionately large rating agency capital charge. There were no investment grade financial guaranty or CDS terminations in Third Quarter 2017. The Company terminated investment grade financial guaranty and CDS contracts with net par of \$72 million, \$609 million and \$298 million in Third Quarter 2018, Nine Months 2018 and Nine Months 2017, respectively.

## Alternative Strategies

The Company considers alternative strategies in order to create long-term shareholder value, including through acquisitions, investments and commutations. For example, the Company considers opportunities to acquire financial guaranty portfolios, whether by acquiring financial guarantors who are no longer actively writing new business or their insured portfolios, or by commuting business that it had previously ceded. These transactions enable the Company to improve its future earnings and deploy some of its excess capital.

**Assumption of Insured Portfolio and Acquisitions.** On June 1, 2018, the Company closed a transaction with SGI (SGI Transaction) under which AGC assumed, generally on a 100% quota share basis, substantially all of SGI's insured portfolio and AGM reassumed a book of business previously ceded to SGI by AGM. The net par value of exposures reinsured and commuted as of June 1, 2018 totaled approximately \$12 billion. The SGI Transaction reduced shareholders' equity by \$0.16 per share, and increased non-GAAP adjusted book value by \$2.25 per share. Additionally, beginning on June 1, 2018, on behalf of SGI, AGC began providing certain administrative services on the assumed portfolio, including surveillance, risk management, and claims processing. See New Business Production above, and Part I, Item 1, Financial Statements, Note 2, Assumption of Insured Portfolio and Business Combinations, for additional information.

On January 10, 2017, AGC completed its acquisition of MBIA UK, which added a total of \$12 billion in net par. At acquisition, MBIA UK contributed shareholders' equity of \$84 million and non-GAAP adjusted book value of \$322 million. For additional information on the MBIA UK Acquisition, see Note 2, Acquisitions, in Part II, Item 8. "Financial Statements and Supplementary Data" of AGL's Annual Report on Form 10-K for the year ended December 31, 2017.

**Commutations:** Commutations resulted in gains of \$1 million in Third Quarter 2018, losses of \$16 million in Nine Months 2018, gains of \$255 million in Third Quarter 2017 and gains of \$328 million in Nine Months 2017. The commutations added net unearned premium reserve of \$4 million in Third Quarter 2018, \$62 million in Third Quarter 2017, \$64 million in Nine Months 2018 and \$80 million in Nine Months 2017. The Company may also in the future enter into new commutation agreements to reassume portions of its insured business ceded to other reinsurers (ceded business). See Part I, Item 1, Financial Statements, Note 13, Reinsurance and Other Monoline Exposures, for additional information.

**Alternative Investments.** The alternative investments group has been investigating a number of new business opportunities that complement the Company's financial guaranty business, are in line with its risk profile and benefit from its core competencies, including, among others, both controlling and non-controlling investments in investment managers.

In February 2018, the Company acquired a minority interest in the holding company of Rubicon Infrastructure Advisors, a full-service investment firm that provides investment banking services within the infrastructure sector. In September 2017, the Company acquired a minority interest in Wasmer, Schroeder & Company LLC, an independent investment advisory firm specializing in separately managed accounts (SMAs).

In February 2017 the Company agreed to purchase up to \$100 million of limited partnership interests in a fund that invests in the equity of private equity managers.

The Company continues to investigate additional opportunities, but there can be no assurance if or when the Company will find suitable opportunities on appropriate terms.

#### Loss Mitigation

In an effort to avoid or reduce potential losses in its insurance portfolios, the Company employs a number of strategies.

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In the public finance area, the Company believes that its experience and the resources it is prepared to deploy, as well as its ability to provide bond insurance or other contributions as part of a solution, result in more favorable outcomes in distressed public finance situations than would be the case without its participation, as illustrated, for example, by the Company's role in the Detroit, Michigan; Stockton, California; and Jefferson County, Alabama financial crises. Currently, for example, the Company is actively working to mitigate potential losses in connection with the obligations it insures of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations. The Company will also, where appropriate, pursue litigation to enforce its rights, and it has initiated several legal actions to enforce its rights in Puerto Rico. For more information about developments in Puerto Rico and related recovery litigation being pursued by the Company, see Part I, Item 1, Financial Statements, Note 4, Outstanding Exposure.

The Company is currently working with the servicers of some of the residential mortgage-backed securities (RMBS) it insures to encourage the servicers to provide alternatives to distressed borrowers that will encourage them to continue making payments on their loans and so improve the performance of the related RMBS.

The Company also continues to purchase attractively priced obligations, including below-investment-grade (BIG) obligations, that it has insured and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses (loss mitigation securities). The fair value of assets purchased for loss mitigation purposes as of September 30, 2018 (excluding the value of the Company's insurance) was \$1,064 million, with a par of \$1,609 million (including bonds related to FG VIEs of \$39 million in fair value and \$220 million in par).

In some instances, the terms of the Company's policy gives it the option to pay principal on an accelerated basis on an obligation on which it has paid a claim, thereby reducing the amount of guaranteed interest due in the future. The Company has at times exercised this option, which uses cash but reduces projected future losses. The Company may also facilitate the issuance of refunding bonds, by either providing insurance on the refunding bonds or purchasing refunding bonds, or both. Refunding bonds may provide the issuer with payment relief.

## Other Events

The Company is evaluating the impact on its business of the referendum held in the U.K on June 23, 2016, in which a majority voted for the U.K. to exit the EU, known as "Brexit". Negotiations are ongoing to determine the future terms of the U.K.'s relationship with the EU, including the terms of trade between the U.K. and the EU. The Company believes that the negotiations are likely to last at least until early 2019. Brexit may impact laws, rules and regulations applicable to the Company's European subsidiaries and operations and the transactions insured by its European subsidiaries. The Company cannot predict the direction Brexit-related developments will take nor the impact of those developments on its European operations and the economies of the markets the Company serves, but the Company is in the process of implementing contingency plans in the event of a so-called 'hard' Brexit.

## Results of Operations

### Estimates and Assumptions

The Company's condensed consolidated financial statements include amounts that are determined using estimates and assumptions. The actual amounts realized could ultimately be materially different from the amounts currently provided for in the Company's condensed consolidated financial statements. Management believes the most significant items requiring inherently subjective and complex estimates are expected losses, fair value estimates, OTTI, deferred income taxes, and premium revenue recognition. The following discussion of the results of operations includes information regarding the estimates and assumptions used for these items and should be read in conjunction with the notes to the Company's condensed consolidated financial statements.

An understanding of the Company's accounting policies is of critical importance to understanding its condensed consolidated financial statements. See Part II, Item 8. "Financial Statements and Supplementary Data" of the Company's 2017 Annual Report on Form 10-K for a discussion of the significant accounting policies, the loss estimation process, and the fair value methodologies.

The Company carries a significant amount of its assets and a portion of its liabilities at fair value, the majority of which are measured at fair value on a recurring basis. Level 3 assets, consisting primarily of investments and FG VIEs' assets, represented approximately 18% and 17% of the total assets that are measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, respectively. All of the Company's liabilities that are measured at fair value are

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Level 3. See Part I, Item 1, Financial Statements, Note 7, Fair Value Measurement, for additional information about assets and liabilities classified as Level 3.

## Condensed Consolidated Results of Operations

## Condensed Consolidated Results of Operations

|  | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |       | Nine Months<br>Ended<br>September<br>30,<br>2017 |       |
|--|--|-------|--|-------|
|  | 2018   | 2017  | 2018   | 2017  |
|  | (in millions)  |       |  |       |
| Revenues:  |  |       |  |       |
| Net earned premiums  | \$142  | \$186 | \$423  | \$512 |
| Net investment income  | 98   | 99    | 298  | 322   |
| Net realized investment gains (losses)                             | (7 )   | 7     | (14 )  | 54    |
| Net change in fair value of credit derivatives:                    |  |       |  |       |
| Realized gains (losses) and other settlements                      | 1  | (1 )  | 4  | 19    |
| Net unrealized gains (losses)                                      | 20   | 59    | 99   | 87    |
| Net change in fair value of credit derivatives                     | 21   | 58    | 103  | 106   |
| Fair value gains (losses) on FG VIEs                               | 5  | 3     | 11   | 25    |
| Bargain purchase gain and settlement of pre-existing relationships | —  | —     | —  | 58    |
| Commutation gains (losses)   | 1  | 255   | (16 )  | 328   |
| Other income (loss)  | 14   | 15    | (17 )  | 53    |
| Total revenues   | 274  | 623   | 788  | 1,458 |
| Expenses:  |  |       |  |       |
| Loss and LAE   | 17   | 223   | 43   | 354   |
| Amortization of deferred acquisition costs                         | 3  | 5     | 12   | 13    |
| Interest expense   | 23   | 24    | 71   | 73    |
| Other operating expenses   | 56   | 58    | 183  | 183   |
| Total expenses   | 99   | 310   | 309  | 623   |
| Income (loss) before provision for income taxes                    | 175  | 313   | 479  | 835   |
| Provision (benefit) for income taxes                               | 14   | 105   | 46   | 157   |
| Net income (loss)  | \$161  | \$208 | \$433  | \$678 |

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## Net Earned Premiums

Premiums are earned over the contractual lives, or in the case of homogeneous pools of insured obligations, the remaining expected lives, of financial guaranty insurance contracts. The Company estimates remaining expected lives of its insured obligations and makes prospective adjustments for such changes in expected lives. Scheduled net earned premiums decrease each year unless replaced by a higher amount of new business, reassumptions of previously ceded business or books of business acquired in a business combination. See Part I, Item 1, Financial Statements, Note 6, Contracts Accounted for as Insurance, Financial Guaranty Insurance Premiums, for additional information and the expected timing of future premium earnings.

## Net Earned Premiums

|   | Third<br>Quarter |       | Nine<br>Months |       |
|---|------------------|-------|----------------|-------|
|   | 2018             | 2017  | 2018           | 2017  |
|   | (in millions)    |       |                |       |
| Financial guaranty insurance:               |                  |       |                |       |
| Public finance                              |                  |       |                |       |
| Scheduled net earned premiums and accretion | \$78             | \$76  | \$226          | \$240 |
| Accelerations:                              |                  |       |                |       |
| Refundings                                  | 31               | 84    | 112            | 189   |
| Terminations                                | 7                | —     | 14             | 1     |
| Total accelerations                         | 38               | 84    | 126            | 190   |
| Total public finance                        | 116              | 160   | 352            | 430   |
| Structured finance (1)                      |                  |       |                |       |
| Scheduled net earned premiums and accretion | 23               | 23    | 63             | 67    |
| Terminations                                | 2                | 3     | 5              | 14    |
| Total structured finance                    | 25               | 26    | 68             | 81    |
| Other                                       | 1                | 0     | 3              | 1     |
| Total net earned premiums                   | \$142            | \$186 | \$423          | \$512 |

(1) Excludes \$3 million and \$3 million for Third Quarter 2018 and 2017, respectively, and \$9 million and \$11 million for Nine Months 2018 and 2017, respectively, related to consolidated FG VIEs.

Net earned premiums decreased in Third Quarter 2018 compared with Third Quarter 2017 and Nine Months 2018 compared with Nine Months 2017 due primarily to reduced refunding activity due to a reduction in the insured portfolio as well as fewer advanced refunding bonds, caused by changes in tax law. At September 30, 2018, \$3.5 billion of net deferred premium revenue remained to be earned over the life of the insurance contracts. The SGI Transaction contributed \$375 million of net unearned premium reserve on June 1, 2018.

Net earned premiums due to accelerations is attributable to changes in the expected lives of insured obligations driven by (a) refundings of insured obligations or (b) terminations of insured obligations either through negotiated agreements or the exercise of the Company's contractual rights to make claim payments on an accelerated basis.

Refundings occur in the public finance market and had been at historically high levels in recent years due primarily to the low interest rate environment, which has allowed many municipalities and other public finance issuers to refinance their debt obligations at lower rates. The premiums associated with the insured obligations of municipalities and other public finance issuers are generally received upfront when the obligations are issued and insured. When such issuers pay down insured obligations prior to their originally scheduled maturities, the Company is no longer on risk for



payment defaults, and therefore accelerates the recognition of the nonrefundable deferred premium revenue remaining. Provisions in the 2017 Tax Act regarding the termination of the tax-exempt status of advance refunding bonds has resulted in fewer refundings in Nine Months 2018 than in comparable periods in prior years.

Terminations are generally negotiated agreements with beneficiaries resulting in the extinguishment of the Company's insurance obligation with respect to the insured obligations. Terminations are more common in the structured finance asset

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class, but may also occur in the public finance asset class. While each termination may have different terms, they all result in the expiration of the Company's insurance risk, such that the Company accelerates the recognition of the associated unearned premiums and reduces any remaining premiums receivable.

## Net Investment Income

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets.

## Net Investment Income (1)

|  | Third<br>Quarter |      | Nine Months |       |
|--|------------------|------|-------------|-------|
|  | 2018             | 2017 | 2018        | 2017  |
|  | (in millions)    |      |             |       |
| Income from fixed-maturity securities managed by third parties | \$75             | \$74 | \$224       | \$224 |
| Income from internally managed securities (1)                  | 25               | 28   | 81          | 105   |
| Gross investment income  | 100              | 102  | 305         | 329   |
| Investment expenses  | (2 )             | (3 ) | (7 )        | (7 )  |
| Net investment income  | \$98             | \$99 | \$298       | \$322 |

Net investment income excludes \$1 million and \$2 million for Third Quarter 2018 and 2017, respectively, and \$3 (1) million and \$4 million for Nine Months 2018 and 2017, respectively, related to securities in the investment portfolio that were issued by consolidated FG VIEs.

Net investment income for Nine Months 2018 decreased compared to Nine Months 2017 due primarily to the accretion on the Zohar II Notes prior to the MBIA UK Acquisition date in January 2017.

The overall pre-tax book yield was 3.74% as of September 30, 2018 and 3.59% as of September 30, 2017, respectively. Excluding the internally managed portfolio, pre-tax book yield was 3.20% as of September 30, 2018 compared with 3.12% as of September 30, 2017.

## Net Realized Investment Gains (Losses)

The table below presents the components of net realized investment gains (losses).

## Net Realized Investment Gains (Losses)

|  | Third<br>Quarter |       | Nine<br>Months |       |
|--|------------------|-------|----------------|-------|
|  | 2018             | 2017  | 2018           | 2017  |
|  | (in millions)    |       |                |       |
| Gross realized gains on available-for-sale securities  | \$5              | \$23  | \$16           | \$92  |
| Gross realized losses on available-for-sale securities | (3 )             | (3 )  | (9 )           | (9 )  |
| Net realized gains (losses) on other invested assets   | 0                | 0     | (1 )           | 0     |
| OTTI   | (9 )             | (13 ) | (20 )          | (29 ) |
| Net realized investment gains (losses)                 | \$(7)            | \$7   | \$(14)         | \$54  |

Third Quarter 2018 gross realized gains were lower than Third Quarter 2017 due mainly to the sale of investments from the internally managed portfolio in Third Quarter 2017. Realized gains in Nine Months 2018 were lower compared to Nine Months 2017 due primarily to the gain on sale of the Zohar II Notes exchanged in the MBIA UK Acquisition in January 2017. OTTI in all periods presented were primarily attributable to securities purchased for loss mitigation purposes.

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## Net Change in Fair Value of Credit Derivatives

Changes in the fair value of credit derivatives occur primarily because of changes in the issuing company's own credit rating and credit spreads, collateral credit spreads, notional amounts, credit ratings of the referenced entities, expected terms, realized gains (losses) and other settlements, interest rates, and other market factors. With volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Except for net estimated credit impairments (i.e., net expected payments), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. Changes in the fair value of the Company's credit derivatives that do not reflect actual or expected claims or credit losses have no impact on the Company's statutory claims-paying resources, rating agency capital or regulatory capital positions. Changes in expected losses in respect of contracts accounted for as credit derivatives are included in the discussion of "Economic Loss Development" below. In addition, see Part I, Item 1, Financial Statements, Note 7, Fair Value Measurement for information on the valuation of the CDS and Note 8, Contracts Accounted for as Credit Derivatives, for information on the components of the change in fair value of CDS.

During Third Quarter 2018, unrealized fair value gains were generated primarily as a result of price improvements on the underlying collateral of the Company's CDS. This was the primary driver of the unrealized fair value gains in the Pooled Corporate Obligations and Infrastructure Finance sectors. The unrealized fair value gains were partially offset by unrealized fair value losses related to the decreased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection decreased during the period. For those CDS transactions that were pricing at or above their floor levels, when the cost of purchasing CDS protection on AGC and AGM, which management refers to as the CDS spread on AGC and AGM, decreased, the implied spreads that the Company would expect to receive on these transactions increased.

During Nine Months 2018, unrealized fair value gains were generated primarily as a result of the increase in credit given to the primary insurer on one of the Company's second-to-pay CDS policies, CDS terminations, and price improvements on the underlying collateral of the Company's CDS. The unrealized fair value gains were partially offset by unrealized fair value losses related to the decreased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection decreased during the period.

During Third Quarter and Nine Months 2017, unrealized fair value gains were generated primarily as a result of CDS terminations in the Other sector, run-off of net par outstanding, and tighter implied net spreads. The tighter implied net spreads were primarily a result of price improvements on the underlying collateral of the Company's CDS and the increased cost to buy protection in AGC's and AGM's name as the market cost of AGC's and AGM's credit protection increased during the period. For those CDS transactions that were pricing at or above their floor levels, when the cost of purchasing CDS protection on AGC and AGM increased, the implied net spreads that the Company would expect to receive on these transactions decreased.

## Effect of Changes in the Company's Credit Spread on Net Unrealized Gains (Losses) on Credit Derivatives

|  | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 | Third<br>Quarter<br>2018 | Nine<br>Months<br>2017 |
|--|--------------------------|------------------------|--------------------------|------------------------|
| Change in unrealized gains (losses) on credit derivatives:     |                          |                        |                          |                        |
| Before considering implication of the Company's credit spreads | \$37                     | \$38                   | \$142                    | \$75                   |
| Resulting from change in the Company's credit spreads          | (17)                     | 21                     | (43)                     | 12                     |

After considering implication of the Company's credit spreads \$20 \$59 \$99 \$87

Management believes that the trading level of AGC's and AGM's credit spreads over the past several years has been due to the correlation between AGC's and AGM's risk profile and the current risk profile of the broader financial markets.

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## Sensitivity to Changes in Credit Spread

The following table summarizes the estimated change in fair values on the net balance of the Company's credit derivative positions assuming immediate parallel shifts in credit spreads on AGC and AGM and on the risks that they both assume.

## Effect of Changes in Credit Spread

As of September 30, 2018

| Credit Spreads (1)       | Estimated     | Estimated       | Estimated |
|--------------------------|---------------|-----------------|-----------|
|                          | Fair Value    | Net Gain/(Loss) | Change    |
|                          | (Pre-Tax)     | (Pre-Tax)       |           |
|                          | (in millions) |                 |           |
| 100% widening in spreads | \$(437)       | \$ (200)        | )         |
| 50% widening in spreads  | (337 )        | (100)           | )         |
| 25% widening in spreads  | (287 )        | (50)            | )         |
| 10% widening in spreads  | (257 )        | (20)            | )         |
| Base Scenario            | (237 )        | —               |           |
| 10% narrowing in spreads | (217 )        | 20              |           |
| 25% narrowing in spreads | (187 )        | 50              |           |
| 50% narrowing in spreads | (137 )        | 100             |           |

(1) Includes the effects of spreads on both the underlying asset classes and the Company's own credit spread.

## Financial Guaranty Variable Interest Entities

As of September 30, 2018 and December 31, 2017, the Company consolidated 31 and 32 FG VIEs, respectively. The table below presents the effects on reported GAAP income resulting from consolidating these FG VIEs and eliminating intercompany transactions. The consolidation of FG VIEs has an effect on net income and shareholders' equity due to:

changes in fair value gains (losses) on FG VIEs' assets and liabilities (effective January 1, 2018 the change in fair value of FG VIEs' liabilities with recourse attributable to ISCR is recorded in OCI, instead of net income - See Part I, Item 1, Financial Statements, Note 1, Business and Basis of Presentation, for additional information),

the elimination of premiums and losses related to the AGC and AGM FG VIEs' liabilities with recourse, and

the elimination of investment balances related to the Company's purchase of AGC and AGM insured FG VIEs' debt.

Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. See Part I, Item 1, Financial Statements, Note 9, Variable Interest Entities, for additional information.

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## Effect of Consolidating FG VIEs on Net Income (Loss)

|  | Third<br>Quarter<br>2018 |       | Nine<br>Months<br>2017 |       |
|--|--------------------------|-------|------------------------|-------|
|  | 2018                     | 2017  | 2018                   | 2017  |
|  | (in millions)            |       |                        |       |
| Fair value gains (losses) on FG VIEs (1)         | \$5                      | \$3   | \$11                   | \$25  |
| Elimination of insurance and investment balances | (7 )                     | (4 )  | (12 )                  | (10 ) |
| Effect on income before tax                      | (2 )                     | (1 )  | (1 )                   | 15    |
| Less: tax provision (benefit)                    | 0                        | 0     | 0                      | 5     |
| Effect on net income (loss)                      | \$(2)                    | \$(1) | \$(1)                  | \$10  |

(1) Effective January 1, 2018, as a result of the adoption of Accounting Standards Update 2016-01, the change in fair value of FG VIEs' liabilities with recourse attributed to ISCR is excluded from the condensed consolidated statements of operations and recorded in OCI. Upon adoption, the Company reclassified a loss of approximately \$33 million, net of tax, from retained earnings to accumulated OCI (AOCI).

## Bargain Purchase Gain and Settlement of Pre-existing Relationships

In connection with the MBIA UK Acquisition in Nine Months 2017, the Company recognized a \$56 million bargain purchase gain and a \$2 million gain on settlement of pre-existing relationships. See Part I, Item 1, Financial Statements, Note 2, Assumption of Insured Portfolio and Business Combinations, for additional information.

## Commutation Gains (Losses)

The Company recognized commutation gains of \$1 million in Third Quarter 2018, commutation losses of \$16 million in Nine Months 2018, and commutation gains of \$255 million and \$328 million in Third Quarter 2017 and Nine Months 2017, respectively. The losses in Nine Months 2018 related to the commutation component of the SGI Transaction. See Part I, Item 1, Financial Statements, Note 13, Reinsurance and Other Monoline Exposures, for additional information.

## Other Income (Loss)

Other income (loss) comprises recurring items such as foreign exchange remeasurement gains and losses, fair value gains and losses on CCS, fair value gains (losses) on equity securities, ancillary fees on financial guaranty policies such as commitment and consent, and if applicable, other revenue items on financial guaranty insurance and reinsurance contracts such as loss mitigation recoveries and certain non-recurring items.

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## Other Income (Loss)

|   | Third<br>Quarter |      | Nine<br>Months |      |
|---|------------------|------|----------------|------|
|   | 2018             | 2017 | 2018           | 2017 |
|   | (in millions)    |      |                |      |
| Foreign exchange gain (loss) on remeasurement (1)   | \$(9 )           | \$17 | \$(22)         | \$52 |
| Fair value gains (losses) on equity investments (2) | 32               | —    | 29             | —    |
| Loss on extinguishment of debt (3)                  | (9 )             | (2 ) | (26 )          | (9 ) |
| Other   | 0                | 0    | 2              | 10   |
| Total other income (loss)                           | \$14             | \$15 | \$(17)         | \$53 |

(1) Foreign exchange gains relate primarily to remeasurement of premiums receivable and are due mainly to changes in the exchange rate of the British pound sterling relative to the U.S. dollar.

The Company recorded a gain on change in fair value of equity securities in Third Quarter 2018 and Nine Months (2)2018. Both periods include a gain of \$31 million related to the Company's minority interest in the parent company of TMC Bonds LLC, which it sold in Third Quarter 2018.

The loss on extinguishment of debt is related to AGUS' purchase of a portion of the principal amount of AGMH's outstanding Junior Subordinated Debentures. The loss represents the difference between the amount paid to (3)purchase AGMH's debt and the carrying value of the debt, which includes the unamortized fair value adjustments that were recorded upon the acquisition of AGMH in 2009. See Part I, Item 1, Financial Statements, Note 15, Long-Term Debt and Credit Facilities, for additional information.

## Economic Loss Development

The insured portfolio includes policies accounted for under three separate accounting models depending on the characteristics of the contract and the Company's control rights. See Part I, Item 1, Financial Statements, Note 5, Expected Loss to be Paid, for a discussion of the assumptions and methodologies used in calculating the expected loss to be paid for all contracts. For a discussion of the loss estimation process, approach to projecting losses and the measurement and recognition accounting policies under GAAP for each type of contract, see Part II, Item 8, "Financial Statements and Supplementary Data" of the Company's 2017 Annual Report on Form 10-K:

♣Note 5 for expected loss to be paid,

♣Note 6 for contracts accounted for as insurance,

♣Note 7 for fair value methodologies for credit derivatives and FG VIEs' assets and liabilities,

♣Note 8 for contracts accounted for as credit derivatives, and

♣Note 9 for FG VIEs.

The discussion of losses that follows encompasses losses on all contracts in the insured portfolio regardless of accounting model, unless otherwise specified. Net expected loss to be paid consists primarily of the present value of future: expected claim and LAE payments, expected recoveries from issuers or excess spread and other collateral in the transaction structures, cessions to reinsurers, and expected recoveries/payables for breaches of representations and warranties and the effects of other loss mitigation strategies. Current risk free rates are used to discount expected losses at the end of each reporting period and therefore changes in such rates from period to period affect the expected loss estimates reported. Assumptions used in the determination of the net expected loss to be paid such as delinquency, severity, and discount rates and expected time frames to recovery in the mortgage market were consistent



by sector regardless of the accounting model used. The primary drivers of economic loss development are discussed below. Changes in risk free rates used to discount losses affect economic loss development, and loss and LAE; however, the effect of changes in discount rates are not indicative of actual credit impairment or improvement in the period.

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## Net Expected Loss to be Paid

|                          | As of<br>September 30,<br>2018 | As of<br>December 31,<br>2017 |
|--------------------------|--------------------------------|-------------------------------|
|                          | (in millions)                  |                               |
| Public finance           | \$870                          | \$ 1,203                      |
| Structured finance       |                                |                               |
| U.S. RMBS                | 303                            | 73                            |
| Other structured finance | 18                             | 27                            |
| Structured finance       | 321                            | 100                           |
| Total                    | \$1,191                        | \$ 1,303                      |

## Economic Loss Development (Benefit) (1)

|                          | Third<br>Quarter<br>2018 | Third<br>Quarter<br>2017 | Nine<br>Months<br>2018 | Nine<br>Months<br>2017 |
|--------------------------|--------------------------|--------------------------|------------------------|------------------------|
|                          | (in millions)            |                          |                        |                        |
| Public finance           | \$39                     | \$229                    | \$50                   | \$427                  |
| Structured finance:      |                          |                          |                        |                        |
| U.S. RMBS                | (40 )                    | (19 )                    | (52 )                  | (70 )                  |
| Other structured finance | 1                        | (6 )                     | (3 )                   | (59 )                  |
| Structured finance       | (39 )                    | (25 )                    | (55 )                  | (129 )                 |
| Total                    | \$0                      | \$204                    | \$(5 )                 | \$298                  |

(1) Economic loss development includes the effects of changes in assumptions based on observed market trends, changes in discount rates, accretion of discount and the economic effects of loss mitigation efforts.

## Third Quarter 2018 Net Economic Loss Development

The total economic loss development was de minimis in Third Quarter 2018, comprising a net economic benefit in structured finance that was offset by economic development in U.S. public finance. The risk-free rates for U.S. dollar denominated obligations used to discount expected losses ranged from 0.0% to 3.20% with a weighted average of 3.03% as of September 30, 2018 and 0.0% to 3.03% with a weighted average of 2.85% as of June 30, 2018. The effect of changes in the risk-free rates used to discount expected losses was a benefit of \$9 million in Third Quarter 2018.

**U.S. Public Finance Economic Loss Development:** The net par outstanding for U.S. public finance obligations rated BIG by the Company was \$6.2 billion as of September 30, 2018, compared with \$6.3 billion as of June 30, 2018. The Company projects that its total net expected loss across its troubled U.S. public finance exposures as of September 30, 2018, will be \$832 million, compared with \$1,041 million as of June 30, 2018. Economic loss development in Third Quarter 2018 was \$42 million, which was primarily attributable to Puerto Rico exposures. See "Insured Portfolio-Exposure to Puerto Rico" below for details about significant developments that have taken place in Puerto Rico.

**U.S. RMBS Economic Loss Development:** The net benefit attributable to U.S. RMBS was \$40 million and was mainly related to improved performance of the underlying collateral.

See Part I, Item 1, Financial Statements, Note 5, Expected Loss to be Paid for additional information.

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Third Quarter 2017 Net Economic Loss Development

Total economic loss of \$204 million in Third Quarter 2017 was primarily related to the public finance sector, offset in part by improvements in the structured finance sector. The risk-free rates used to discount expected losses ranged from 0.0% to 2.94% with a weighted average of 2.27% as of September 30, 2017 and 0.0% to 2.83% with a weighted average of 2.32% as of June 30, 2017. The effect of changes in the risk-free rates used to discount expected losses was a benefit of \$6 million in Third Quarter 2017.

U.S. Public Finance Economic Loss Development: The net par outstanding for U.S. public finance obligations rated BIG by the Company was \$7.3 billion as of September 30, 2017 compared with \$7.1 billion as of June 30, 2017. The Company projected that its total net expected loss across its troubled U.S. public finance credits as of September 30, 2017 would be \$1,046 million, compared with \$1,044 million as of June 30, 2017. Economic loss development in Third Quarter 2017 was \$229 million, which was primarily attributable to Puerto Rico exposures.

U.S. RMBS Economic Loss Development: The net benefit attributable to U.S. RMBS was \$19 million and was mainly related to improvement in the underlying collateral performance of home equity lines of credit mortgages and improvements in observed liquidation rates.

Other Structured Finance Economic Loss Development: The net benefit attributable to structured finance (excluding U.S. RMBS) was \$6 million, due primarily to decreased future loss expectations on certain transactions reinsured by the Company.

Nine Months 2018 Net Economic Loss Development

The total economic benefit of \$5 million in Nine Months 2018 was generated mainly by the structured finance sector, partially offset by economic loss development in the U.S. public finance sector. The economic benefit in the structured finance sector in Nine Months 2018 of \$55 million was primarily attributable to improved collateral performance and certain assumption updates. As part of the SGI Transaction, the Company assumed \$130 million in expected losses on U.S. RMBS transactions in Nine Months 2018. The benefit in the structured finance sector was partially offset by U.S. public finance economic loss development of \$59 million, which was primarily attributable to Puerto Rico exposures, partially offset by the State of Connecticut's agreement to pay the debt service costs of certain bonds of the City of Hartford, including the bonds insured by the Company. The effect of the change in the risk-free rates used to discount expected losses was a benefit of \$15 million in Nine Months 2018.

Nine Months 2017 Net Economic Loss Development

Total economic loss development of \$298 million in Nine Months 2017 was generated mainly by the U.S. public finance sector, partially offset by a net benefit in the structured finance sector. Economic loss development in the public finance sector in Nine Months 2017 was \$427 million, which was primarily attributable to Puerto Rico exposures. This was partially offset by a \$129 million benefit in structured finance due to lower re-default assumptions on first and second lien modified loans, and a benefit from a litigation settlement related to two triple-X transactions. The effect of the change in the risk-free rates used to discount expected losses was a loss of \$28 million in Nine Months 2017.

Loss and LAE (Financial Guaranty Insurance Contracts)

The primary differences between net economic loss development and the amount reported as loss and LAE in the condensed consolidated statements of operations are that loss and LAE:

considers deferred premium revenue in the calculation of loss reserves and loss and LAE for financial guaranty insurance contracts,

eliminates loss and LAE related to consolidated FG VIEs and

does not include estimated losses on credit derivatives.

Loss and LAE reported in non-GAAP operating income (i.e., operating loss and LAE) includes losses on financial guaranty insurance contracts (other than those eliminated due to consolidation of FG VIEs), and credit derivatives.

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For financial guaranty insurance contracts each transaction's expected loss to be expensed is compared with the deferred premium revenue of that transaction. When the expected loss to be expensed exceeds the deferred premium revenue, a loss is recognized in the condensed consolidated statements of operations for the amount of such excess. Therefore, the timing of loss recognition in income does not necessarily coincide with the timing of the actual credit impairment or improvement reported in net economic loss development. Transactions (particularly BIG transactions) acquired in a business combination or seasoned portfolios assumed from legacy financial guaranty insurers generally have the largest deferred premium revenue balances. Therefore the largest differences between net economic loss development and loss and LAE on financial guaranty insurance contracts generally relate to these policies.

The amount of loss and LAE recognized in the condensed consolidated statements of operations for financial guaranty contracts accounted for as insurance is dependent on the amount of economic loss development discussed above and the deferred premium revenue amortization in a given period, on a contract-by-contract basis.

While expected loss to be paid is an important liquidity measure that provides the present value of amounts that the Company expects to pay or recover in future periods on all contracts, expected loss to be expensed is important because it presents the Company's projection of loss and LAE that will be recognized in future periods as deferred premium revenue amortizes into income in the condensed consolidated statements of operations for financial guaranty insurance policies.

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

Loss and LAE Reported  
on the Condensed Consolidated Statements of Operations

|                          | Loss (Benefit) |       |             |       |
|--------------------------|----------------|-------|-------------|-------|
|                          | Third Quarter  |       | Nine Months |       |
|                          | 2018           | 2017  | 2018        | 2017  |
|                          | (in millions)  |       |             |       |
| Public finance           | \$39           | \$233 | \$71        | \$421 |
| Structured finance:      |                |       |             |       |
| U.S. RMBS (1)            | (21)           | (5)   | (17)        | (19)  |
| Other structured finance | (1)            | (5)   | (11)        | (48)  |
| Structured finance       | (22)           | (10)  | (28)        | (67)  |
| Total loss and LAE (2)   | \$17           | \$223 | \$43        | \$354 |

(1) Excludes a benefit of \$3 million and a loss of \$1 million for Third Quarter 2018 and 2017, respectively, and losses of \$0 million and \$5 million for Nine Months 2018 and 2017, respectively, related to consolidated FG VIEs.

(2) Excludes credit derivative loss of \$1 million and benefit of \$1 million for Third Quarter 2018 and Third Quarter 2017 and credit derivative loss of \$3 million and benefit of \$25 million for Nine Months 2018 and Nine Months 2017.

Loss and LAE in Third Quarter 2018 was mainly driven by higher loss reserves on certain Puerto Rico exposures, partially offset by a benefit on U.S. RMBS exposures. Loss and LAE in Third Quarter 2017 was mainly driven by an increase in loss reserves on certain Puerto Rico exposures.

Loss and LAE in Nine Months 2018 was mainly driven by higher loss reserves on certain Puerto Rico exposures, partially offset by the reduction of loss reserves on the City of Hartford, CT exposure and a benefit on U.S. RMBS exposures. Loss and LAE in Nine Months 2017 was mainly driven by higher loss reserves on certain Puerto Rico exposures, partially offset by a benefit from a litigation settlement related to two triple-X transactions.

For additional information on the expected timing of net expected losses to be expensed see Part I, Item 1, Financial Statements, Note 6, Contracts Accounted for as Insurance, Financial Guaranty Insurance Losses.

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## Provision for Income Tax

## Provision for Income Taxes and Effective Tax Rates

|  | Third Quarter         |        | Nine Months |        |
|--|-----------------------|--------|-------------|--------|
|  | 2018                  | 2017   | 2018        | 2017   |
|  | (dollars in millions) |        |             |        |
| Total provision (benefit) for income taxes | \$14                  | \$105  | \$46        | \$157  |
| Effective tax rate                         | 8.3 %                 | 33.6 % | 9.7 %       | 18.8 % |

The Company's effective tax rate reflects the proportion of income recognized by each of the Company's operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 21% in 2018 compared with 35% in 2017, U.K. subsidiaries taxed at the U.K. marginal corporate tax rate of 19% unless taxed as a U.S. controlled foreign corporation, and no taxes for the Company's Bermuda subsidiaries, which consist of Assured Guaranty Re Ltd. (AG Re), Assured Guaranty Re Overseas Ltd. (AGRO), and Cedar Personnel Ltd., unless subject to U.S. tax by election or as a U.S. controlled foreign corporation. In April 2017, the Company received a final letter from the Internal Revenue Service to close the audit for the period of 2009 - 2012, with no additional findings or changes, and as a result the Company released previously recorded uncertain tax position reserves and accrued interest of approximately \$37 million in Third Quarter 2017. The Nine Months 2018 effective tax rate reflects the release of \$7 million and \$11 million of previously recorded uncertain tax position reserves and accrued interest in the first quarter and third quarter of 2018, respectively, due to the closing of the 2013 and 2014 audit years, and the first quarter of 2017 effective tax rate reflects the tax benefit of the bargain purchase gain related to the MBIA UK Acquisition.

## Non-GAAP Financial Measures

To reflect the key financial measures that management analyzes in evaluating the Company's operations and progress towards long-term goals, the Company discloses both financial measures determined in accordance with GAAP and financial measures not determined in accordance with GAAP (non-GAAP financial measures).

Financial measures identified as non-GAAP should not be considered substitutes for GAAP financial measures. The primary limitation of non-GAAP financial measures is the potential lack of comparability to financial measures of other companies, whose definitions of non-GAAP financial measures may differ from those of the Company.

By disclosing non-GAAP financial measures, the Company gives investors, analysts and financial news reporters access to information that management and the Board of Directors review internally. The Company believes its presentation of non-GAAP financial measures, along with the effect of FG VIE consolidation, provides information that is necessary for analysts to calculate their estimates of Assured Guaranty's financial results in their research reports on Assured Guaranty and for investors, analysts and the financial news media to evaluate Assured Guaranty's financial results.

GAAP requires the Company to consolidate certain VIEs that have issued debt obligations insured by the Company. However, the Company does not own such VIEs and its exposure is limited to its obligation under its financial guaranty insurance contract. Management and the Board of Directors use non-GAAP financial measures adjusted to remove FG VIE consolidation (which the Company refers to as its core financial measures), as well as GAAP financial measures and other factors, to evaluate the Company's results of operations, financial condition and progress towards long-term goals. The Company uses these core financial measures in its decision making process and in its calculation of certain components of management compensation. Wherever possible, the Company has separately disclosed the effect of FG VIE consolidation.



Many investors, analysts and financial news reporters use non-GAAP operating shareholders' equity, adjusted to remove the effect of FG VIE consolidation, as the principal financial measure for valuing AGL's current share price or projected share price and also as the basis of their decision to recommend, buy or sell AGL's common shares. Many of the Company's fixed income investors also use this measure to evaluate the Company's capital adequacy.

Many investors, analysts and financial news reporters also use non-GAAP adjusted book value, adjusted to remove the effect of FG VIE consolidation, to evaluate AGL's share price and as the basis of their decision to recommend, buy or sell the AGL common shares. Non-GAAP operating income adjusted for the effect of FG VIE consolidation enables investors and analysts to evaluate the Company's financial results in comparison with the consensus analyst estimates distributed publicly by financial databases.

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The core financial measures that the Company uses to help determine compensation are: (1) non-GAAP operating income, adjusted to remove the effect of FG VIE consolidation, (2) non-GAAP operating shareholders' equity, adjusted to remove the effect of FG VIE consolidation, (3) growth in non-GAAP adjusted book value per share, adjusted to remove the effect of FG VIE consolidation, and (4) PVP.

The following paragraphs define each non-GAAP financial measure disclosed by the Company and describe why it is useful. To the extent there is a directly comparable GAAP financial measure, a reconciliation of the non-GAAP financial measure and the most directly comparable GAAP financial measure is presented below.

Non-GAAP Operating Income

Management believes that non-GAAP operating income is a useful measure because it clarifies the understanding of the underwriting results and financial condition of the Company and presents the results of operations of the Company excluding the fair value adjustments on credit derivatives and CCS that are not expected to result in economic gain or loss, as well as other adjustments described below. Management adjusts non-GAAP operating income further by removing FG VIE consolidation to arrive at its core operating income measure. Non-GAAP operating income is defined as net income (loss) attributable to AGL, as reported under GAAP, adjusted for the following:

- 1) Elimination of realized gains (losses) on the Company's investments, except for gains and losses on securities classified as trading. The timing of realized gains and losses, which depends largely on market credit cycles, can vary considerably across periods. The timing of sales is largely subject to the Company's discretion and influenced by market opportunities, as well as the Company's tax and capital profile.
- 2) Elimination of non-credit-impairment unrealized fair value gains (losses) on credit derivatives that are recognized in net income, which is the amount of unrealized fair value gains (losses) in excess of the present value of the expected estimated economic credit losses, and non-economic payments. Such fair value adjustments are heavily affected by, and in part fluctuate with, changes in market interest rates, the Company's credit spreads, and other market factors and are not expected to result in an economic gain or loss.
- 3) Elimination of fair value gains (losses) on the Company's CCS that are recognized in net income. Such amounts are affected by changes in market interest rates, the Company's credit spreads, price indications on the Company's publicly traded debt, and other market factors and are not expected to result in an economic gain or loss.
- 4) Elimination of foreign exchange gains (losses) on remeasurement of net premium receivables and loss and LAE reserves that are recognized in net income. Long-dated receivables and loss and LAE reserves represent the present value of future contractual or expected cash flows. Therefore, the current period's foreign exchange remeasurement gains (losses) are not necessarily indicative of the total foreign exchange gains (losses) that the Company will ultimately recognize.
- 5) Elimination of the tax effects related to the above adjustments, which are determined by applying the statutory tax rate in each of the jurisdictions that generate these adjustments.

Table of ContentsReconciliation of Net Income (Loss)  
to Non-GAAP Operating Income

|  | Third Quarter |        | Nine Months |       |
|--|---------------|--------|-------------|-------|
|  | 2018          | 2017   | 2018        | 2017  |
|  | (in millions) |        |             |       |
| Net income (loss)  | \$161         | \$208  | \$433       | \$678 |
| Less pre-tax adjustments:  |               |        |             |       |
| Realized gains (losses) on investments   | (7 )          | 7      | (14 )       | 54    |
| Non-credit impairment unrealized fair value gains (losses) on credit derivatives   | 17            | 55     | 91          | 60    |
| Fair value gains (losses) on CCS (1)   | (1 )          | (4 )   | (3 )        | (4 )  |
| Foreign exchange gains (losses) on remeasurement of premiums receivable and loss and LAE reserves (1)  | (8 )          | 18     | (20 )       | 49    |
| Total pre-tax adjustments  | 1             | 76     | 54          | 159   |
| Less tax effect on pre-tax adjustments   | (1 )          | (24 )  | (11 )       | (51 ) |
| Non-GAAP operating income  | \$161         | \$156  | \$390       | \$570 |
| Gain (loss) related to FG VIE consolidation (net of tax provision (benefit) of \$0, \$(1), \$0 and \$5 included in non-GAAP operating income | \$(2 )        | \$(1 ) | \$(1 )      | \$9   |

(1) Included in other income (loss) in the condensed consolidated statements of operations.

## Non-GAAP Operating Shareholders' Equity and Non-GAAP Adjusted Book Value

Management believes that non-GAAP operating shareholders' equity is a useful measure because it presents the equity of the Company excluding the fair value adjustments on investments, credit derivatives and CCS, that are not expected to result in economic gain or loss, along with other adjustments described below. Management adjusts non-GAAP operating shareholders' equity further by removing FG VIE consolidation to arrive at its core operating shareholders' equity and core adjusted book value.

Non-GAAP operating shareholders' equity is the basis of the calculation of non-GAAP adjusted book value (see below). Non-GAAP operating shareholders' equity is defined as shareholders' equity attributable to AGL, as reported under GAAP, adjusted for the following:

1) Elimination of non-credit-impairment unrealized fair value gains (losses) on credit derivatives, which is the amount of unrealized fair value gains (losses) in excess of the present value of the expected estimated economic credit losses, and non-economic payments. Such fair value adjustments are heavily affected by, and in part fluctuate with, changes in market interest rates, credit spreads and other market factors and are not expected to result in an economic gain or loss.

2) Elimination of fair value gains (losses) on the Company's CCS. Such amounts are affected by changes in market interest rates, the Company's credit spreads, price indications on the Company's publicly traded debt, and other market factors and are not expected to result in an economic gain or loss.

3) Elimination of unrealized gains (losses) on the Company's investments that are recorded as a component of accumulated other comprehensive income (AOCI) (excluding foreign exchange remeasurement). The AOCI component of the fair value adjustment on the investment portfolio is not deemed economic because the Company generally holds these investments to maturity and therefore should not recognize an economic gain or loss.

4) Elimination of the tax effects related to the above adjustments, which are determined by applying the statutory tax rate in each of the jurisdictions that generate these adjustments.

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Management uses non-GAAP adjusted book value, adjusted for FG VIE consolidation, to measure the intrinsic value of the Company, excluding franchise value. Growth in non-GAAP adjusted book value per share, adjusted for FG VIE consolidation (core adjusted book value), is one of the key financial measures used in determining the amount of certain long-term compensation elements to management and employees and used by rating agencies and investors. Management believes that non-GAAP adjusted book value is a useful measure because it enables an evaluation of the Company's in-force premiums and revenues net of expected losses. Non-GAAP adjusted book value is non-GAAP operating shareholders' equity, as defined above, further adjusted for the following:

- 1) Elimination of deferred acquisition costs, net. These amounts represent net deferred expenses that have already been paid or accrued and will be expensed in future accounting periods.
- 2) Addition of the net present value of estimated net future revenue on non-financial guaranty contracts. See below.
- 3) Addition of the deferred premium revenue on financial guaranty contracts in excess of expected loss to be expensed, net of reinsurance. This amount represents the expected future net earned premiums, net of expected losses to be expensed, which are not reflected in GAAP equity.
- 4) Elimination of the tax effects related to the above adjustments, which are determined by applying the statutory tax rate in each of the jurisdictions that generate these adjustments.

The unearned premiums and revenues included in non-GAAP adjusted book value will be earned in future periods, but actual earnings may differ materially from the estimated amounts used in determining current non-GAAP adjusted book value due to changes in foreign exchange rates, prepayment speeds, terminations, credit defaults and other factors.

Table of ContentsReconciliation of Shareholders' Equity  
to Non-GAAP Adjusted Book Value

|   | As of<br>September 30,<br>2018                     |              | As of<br>December 31,<br>2017 |              |
|---|--|--------------|-------------------------------|--------------|
|   | After-Tax  | Per<br>Share | After-Tax                     | Per<br>Share |
|   | (dollars in millions, except<br>per share amounts) |              |                               |              |
| Shareholders' equity  | \$6,583  | \$61.73      | \$6,839                       | \$58.95      |
| Less pre-tax adjustments:   |  |              |                               |              |
| Non-credit impairment unrealized fair value gains (losses) on credit derivatives  | (55 )  | (0.51 )      | (146 )                        | (1.26 )      |
| Fair value gains (losses) on CCS  | 57   | 0.53         | 60                            | 0.52         |
| Unrealized gain (loss) on investment portfolio excluding foreign exchange effect  | 215  | 2.02         | 487                           | 4.20         |
| Less taxes  | (54 )  | (0.51 )      | (83 )                         | (0.71 )      |
| Non-GAAP operating shareholders' equity   | 6,420  | 60.20        | 6,521                         | 56.20        |
| Pre-tax adjustments:  |  |              |                               |              |
| Less: Deferred acquisition costs  | 103  | 0.97         | 101                           | 0.87         |
| Plus: Net present value of estimated net future revenue   | 211  | 1.99         | 146                           | 1.26         |
| Plus: Net unearned premium reserve on financial guaranty contracts in excess of expected loss to be expensed                          | 3,012  | 28.24        | 2,966                         | 25.56        |
| Plus taxes  | (528 )   | (4.95 )      | (512 )                        | (4.41 )      |
| Non-GAAP adjusted book value  | \$9,012  | \$84.51      | \$9,020                       | \$77.74      |
| Gain (loss) related to FG VIE consolidation included in non-GAAP operating shareholders' equity (net of tax provision of \$1 and \$2) | \$3  | \$0.03       | 5                             | 0.03         |
| Gain (loss) related to FG VIE consolidation included in non-GAAP adjusted book value (net of tax benefit of \$4 and \$3)              | \$(14 )  | \$(0.14 )    | (14 )                         | (0.12 )      |

## Net Present Value of Estimated Net Future Revenue

Management believes that this amount is a useful measure because it enables an evaluation of the value of future estimated revenue for non-financial guaranty insurance contracts. There is no corresponding GAAP financial measure. This amount represents the present value of estimated future revenue from the Company's non-financial guaranty insurance contracts, net of reinsurance, ceding commissions and premium taxes, for contracts without expected economic losses, and is discounted at 6%. Estimated net future revenue may change from period to period due to changes in foreign exchange rates, prepayment speeds, terminations, credit defaults or other factors that affect par outstanding or the ultimate maturity of an obligation.

## PVP or Present Value of New Business Production

Management believes that PVP is a useful measure because it enables the evaluation of the value of new business production for the Company by taking into account the value of estimated future installment premiums on all new contracts underwritten in a reporting period as well as premium supplements and additional installment premium on existing contracts as to which the issuer has the right to call the insured obligation but has not exercised such right, whether in insurance or credit derivative contract form, which management believes GAAP gross written premiums and the net credit derivative premiums received and receivable portion of net realized gains and other settlements on

credit derivatives (Credit Derivative Realized Gains (Losses)) do not adequately measure. PVP in respect of contracts written in a specified period is defined as gross upfront and installment premiums received and the present value of gross estimated future installment premiums, discounted, in each case, at 6%. Under GAAP, financial guaranty installment premiums are discounted at a risk free rate. Additionally, under GAAP, management records future installment premiums on financial guaranty insurance contracts covering non-homogeneous pools of assets based on the contractual term of the transaction, whereas for PVP purposes, management records an estimate of the future installment premiums the Company expects to receive, which may be based upon a shorter period of time than the

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contractual term of the transaction. Actual future earned or written premiums and Credit Derivative Realized Gains (Losses) may differ from PVP due to factors including, but not limited to, changes in foreign exchange rates, prepayment speeds, terminations, credit defaults, or other factors that affect par outstanding or the ultimate maturity of an obligation.

## Reconciliation of GWP to PVP

|  | Third Quarter 2018 |        |                    |        | Third Quarter 2017 |        |                    |            |       |      |
|--|--------------------|--------|--------------------|--------|--------------------|--------|--------------------|------------|-------|------|
|  | Public Finance     |        | Structured Finance |        | Public Finance     |        | Structured Finance |            |       |      |
|  | Non U.S.           |        | Non U.S.           |        | Non U.S.           |        | Non U.S.           |            |       |      |
|  | U.S.               | - U.S. | U.S.               | - U.S. | Total U.S.         | - U.S. | U.S.               | Non - U.S. | Total |      |
|  | (in millions)      |        |                    |        |                    |        |                    |            |       |      |
| GWP  | \$24               | \$17   | \$9                | \$0    | \$50               | \$37   | \$8                | \$1        | \$(1) | \$45 |
| Less: Installment GWP and other GAAP adjustments (1) | (9)                | 17     | 4                  | 0      | 12                 | 2      | 8                  | 1          | (1)   | 10   |
| Upfront GWP  | 33                 | —      | 5                  | —      | 38                 | 35     | —                  | —          | —     | 35   |
| Plus: Installment premium PVP                        | 0                  | 12     | 2                  | 0      | 14                 | 4      | 4                  | 0          | —     | 8    |
| PVP  | \$33               | \$12   | \$7                | \$0    | \$52               | \$39   | \$4                | \$0        | \$—   | \$43 |

|  | Nine Months 2018 |        |                    |        | Nine Months 2017 |        |                    |            |       |       |
|--|------------------|--------|--------------------|--------|------------------|--------|--------------------|------------|-------|-------|
|  | Public Finance   |        | Structured Finance |        | Public Finance   |        | Structured Finance |            |       |       |
|  | Non U.S.         |        | Non U.S.           |        | Non U.S.         |        | Non U.S.           |            |       |       |
|  | U.S.             | - U.S. | U.S.               | - U.S. | Total U.S.       | - U.S. | U.S.               | Non - U.S. | Total |       |
|  | (in millions)    |        |                    |        |                  |        |                    |            |       |       |
| GWP  | \$227            | \$111  | \$168              | \$10   | \$516            | \$132  | \$92               | \$3        | \$8   | \$235 |
| Less: Installment GWP and other GAAP adjustments (1) | 9                | 72     | 10                 | 1      | 92               | (1)    | 90                 | 3          | (2)   | 90    |
| Upfront GWP  | 218              | 39     | 158                | 9      | 424              | 133    | 2                  | —          | 10    | 145   |
| Plus: Installment premium PVP (2)                    | 84               | 52     | 7                  | 0      | 143              | 4      | 56                 | 5          | 2     | 67    |
| PVP  | \$302            | \$91   | \$165              | \$9    | \$567            | \$137  | \$58               | \$5        | \$12  | \$212 |

Includes present value of new business on installment policies discounted at the prescribed GAAP discount rates, (1)GWP adjustments on existing installment policies due to changes in assumptions, any cancellations of assumed reinsurance contracts, and other GAAP adjustments.

(2)Includes PVP of credit derivatives assumed in the SGI Transaction in second quarter of 2018.

## Insured Portfolio

## Financial Guaranty Exposure

The following tables present the insured financial guaranty portfolio by asset class net of cessions to reinsurers. It includes all financial guaranty contracts outstanding as of the dates presented, regardless of the form written (i.e., credit derivative form or traditional financial guaranty insurance form) or the applicable accounting model (i.e., insurance, derivative or VIE consolidation). The Company excludes amounts attributable to loss mitigation securities from par and scheduled principal and interest payments (debt service) outstanding. These amounts are



included in the investment portfolio, because the Company manages such securities as investments and not insurance exposure. As of September 30, 2018 and December 31, 2017, the Company excluded \$1.9 billion and \$2.0 billion, respectively, of net par attributable to loss mitigation strategies. See Part I, Item 1, Financial Statements, Note 4, Outstanding Exposure, for additional information.

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## Financial Guaranty

## Net Par Outstanding and Average Internal Rating by Sector

| Sector                            | As of<br>September 30,<br>2018                  |                | As of<br>December 31,<br>2017 |                |
|-----------------------------------|---|----------------|-------------------------------|----------------|
|                                   | Net Par<br>Outstanding<br>(dollars in millions) | Avg.<br>Rating | Net Par<br>Outstanding        | Avg.<br>Rating |
| Public finance:                   |   |                |                               |                |
| U.S.:                             |   |                |                               |                |
| General obligation                | \$80,521  | A-             | \$90,705                      | A-             |
| Tax backed                        | 41,308  | A-             | 44,350                        | A-             |
| Municipal utilities               | 29,901  | A-             | 32,357                        | A-             |
| Transportation                    | 15,347  | A-             | 17,030                        | A-             |
| Higher education                  | 6,739   | A-             | 8,195                         | A              |
| Healthcare                        | 6,668   | A-             | 8,763                         | A              |
| Infrastructure finance            | 5,300   | A-             | 4,216                         | BBB+           |
| Housing revenue                   | 1,367   | BBB+           | 1,319                         | BBB+           |
| Investor-owned utilities          | 1,061   | A-             | 523                           | A-             |
| Other public finance—U.S.         | 2,206   | A-             | 1,934                         | A              |
| Total public finance—U.S.         | 190,418   | A-             | 209,392                       | A-             |
| Non-U.S.:                         |   |                |                               |                |
| Regulated utilities               | 18,561  | BBB+           | 16,689                        | BBB+           |
| Infrastructure finance            | 18,380  | BBB            | 18,234                        | BBB            |
| Pooled infrastructure             | 1,408   | AAA            | 1,561                         | AAA            |
| Other public finance              | 6,386   | A              | 6,438                         | A              |
| Total public finance—non-U.S.     | 44,735  | BBB+           | 42,922                        | BBB+           |
| Total public finance              | 235,153   | A-             | 252,314                       | A-             |
| Structured finance:               |   |                |                               |                |
| U.S.:                             |   |                |                               |                |
| RMBS                              | 4,566   | BBB-           | 4,818                         | BBB-           |
| Insurance securitizations         | 1,435   | A+             | 1,449                         | A+             |
| Consumer receivables              | 1,318   | A-             | 1,590                         | A-             |
| Pooled corporate obligations      | 1,313   | A+             | 1,347                         | A              |
| Financial products                | 1,199   | AA-            | 1,418                         | AA-            |
| Other structured finance—U.S.     | 780   | A-             | 602                           | A              |
| Total structured finance—U.S.     | 10,611  | BBB+           | 11,224                        | BBB+           |
| Non-U.S.:                         |   |                |                               |                |
| RMBS                              | 594   | A-             | 637                           | A-             |
| Pooled corporate obligations      | 126   | A              | 157                           | A+             |
| Other structured finance          | 456   | A+             | 620                           | A              |
| Total structured finance—non-U.S. | 1,176   | A              | 1,414                         | A              |
| Total structured finance          | 11,787  | A-             | 12,638                        | A-             |
| Total net par outstanding         | \$246,940                                       | A-             | \$264,952                     | A-             |



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The following tables set forth the Company's net financial guaranty portfolio by internal rating.

## Financial Guaranty Portfolio by Internal Rating

| Rating<br>Category        | As of<br>September 30,<br>2018 |                  | As of<br>December 31,<br>2017 |                  |
|---------------------------|--------------------------------|------------------|-------------------------------|------------------|
|                           | Net Par<br>Outstanding         | %<br>Outstanding | Net Par<br>Outstanding        | %<br>Outstanding |
|                           | (dollars in millions)          |                  |                               |                  |
| AAA                       | \$4,819                        | 1.9 %            | \$5,392                       | 2.1 %            |
| AA                        | 26,392                         | 10.7             | 34,212                        | 12.9             |
| A                         | 124,706                        | 50.5             | 134,396                       | 50.7             |
| BBB                       | 80,730                         | 32.7             | 78,714                        | 29.7             |
| BIG                       | 10,293                         | 4.2              | 12,238                        | 4.6              |
| Total net par outstanding | \$246,940                      | 100.0%           | \$264,952                     | 100.0%           |

## Exposure to Puerto Rico

The Company had insured exposure to general obligation bonds of the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations aggregating \$4.8 billion net par as of September 30, 2018, all of which was rated BIG. Puerto Rico experienced significant general fund budget deficits and a challenging economic environment since at least the financial crisis. In 2017, Hurricane Maria created additional challenges for Puerto Rico. Beginning on January 1, 2016, a number of Puerto Rico exposures have defaulted on bond payments, and the Company has now paid claims on all of its Puerto Rico exposures except for Puerto Rico Aqueduct and Sewer Authority (PRASA), Municipal Finance Agency (MFA) and University of Puerto Rico (U of PR). Additional information about recent developments in Puerto Rico and the individual exposures insured by the Company may be found in Part I, Item 1, Financial Statements, Note 4, Outstanding Exposure.

The Company groups its Puerto Rico exposure into three categories:

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

**Public Corporations – Certain Revenues Potentially Subject to Clawback.** The Company includes in this category the debt of public corporations for which applicable law permits the Commonwealth to claw back, subject to certain conditions and for the payment of public debt, at least a portion of the revenues supporting the bonds the Company insures. As a constitutional condition to clawback, available Commonwealth revenues for any fiscal year must be insufficient to pay Commonwealth debt service before the payment of any appropriations for that year. The Company believes that this condition has not been satisfied to date, and accordingly that the Commonwealth has not to date been entitled to claw back revenues supporting debt insured by the Company. Prior to the enactment of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), the Company sued various Puerto Rico governmental officials in the United States District Court for the District of Puerto Rico asserting that Puerto Rico's attempt to "claw back" pledged taxes is unconstitutional, and demanding declaratory and injunctive relief.

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



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Exposure to Puerto Rico  
As of September 30, 2018

|   | Net Par Outstanding |         |         |                     | Total<br>Net Par<br>Outstanding<br>(2) | Gross<br>Par<br>Outstanding |
|---|---------------------|---------|---------|---------------------|--|-----------------------------|
|   | AGM                 | AGC     | AG Re   | Eliminations<br>(1) |  |                             |
|   | (in millions)       |         |         |                     |  |                             |
| Commonwealth Constitutionally Guaranteed<br>Commonwealth of Puerto Rico - General Obligation<br>Bonds (3)                 | \$647               | \$302   | \$393   | \$ (1 )             | \$ 1,341                               | \$ 1,385                    |
| Puerto Rico Public Buildings Authority (PBA)<br>Public Corporations - Certain Revenues Potentially<br>Subject to Clawback | 9                   | 141     | 0       | (9 )                | 141                                    | 146                         |
| Puerto Rico Highways and Transportation Authority<br>(PRHTA) (Transportation revenue) (3)                                 | 233                 | 495     | 195     | (79 )               | 844                                    | 874                         |
| PRHTA (Highway revenue) (3)   | 351                 | 84      | 40      | —                   | 475                                    | 536                         |
| Puerto Rico Convention Center District Authority<br>(PRCCDA)  | —                   | 152     | —       | —                   | 152                                    | 152                         |
| Puerto Rico Infrastructure Financing Authority (PRIFA)  | —                   | 15      | 1       | —                   | 16                                     | 16                          |
| Other Public Corporations   |                     |         |         |                     |  |                             |
| Puerto Rico Electric Power Authority (PREPA) (3)  | 544                 | 72      | 232     | —                   | 848                                    | 866                         |
| PRASA   | —                   | 284     | 89      | —                   | 373                                    | 373                         |
| MFA   | 189                 | 40      | 74      | —                   | 303                                    | 349                         |
| Puerto Rico Sales Tax Financing Corporation (COFINA)<br>(3)   | 264                 | —       | 9       | —                   | 273                                    | 273                         |
| U of PR   | —                   | 1       | —       | —                   | 1                                      | 1                           |
| Total exposure to Puerto Rico   | \$2,237             | \$1,586 | \$1,033 | \$ (89 )            | \$ 4,767                               | \$ 4,971                    |

(1) Net par outstanding eliminations relate to second-to-pay policies under which an Assured Guaranty insurance subsidiary guarantees an obligation already insured by another Assured Guaranty insurance subsidiary.

(2) Includes exposure to capital appreciation bonds with a current aggregate net par outstanding of \$23 million and a fully accreted net par at maturity of \$53 million. Of these amounts, current net par of \$21 million and fully accreted net par at maturity of \$50 million relate to the COFINA and current net par of \$2 million and fully accreted net par at maturity of \$3 million relate to the Commonwealth General Obligation Bonds.

(3) As of the date of this filing, the seven-member financial oversight board established by PROMESA has certified a filing under Title III of PROMESA for these exposures.

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

Amortization Schedule  
of Net Par Outstanding of Puerto Rico  
As of September 30, 2018

|  | Scheduled Net Par Amortization |              |              |              |              |       |       |       |                |                |                |                | Total |              |
|--|--------------------------------|--------------|--------------|--------------|--------------|-------|-------|-------|----------------|----------------|----------------|----------------|-------|--------------|
|  | 2018<br>(4Q)                   | 2019<br>(1Q) | 2019<br>(2Q) | 2019<br>(3Q) | 2019<br>(4Q) | 2020  | 2021  | 2022  | 2023 -<br>2027 | 2028 -<br>2032 | 2033 -<br>2037 | 2038 -<br>2042 |       | 2043<br>2047 |
|  | (in millions)                  |              |              |              |              |       |       |       |                |                |                |                |       |              |
| Commonwealth Constitutionally Guaranteed                               |                                |              |              |              |              |       |       |       |                |                |                |                |       |              |
| Commonwealth of Puerto Rico - General Obligation Bonds                 | \$0                            | \$0          | \$0          | \$87         | \$—          | \$141 | \$15  | \$37  | \$279          | \$215          | \$567          | \$—            | \$—   | \$1,341      |
| PBA  | —                              | —            | 3            | —            | 5            | 13    | 0     | 64    | 16             | 40             | —              | —              | 141   |              |
| Public Corporations - Certain Revenues Potentially Subject to Clawback |                                |              |              |              |              |       |       |       |                |                |                |                |       |              |
| PRHTA (Transportation revenue)   | —                              | —            | 32           | —            | 25           | 18    | 28    | 120   | 157            | 279            | 185            | —              | 844   |              |
| PRHTA (Highway revenue)  | —                              | —            | 21           | —            | 22           | 35    | 6     | 100   | 112            | 179            | —              | —              | 475   |              |
| PRCCDA   | —                              | —            | —            | —            | —            | —     | —     | 19    | 24             | 109            | —              | —              | 152   |              |
| PRIFA  | —                              | —            | —            | —            | —            | —     | —     | 2     | —              | —              | 14             | —              | 16    |              |
| Other Public Corporations  |                                |              |              |              |              |       |       |       |                |                |                |                |       |              |
| PREPA  | —                              | —            | 26           | —            | 48           | 28    | 28    | 467   | 238            | 13             | —              | —              | 848   |              |
| PRASA  | —                              | —            | —            | —            | —            | —     | —     | 81    | 29             | —              | 2              | 261            | 373   |              |
| MFA  | —                              | —            | 55           | —            | 45           | 40    | 40    | 102   | 21             | —              | —              | —              | 303   |              |
| COFINA   | 0                              | 0            | 0            | 0            | 0            | (1)   | (2)   | (2)   | (5)            | (1)            | 30             | 252            | 2     | 273          |
| U of PR  | —                              | —            | 0            | —            | 0            | 0     | 0     | 0     | 1              | 0              | —              | —              | 1     |              |
| Total  | \$0                            | \$0          | \$0          | \$224        | \$0          | \$285 | \$147 | \$137 | \$1,229        | \$812          | \$1,217        | \$453          | \$263 | \$4,767      |

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Amortization Schedule  
of Net Debt Service Outstanding of Puerto Rico  
As of September 30, 2018

|  | Scheduled Net Debt Service Amortization |              |              |              |              |       |       |       |                |                |                |                   | 2038<br>-<br>2042 | 2043<br>-<br>2047 | Total |                   |
|--|---|--------------|--------------|--------------|--------------|-------|-------|-------|----------------|----------------|----------------|-------------------|-------------------|-------------------|-------|-------------------|
|  | 2018<br>(4Q)                            | 2019<br>(1Q) | 2019<br>(2Q) | 2019<br>(3Q) | 2019<br>(4Q) | 2020  | 2021  | 2022  | 2023 -<br>2027 | 2028 -<br>2032 | 2033 -<br>2037 | 2038<br>-<br>2042 |                   |                   |       | 2043<br>-<br>2047 |
|  | (in millions)                           |              |              |              |              |       |       |       |                |                |                |                   |                   |                   |       |                   |
| Commonwealth Constitutionally Guaranteed                               |   |              |              |              |              |       |       |       |                |                |                |                   |                   |                   |       |                   |
| Commonwealth of Puerto Rico - General Obligation Bonds                 | \$0                                     | \$35         | \$ 0         | \$ 121       | \$ —         | \$206 | \$74  | \$94  | \$536          | \$396          | \$649          | \$—               | \$—               | \$2,111           |       |                   |
| PBA  | —                                       | 3            | —            | 7            | —            | 12    | 20    | 6     | 92             | 31             | 45             | —                 | —                 | 216               |       |                   |
| Public Corporations - Certain Revenues Potentially Subject to Clawback |   |              |              |              |              |       |       |       |                |                |                |                   |                   |                   |       |                   |
| PRHTA (Transportation revenue)   | —                                       | 22           | —            | 54           | —            | 67    | 59    | 68    | 301            | 300            | 372            | 210               | —                 | 1,453             |       |                   |
| PRHTA (Highway revenue)  | —                                       | 13           | —            | 34           | —            | 46    | 58    | 27    | 186            | 182            | 203            | —                 | —                 | 749               |       |                   |
| PRCCDA   | —                                       | 3            | —            | 4            | —            | 7     | 7     | 7     | 54             | 54             | 121            | —                 | —                 | 257               |       |                   |
| PRIFA  | —                                       | 0            | —            | 0            | —            | 1     | 1     | 1     | 6              | 4              | 3              | 16                | —                 | 32                |       |                   |
| Other Public Corporations  |   |              |              |              |              |       |       |       |                |                |                |                   |                   |                   |       |                   |
| PREPA  | 3                                       | 17           | 3            | 43           | 3            | 87    | 63    | 62    | 588            | 273            | 15             | —                 | —                 | 1,157             |       |                   |
| PRASA  | —                                       | 10           | —            | 10           | —            | 19    | 19    | 19    | 172            | 99             | 68             | 69                | 314               | 799               |       |                   |
| MFA  | —                                       | 8            | —            | 62           | —            | 58    | 50    | 48    | 123            | 22             | —              | —                 | —                 | 371               |       |                   |
| COFINA   | 0                                       | 6            | 0            | 6            | 0            | 13    | 13    | 13    | 70             | 74             | 96             | 307               | 2                 | 600               |       |                   |
| U of PR  | —                                       | 0            | —            | 0            | —            | 0     | 0     | 0     | 0              | 1              | 0              | —                 | —                 | 1                 |       |                   |
| Total  | \$3                                     | \$117        | \$ 3         | \$341        | \$ 3         | \$516 | \$364 | \$345 | \$2,128        | \$1,436        | \$1,572        | \$602             | \$316             | \$7,746           |       |                   |

## Financial Guaranty Exposure to U.S. Residential Mortgage-Backed Securities

The tables below provide information on the risk ratings and certain other risk characteristics of the Company's financial guaranty insurance, FG VIE and credit derivative U.S. RMBS exposures. As of September 30, 2018, U.S. RMBS exposures represent 2% of the total net par outstanding, and BIG U.S. RMBS represent 25% of total BIG net par outstanding. See Part I, Item 1, Financial Statements, Note 5, Expected Loss to be Paid, for a discussion of expected losses to be paid on U.S. RMBS exposures.

## Distribution of U.S. RMBS by Rating and Type of Exposure as of September 30, 2018

| Ratings: | Prime<br>First<br>Lien | Alt-A<br>First Lien | Option<br>ARMs | Subprime<br>First Lien | Second<br>Lien | Total Net<br>Par<br>Outstanding |
|----------|------------------------|---------------------|----------------|------------------------|----------------|---------------------------------|
|          | (in millions)          |                     |                |                        |                |                                 |
| AAA      | \$4                    | \$ 136              | \$ 22          | \$ 1,125               | \$ 2           | \$ 1,289                        |
| AA       | 30                     | 145                 | 22             | 224                    | —              | 421                             |
| A        | 0                      | —                   | 0              | 101                    | 0              | 101                             |
| BBB      | 0                      | 11                  | —              | 29                     | 155            | 196                             |
| BIG      | 108                    | 434                 | 49             | 1,167                  | 802            | 2,560                           |



Total exposures \$142 \$ 727 \$ 93 \$ 2,645 \$ 959 \$ 4,566

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## Distribution of U.S. RMBS by Year Insured and Type of Exposure as of September 30, 2018

| Year insured:   | Prime First Lien<br>(in millions) | Alt-A First Lien | Option ARMs | Subprime First Lien | Second Lien | Total Net Par Outstanding |
|-----------------|-----------------------------------|------------------|-------------|---------------------|-------------|---------------------------|
| 2004 and prior  | \$ 29                             | \$ 24            | \$ 2        | \$ 752              | \$ 74       | \$ 880                    |
| 2005            | 63                                | 248              | 30          | 236                 | 183         | 760                       |
| 2006            | 50                                | 51               | 15          | 489                 | 282         | 887                       |
| 2007            | —                                 | 404              | 46          | 1,107               | 420         | 1,977                     |
| 2008            | —                                 | —                | —           | 61                  | —           | 61                        |
| Total exposures | \$ 142                            | \$ 727           | \$ 93       | \$ 2,645            | \$ 959      | \$ 4,566                  |

## Financial Guaranty Exposure to the U.S. Virgin Islands

See Part I, Item 1, Financial Statements, Note 4, Outstanding Exposure.

## Non-Financial Guaranty Exposure

The Company also provides non-financial guaranty insurance and reinsurance on transactions with similar risk profiles to its structured finance exposures written in financial guaranty form. All non-financial guaranty exposures shown in the table below are rated investment grade internally.

## Non-Financial Guaranty Exposure

|  | Gross Exposure           |                         | Net Exposure             |                         |
|--|--------------------------|-------------------------|--------------------------|-------------------------|
|  | As of September 30, 2018 | As of December 31, 2017 | As of September 30, 2018 | As of December 31, 2017 |
|  | (in millions)            |                         |                          |                         |
| Capital relief triple-X life reinsurance (1) | \$ 883                   | \$ 773                  | \$ 766                   | \$ 675                  |
| Aircraft RVI policies                        | 340                      | 201                     | 218                      | 140                     |

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

## Monoline and Reinsurer Exposures

The Company has exposure to other monolines and reinsurers through reinsurance arrangements (both as a ceding company and as an assuming company) and in "second-to-pay" transactions. Ceded par outstanding represents the portion of insured risk ceded to external reinsurers. Under these relationships, the Company has ceded a portion of its insured risk to the reinsurer in exchange for the reinsurer receiving a share of the Company's premiums for the insured risk (typically, net of a ceding commission). The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. The Company's ceded

contracts generally allow the Company to recapture ceded financial guaranty business after certain triggering events, such as reinsurer downgrades.

In accordance with U.S. statutory accounting requirements and U.S. insurance laws and regulations, in order for the Company to receive credit for liabilities ceded to reinsurers domiciled outside of the U.S., such reinsurers must secure their liabilities to the Company. These reinsurers are required to post collateral for the benefit of the Company in an amount at least equal to the sum of their ceded unearned premium reserve, loss reserves and contingency reserves, all calculated on a statutory basis of accounting. In addition, certain authorized reinsurers post collateral on terms negotiated with the Company. The total collateral posted by all non-affiliated reinsurers as of September 30, 2018 was approximately \$85 million.

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Assumed par outstanding represents the amount of par assumed by the Company from third party insurers and reinsurers, including other monoline financial guaranty companies. Under these relationships, the Company assumes a portion of the ceding company's insured risk in exchange for a premium. The Company may be exposed to risk in this portfolio in that the Company may be required to pay losses without a corresponding premium in circumstances where the ceding company is experiencing financial distress and is unable to pay premiums.

In "second-to-pay" transactions, the Company provides insurance on an obligation that is already insured by another financial guarantor. In that case, if the underlying obligor and the financial guarantor both fail to pay an amount scheduled to be paid, the Company would be obligated to pay. The Company underwrites these transactions based on the underlying obligation, without regard to the financial guarantor. See Part I, Item 1, Financial Statements, Note 13, Reinsurance and Other Monoline Exposures, for additional information.

Liquidity and Capital Resources

Liquidity Requirements and Sources

AGL and its Holding Company Subsidiaries

The liquidity of AGL, AGUS and AGMH is largely dependent on dividends from their operating subsidiaries and their access to external financing. The liquidity requirements of these entities include the payment of operating expenses, interest on debt issued by AGUS and AGMH, and dividends on AGL's common shares. AGL and its holding company subsidiaries may also require liquidity to make periodic capital investments in their operating subsidiaries, purchase outstanding Company debt or, in the case of AGL, to repurchase its common shares pursuant to its share repurchase authorization. In the ordinary course of business, the Company evaluates its liquidity needs and capital resources in light of holding company expenses and dividend policy, as well as rating agency considerations. The Company also subjects its cash flow projections and its assets to a stress test, maintaining a liquid asset balance of one time its stressed operating company net cash flows. Management believes that AGL will have sufficient liquidity to satisfy its needs over the next twelve months. See "—Distributions From Subsidiaries" below for a discussion of the dividend restrictions of its insurance company subsidiaries.

The following table presents significant holding company cash flow activity (other than operating expenses) related to distributions from subsidiaries and outflows for debt service, dividends to AGL shareholders and other capital management activities.

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## AGL and U.S. Holding Company Subsidiaries

## Significant Cash Flow Items

|                                    | Third<br>Quarter<br>2018 |       | Nine<br>Months<br>2017 |        |
|------------------------------------|--------------------------|-------|------------------------|--------|
|                                    | 2018                     | 2017  | 2018                   | 2017   |
|                                    | (in millions)            |       |                        |        |
| Intercompany sources (uses):       |                          |       |                        |        |
| Distributions to AGL from:         |                          |       |                        |        |
| AG Re                              | \$18                     | \$45  | \$98                   | \$125  |
| AGUS                               | 140                      | 70    | 362                    | 390    |
| Distributions to AGUS from:        |                          |       |                        |        |
| AGC (1)                            | 15                       | 15    | 291                    | 66     |
| AGMH                               | —                        | 55    | 50                     | 128    |
| Distributions to AGMH from:        |                          |       |                        |        |
| AGM                                | 58                       | 63    | 131                    | 142    |
| Other subsidiaries (2)             | 34                       | —     | 34                     | —      |
| External sources (uses):           |                          |       |                        |        |
| Dividends paid to AGL shareholders | (18 )                    | (17 ) | (55 )                  | (53 )  |
| Repurchases of common shares (3)   | (130)                    | (80 ) | (380)                  | (431 ) |
| Interest paid by AGMH and AGUS (4) | (9 )                     | (8 )  | (67 )                  | (53 )  |
| Purchase of AGMH's debt by AGUS    | (49 )                    | (22 ) | (72 )                  | (27 )  |

(1) Includes repurchase of \$200 million in shares of its common stock from its direct parent, AGUS, in 2018.

(2) See Part I, Item 1, Financial Statements, Note 10, Investments and Cash, for a description of the Company's minority interest in the parent company of TMC LLC, which it sold in Third Quarter 2018.

(3) See Part I, Item 1, Financial Statements, Note 17, Shareholders' Equity, for additional information about share repurchases and authorizations.

(4) See Long-Term Obligations below for interest paid by subsidiary.

## Distributions From Subsidiaries

The Company anticipates that for the next twelve months, amounts paid by AGL's direct and indirect insurance company subsidiaries as dividends or other distributions will be a major source of its liquidity. The insurance company subsidiaries' ability to pay dividends depends upon their financial condition, results of operations, cash requirements, other potential uses for such funds, and compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of their states of domicile. Dividend restrictions applicable to AGC, AGM, Municipal Assurance Corp. (MAC) and to AG Re are described in Part I, Item 1, Financial Statements, Note 11, Insurance Company Regulatory Requirements.

Dividend restrictions by insurance company subsidiary are as follows:

The maximum amount available during 2018 for AGM to distribute as dividends without regulatory approval is estimated to be approximately \$171 million, of which \$40 million is estimated to be available for distribution in the fourth quarter of 2018.

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The maximum amount available during 2018 for AGC to distribute as ordinary dividends is approximately \$133 million, of which approximately \$42 million is available for distribution in the fourth quarter of 2018.

The maximum amount available during 2018 for MAC to distribute as dividends to Municipal Assurance Holdings Inc., which is owned by AGM and AGC, without regulatory approval is estimated to be approximately \$27 million, all of which has already been distributed.

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Based on the applicable law and regulations, in 2018 AG Re has the capacity to (i) make capital distributions in an aggregate amount up to \$128 million without the prior approval of the Bermuda Monetary Authority and (ii) declare and pay dividends in an aggregate amount up to approximately \$324 million as of September 30, 2018. Such dividend capacity can be further limited by the actual amount of AG Re's unencumbered assets, which amount changes from time to time due in part to collateral posting requirements. As of September 30, 2018, AG Re had unencumbered assets of approximately \$437 million.

Generally, dividends paid by a U.S. company to a Bermuda holding company are subject to a 30% withholding tax. After AGL became tax resident in the U.K., it became subject to the tax rules applicable to companies resident in the U.K., including the benefits afforded by the U.K.'s tax treaties. The income tax treaty between the U.K. and the U.S. reduces or eliminates the U.S. withholding tax on certain U.S. sourced investment income (to 5% or 0%), including dividends from U.S. subsidiaries to U.K. resident persons entitled to the benefits of the treaty.

## External Financing

From time to time, AGL and its subsidiaries have sought external debt or equity financing in order to meet their obligations. External sources of financing may or may not be available to the Company, and if available, the cost of such financing may not be acceptable to the Company.

## Intercompany Loans and Guarantees

From time to time, AGL and its subsidiaries have entered into intercompany loan facilities. For example, on October 25, 2013, AGL, as borrower, and AGUS, as lender, entered into a revolving credit facility pursuant to which AGL may, from time to time, borrow for general corporate purposes. Under the credit facility, AGUS committed to lend a principal amount not exceeding \$225 million in the aggregate. In September 2018, AGL and AGUS amended the revolving credit facility to extend the commitment until October 25, 2023 (the loan commitment termination date). The unpaid principal amount of each loan will bear semi-annual interest at a fixed rate equal to 100% of the then applicable interest rate as determined under Internal Revenue Code Section 1274(d), and interest on all loans will be computed for the actual number of days elapsed on the basis of a year consisting of 360 days. Accrued interest on all loans will be paid on the last day of each June and December, beginning on December 31, 2013, and at maturity. AGL must repay the then unpaid principal amounts of the loans, if any, by the third anniversary of the loan termination date. AGL has not drawn upon the credit facility.

In addition, in 2012 AGUS borrowed \$90 million from its affiliate AGRO to fund the acquisition of MAC. In 2016, the parties agreed to extend the maturity date of the loan from May 2017 to November 2019. During 2017, AGUS repaid \$10 million in outstanding principal as well as accrued and unpaid interest. As of September 30, 2018, \$60 million remained outstanding.

Furthermore, AGL fully and unconditionally guarantees the payment of the principal of, and interest on, the \$1,130 million aggregate principal amount of senior notes issued by AGUS and AGMH, and the \$450 million aggregate principal amount of junior subordinated debentures issued by AGUS and AGMH, in each case, as described under "Commitments and Contingencies -- Long-Term Debt Obligations" below.

## Cash and Investments

As of September 30, 2018, AGL had \$48 million in cash and short-term investments. AGUS and AGMH had a total of \$149 million in cash and short-term investments. In addition, the Company's U.S. holding companies have \$99 million in fixed-maturity securities (excluding AGUS's investment in AGMH's debt) with weighted average duration of 0.4 years.

Insurance Company Subsidiaries

Liquidity of the insurance company subsidiaries is primarily used to pay for:

- operating expenses,
- claims on the insured portfolio,
- dividends or other distributions to AGL, AGUS and/or AGMH, as applicable,
- posting of collateral in connection with reinsurance and credit derivative transactions,
- reinsurance premiums,
- principal of and, where applicable, interest on surplus notes, and
- capital investments in their own subsidiaries, where appropriate.



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Management believes that its subsidiaries' liquidity needs for the next twelve months can be met from current cash, short-term investments and operating cash flow, including premium collections and coupon payments as well as scheduled maturities and paydowns from their respective investment portfolios. The Company targets a balance of its most liquid assets including cash and short-term securities, Treasuries, agency RMBS and pre-refunded municipal bonds equal to 1.5 times its projected operating company cash flow needs over the next four quarters. The Company intends to hold and has the ability to hold temporarily impaired debt securities until the date of anticipated recovery.

Beyond the next twelve months, the ability of the operating subsidiaries to declare and pay dividends may be influenced by a variety of factors, including market conditions, insurance regulations and rating agency capital requirements and general economic conditions.

Insurance policies issued provide, in general, that payments of principal, interest and other amounts insured may not be accelerated by the holder of the obligation. Amounts paid by the Company therefore are typically in accordance with the obligation's original payment schedule, unless the Company accelerates such payment schedule, at its sole option.

Payments made in settlement of the Company's obligations arising from its insured portfolio may, and often do, vary significantly from year-to-year, depending primarily on the frequency and severity of payment defaults and whether the Company chooses to accelerate its payment obligations in order to mitigate future losses.

## Claims (Paid) Recovered

|   | Third Quarter |         | Nine Months |         |
|---|---------------|---------|-------------|---------|
|   | 2018          | 2017    | 2018        | 2017    |
|   | (in millions) |         |             |         |
| Public finance                                  | \$(251)       | \$(222) | \$(384)     | \$(251) |
| Structured finance:                             |               |         |             |         |
| U.S. RMBS                                       | 17            | 13      | 152         | 40      |
| Other structured finance                        | (7 )          | 0       | (6 )        | (14 )   |
| Structured finance                              | 10            | 13      | 146         | 26      |
| Claims (paid) recovered, net of reinsurance (1) | \$(241)       | \$(209) | \$(238)     | \$(225) |

(1) Includes \$1 million and \$3 million paid for consolidated FG VIEs for Third Quarter 2018 and 2017, respectively, and \$2 million and \$7 million paid for consolidated FG VIEs for Nine Months 2018 and 2017, respectively.

In addition, the Company has net par exposure to the general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$4.8 billion, all of which is rated BIG. Puerto Rico has experienced significant general fund budget deficits in recent years. Beginning in 2016, the Commonwealth and certain related authorities and public corporations have defaulted on obligations to make payments on its debt. In addition to high debt levels, Puerto Rico faces a challenging economic environment, exacerbated by the impact of hurricane Maria in September 2017. Information regarding the Company's exposure to the Commonwealth of Puerto Rico and its related authorities and public corporations is set forth in Part I, Item 1, Financial Statements, Note 4, Outstanding Exposure.

In connection with the acquisition of AGMH, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds). The tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the strip coverage) from its own sources. AGM issued financial guaranty insurance policies (known as strip policies) that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. Following such events, AGM can then seek reimbursement of its strip policy payments from the tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

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Currently, all the leveraged lease transactions in which AGM acts as strip coverage provider are breaching a rating trigger related to AGM and are subject to early termination. However, early termination of a lease does not result in a draw on the AGM policy if the tax-exempt entity makes the required termination payment. If all the leases were to terminate early and the tax-exempt entities did not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of approximately \$827 million as of September 30, 2018. To date, none of the leveraged lease transactions that involve AGM has experienced an early termination due to a lease default and a claim on the AGM policy. At September 30, 2018, approximately \$1.6 billion of cumulative strip par exposure had been terminated since 2008 on a consensual basis. The consensual terminations have resulted in no claims on AGM.

The terms of the Company's CDS contracts generally are modified from standard CDS contract forms approved by International Swaps and Derivative Association, Inc. in order to provide for payments on a scheduled "pay-as-you-go" basis and to replicate the terms of a traditional financial guaranty insurance policy. However, the Company may also be required to pay if the obligor becomes bankrupt or if the reference obligation were restructured if, after negotiation, those credit events are specified in the documentation for the credit derivative transactions. Furthermore, the Company may be required to make a payment due to an event that is unrelated to the performance of the obligation referenced in the credit derivative. If events of default or termination events specified in the credit derivative documentation were to occur, the Company may be required to make a cash termination payment to its swap counterparty upon such termination. Any such payment would probably occur prior to the maturity of the reference obligation and be in an amount larger than the amount due for that period on a "pay-as-you-go" basis.

The transaction documentation with one counterparty for \$333 million of the CDS insured by AGC requires AGC to post collateral, subject to a cap, to secure its obligation to make payments under such contracts. As of September 30, 2018, AGC had posted \$1 million of collateral to satisfy these requirements and the maximum posting requirement was \$300 million.

## Condensed Consolidated Cash Flows

## Condensed Consolidated Cash Flow Summary

|  | Third<br>Quarter |        | Nine Months |        |
|--|------------------|--------|-------------|--------|
|  | 2018             | 2017   | 2018        | 2017   |
|  | (in millions)    |        |             |        |
| Net cash flows provided by (used in) operating activities before effects of FG VIE consolidation | \$ (93)          | \$ 150 | \$ 345      | \$ 338 |
| Effect of FG VIE consolidation   | 1                | 6      | 7           | 16     |
| Net cash flows provided by (used in) operating activities - reported                             | (92 )            | 156    | 352         | 354    |
| Net cash flows provided by (used in) investing activities before effects of FG VIE consolidation | 180              | (161 ) | 111         | 124    |
| Effect of FG VIE consolidation   | 28               | 32     | 83          | 108    |
| Net cash flows provided by (used in) investing activities - reported                             | 208              | (129 ) | 194         | 232    |
| Net cash flows provided by (used in) financing activities before effects of FG VIE consolidation | (193 )           | (119 ) | (516 )      | (521 ) |
| Effect of FG VIE consolidation   | (29 )            | (38 )  | (90 )       | (124 ) |
| Net cash flows provided by (used in) financing activities - reported (1)                         | (222 )           | (157 ) | (606 )      | (645 ) |
| Effect of exchange rate changes  | (1 )             | 1      | (2 )        | 4      |
| Cash and restricted cash at beginning of period  | 189              | 201    | 144         | 127    |
| Total cash and restricted cash at the end of the period  | \$ 82            | \$ 72  | \$ 82       | \$ 72  |

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(1) Claims paid on consolidated FG VIEs are presented in the condensed consolidated cash flow statements as a component of paydowns on FG VIEs' liabilities in financing activities as opposed to operating activities.

Excluding net cash flows from consolidated FG VIEs, cash inflows from operating activities increased in Nine Months 2018 compared with Nine Months 2017 due primarily to cash received in connection with the SGI Transaction (see Part I, Item

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1, Financial Statements, Note 2, Assumption of Insured Portfolio and Business Combinations, for additional information), and lower tax payments, which were partially offset by lower commutation premiums received, lower premium collections and higher interest. The decline in cash flow from operating activities in Third Quarter 2018, compared with Third Quarter 2017, was mainly due to lower commutation premiums. Cash flow from operations for all periods were adversely affected by claim payments on Puerto Rico exposures.

Investing activities consisted of primarily net sales (purchases) of fixed-maturity and short-term investment securities acquisitions, and paydowns on FG VIEs' assets.

Financing activities consisted primarily of share repurchases, which were \$380 million and \$431 million in Nine Months 2018 and Nine Months 2017, respectively, and paydowns of FG VIEs' liabilities.

From October 1, 2018 through November 9, 2018, the Company repurchased an additional \$49 million of common shares. The Board of Directors authorized, on August 1, 2018, an additional \$250 million of share repurchases. As of November 9, 2018, after combining the remaining authorization and the new authorization, the Company was authorized to purchase \$169 million of its common shares. For more information about the Company's share repurchases and authorizations, see Part I, Item 1, Financial Statements, Note 17, Shareholders' Equity.

## Commitments and Contingencies

## Leases

AGL and its subsidiaries lease office space and certain other items. Future cash payments associated with contractual obligations pursuant to operating leases for office space have not materially changed since December 31, 2017.

## Long-Term Debt Obligations

The outstanding principal and interest paid on long-term debt were as follows:

Principal Outstanding  
and Interest Paid on Long-Term Debt

|                    | Principal Amount           |                                  | Interest Paid            |                          |                        |                        |
|--------------------|----------------------------|----------------------------------|--------------------------|--------------------------|------------------------|------------------------|
|                    | As of<br>September<br>2018 | As of<br>December<br>31,<br>2017 | Third<br>Quarter<br>2018 | Third<br>Quarter<br>2017 | Nine<br>Months<br>2018 | Nine<br>Months<br>2017 |
|                    | (in millions)              |                                  |                          |                          |                        |                        |
| AGUS               | \$850                      | \$ 850                           | \$2                      | \$ 1                     | \$37                   | \$ 23                  |
| AGMH               | 730                        | 730                              | 7                        | 7                        | 30                     | 30                     |
| AGM                | 5                          | 6                                | 0                        | 0                        | 0                      | 0                      |
| Purchased debt (1) | (100 )                     | (28 )                            | 0                        | 0                        | (1 )                   | 0                      |
| Total              | \$1,485                    | \$ 1,558                         | \$9                      | \$ 8                     | \$66                   | \$ 53                  |

Represents principal amount of Junior Subordinated Debentures issued by AGMH that has been purchased by (1)AGUS. See Part I, Item 1, Financial Statements, Note 15, Long-Term Debt and Credit Facilities, for additional information.

Issued by AGUS:

7% Senior Notes. On May 18, 2004, AGUS issued \$200 million of 7% Senior Notes due 2034 for net proceeds of \$197 million. Although the coupon on the Senior Notes is 7%, the effective rate is approximately 6.4%, taking into account the effect of a cash flow hedge. The notes are redeemable, in whole or in part, at their principal amount plus accrued and unpaid interest at the date of redemption or, if greater, the make-whole redemption price.

5% Senior Notes. On June 20, 2014, AGUS issued \$500 million of 5% Senior Notes due 2024 for net proceeds of \$495 million. The net proceeds from the sale of the notes were used for general corporate purposes, including the purchase of common shares of AGL. The notes are redeemable, in whole or in part, at their principal amount plus accrued and unpaid interest at the date of redemption or, if greater, the make-whole redemption price.

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Series A Enhanced Junior Subordinated Debentures. On December 20, 2006, AGUS issued \$150 million of Debentures due 2066. The Debentures paid a fixed 6.4% rate of interest until December 15, 2016, and thereafter pay a floating rate of interest, reset quarterly, at a rate equal to three month London Interbank Offered Rate (LIBOR) plus a margin equal to 2.38%. AGUS may select at one or more times to defer payment of interest for one or more consecutive periods for up to ten years. Any unpaid interest bears interest at the then applicable rate. AGUS may not defer interest past the maturity date. The debentures are redeemable, in whole or in part, at their principal amount plus accrued and unpaid interest to the date of redemption.

Issued by AGMH:

6 7/8% QUIBS. On December 19, 2001, AGMH issued \$100 million face amount of 6 7/8% QUIBS due December 15, 2101, which are redeemable without premium or penalty in whole or in part at their principal amount plus accrued and unpaid interest up to but not including the date of redemption.

6.25% Notes. On November 26, 2002, AGMH issued \$230 million face amount of 6.25% Notes due November 1, 2102, which are redeemable without premium or penalty in whole or in part at their principal amount plus accrued and unpaid interest up to but not including the date of redemption.

5.6% Notes. On July 31, 2003, AGMH issued \$100 million face amount of 5.6% Notes due July 15, 2103, which are redeemable without premium or penalty in whole or in part at their principal amount plus accrued and unpaid interest up to but not including the date of redemption.

Junior Subordinated Debentures. On November 22, 2006, AGMH issued \$300 million face amount of Junior Subordinated Debentures with a scheduled maturity date of December 15, 2036 and a final repayment date of December 15, 2066. The final repayment date of December 15, 2066 may be automatically extended up to four times in five-year increments provided certain conditions are met. The debentures are redeemable, in whole or in part, at any time prior to December 15, 2036 at their principal amount plus accrued and unpaid interest to the date of redemption or, if greater, the make-whole redemption price. Interest on the debentures will accrue from November 22, 2006 to December 15, 2036 at the annual rate of 6.4%. If any amount of the debentures remains outstanding after December 15, 2036, then the principal amount of the outstanding debentures will bear interest at a floating interest rate equal to one-month LIBOR plus 2.215% until repaid. AGMH may elect at one or more times to defer payment of interest on the debentures for one or more consecutive interest periods that do not exceed ten years. In connection with the completion of this offering, AGMH entered into a replacement capital covenant for the benefit of persons that buy, hold or sell a specified series of AGMH long-term indebtedness ranking senior to the debentures. Under the covenant, the debentures will not be repaid, redeemed, repurchased or defeased by AGMH or any of its subsidiaries on or before the date that is twenty years prior to the final repayment date, except to the extent that AGMH has received proceeds from the sale of replacement capital securities. The proceeds from this offering were used to pay a dividend to the shareholders of AGMH.

## Committed Capital Securities

Each of AGC and AGM have entered into put agreements with four separate custodial trusts allowing AGC and AGM, respectively, to issue an aggregate of \$200 million of non-cumulative redeemable perpetual preferred securities to the trusts in exchange for cash. Each custodial trust was created for the primary purpose of issuing \$50 million face amount of CCS, investing the proceeds in high-quality assets and entering into put options with AGC or AGM, as applicable. The Company does not consider itself to be the primary beneficiary of the trusts and the trusts are not consolidated in Assured Guaranty's financial statements.

The trusts provide AGC and AGM access to new equity capital at their respective sole discretion through the exercise of the put options. Upon AGC's or AGM's exercise of its put option, the relevant trust will liquidate its portfolio of eligible assets and use the proceeds to purchase the AGC or AGM preferred stock, as applicable. AGC or AGM may use the proceeds from its sale of preferred stock to the trusts for any purpose, including the payment of claims. The put agreements have no scheduled termination date or maturity. However, each put agreement will terminate if (subject to certain grace periods) specified events occur. Both AGC and AGM continue to have the ability to exercise their respective put options and cause the related trusts to purchase their preferred stock.

Prior to 2008 or 2007, the amounts paid on the CCS were established through an auction process. All of those auctions failed in 2008 or 2007, and the rates paid on the CCS increased to their respective maximums. The annualized rate on the AGC CCS is one-month LIBOR plus 250 basis points, and the annualized rate on the AGM Committed Preferred Trust Securities (CPS) is one-month LIBOR plus 200 basis points.



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## Investment Portfolio

The Company's principal objectives in managing its investment portfolio are to support the highest possible ratings for each operating company, to manage investment risk within the context of the underlying portfolio of insurance risk, to maintain sufficient liquidity to cover unexpected stress in the insurance portfolio, and to maximize after-tax net investment income.

The Company's fixed-maturity securities and short-term investments had a duration of 5.0 years as of September 30, 2018 and 5.3 years as of December 31, 2017. Generally, the Company's fixed-maturity securities are designated as available-for-sale. For more information about the Investment Portfolio and a detailed description of the Company's valuation of investments see Part I, Item 1, Financial Statements, Note 10, Investments and Cash.

Fixed-Maturity Securities and Short-Term Investments  
by Security Type

|   | As of<br>September 30, 2018 |                         | As of December 31,<br>2017 |                         |
|---|-----------------------------|-------------------------|----------------------------|-------------------------|
|   | Amortize<br>Cost            | Estimated<br>Fair Value | Amortize<br>Cost           | Estimated<br>Fair Value |
|   | (in millions)               |                         |                            |                         |
| Fixed-maturity securities:                      |                             |                         |                            |                         |
| Obligations of state and political subdivisions | \$4,885                     | \$ 4,988                | \$5,504                    | \$ 5,760                |
| U.S. government and agencies                    | 235                         | 242                     | 272                        | 285                     |
| Corporate securities                            | 2,187                       | 2,147                   | 1,973                      | 2,018                   |
| Mortgage-backed securities (1):                 |                             |                         |                            |                         |
| RMBS  | 967                         | 948                     | 852                        | 861                     |
| Commercial mortgage-backed securities (CMBS)    | 537                         | 528                     | 540                        | 549                     |
| Asset-backed securities                         | 893                         | 1,055                   | 730                        | 896                     |
| Non-U.S. government securities                  | 302                         | 284                     | 316                        | 305                     |
| Total fixed-maturity securities                 | 10,006                      | 10,192                  | 10,187                     | 10,674                  |
| Short-term investments                          | 738                         | 738                     | 627                        | 627                     |
| Total fixed-maturity and short-term investments | \$10,744                    | \$ 10,930               | \$10,814                   | \$ 11,301               |

(1) U.S. government-agency obligations were approximately 47% of mortgage backed securities as of September 30, 2018 and 39% as of December 31, 2017, based on fair value.

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The following tables summarize, for all fixed-maturity securities in an unrealized loss position as of September 30, 2018 and December 31, 2017, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position.

## Fixed-Maturity Securities

## Gross Unrealized Loss by Length of Time

As of September 30, 2018

|   | Less than 12 months   |                 | 12 months or more |                 | Total      |                 |
|---|-----------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value            | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
|   | (dollars in millions) |                 |                   |                 |            |                 |
| Obligations of state and political subdivisions | \$1,305               | \$ (25 )        | \$ 273            | \$ (13 )        | \$1,578    | \$ (38 )        |
| U.S. government and agencies                    | 20                    | 0               | 25                | (1 )            | 45         | (1 )            |
| Corporate securities                            | 1,144                 | (26 )           | 260               | (29 )           | 1,404      | (55 )           |
| Mortgage-backed securities:                     |                       |                 |                   |                 |            |                 |
| RMBS  | 386                   | (8 )            | 331               | (27 )           | 717        | (35 )           |
| CMBS  | 229                   | (5 )            | 80                | (6 )            | 309        | (11 )           |
| Asset-backed securities                         | 280                   | (1 )            | 11                | (1 )            | 291        | (2 )            |
| Non-U.S. government securities                  | 86                    | (4 )            | 101               | (17 )           | 187        | (21 )           |
| Total   | \$3,450               | \$ (69 )        | \$ 1,081          | \$ (94 )        | \$4,531    | \$ (163 )       |
| Number of securities (1)                        |                       | 1,003           |                   | 311             |            | 1,283           |
| Number of securities with OTTI                  |                       | 23              |                   | 16              |            | 39              |

## Fixed-Maturity Securities

## Gross Unrealized Loss by Length of Time

As of December 31, 2017

|   | Less than 12 months   |                 | 12 months or more |                 | Total      |                 |
|---|-----------------------|-----------------|-------------------|-----------------|------------|-----------------|
|   | Fair Value            | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
|   | (dollars in millions) |                 |                   |                 |            |                 |
| Obligations of state and political subdivisions | \$166                 | \$ (4 )         | \$ 281            | \$ (7 )         | \$447      | \$ (11 )        |
| U.S. government and agencies                    | 151                   | 0               | 18                | (1 )            | 169        | (1 )            |
| Corporate securities                            | 201                   | (1 )            | 240               | (17 )           | 441        | (18 )           |
| Mortgage-backed securities:                     |                       |                 |                   |                 |            |                 |
| RMBS  | 191                   | (5 )            | 213               | (12 )           | 404        | (17 )           |
| CMBS  | 29                    | 0               | 80                | (3 )            | 109        | (3 )            |
| Asset-backed securities                         | 48                    | 0               | 3                 | 0               | 51         | 0               |
| Non-U.S. government securities                  | 20                    | 0               | 140               | (17 )           | 160        | (17 )           |
| Total   | \$806                 | \$ (10 )        | \$ 975            | \$ (57 )        | \$1,781    | \$ (67 )        |
| Number of securities (1)                        |                       | 244             |                   | 264             |            | 499             |
| Number of securities with OTTI (1)              |                       | 17              |                   | 15              |            | 31              |

The number of securities does not add across because lots consisting of the same securities have been purchased at (1) different times and appear in both categories above (i.e., less than 12 months and 12 months or more). If a security appears in both categories, it is counted only once in the total column.

Of the securities in an unrealized loss position for 12 months or more as of September 30, 2018, 35 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of September 30, 2018 was

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\$49 million. As of December 31, 2017, of the securities in an unrealized loss position for 12 months or more, 28 securities had unrealized losses greater than 10% of book value with an unrealized loss of \$27 million. The Company considered the credit quality, cash flows, interest rate movements, ability to hold security to recovery and intent to sell a security in determining whether a security had a credit loss. The Company determined that the unrealized losses recorded as of September 30, 2018 and December 31, 2017 were yield-related and not the result of OTTI.

Changes in interest rates affect the value of the Company's fixed-maturity portfolio. As interest rates fall, the fair value of fixed-maturity securities generally increases and as interest rates rise, the fair value of fixed-maturity securities generally decreases. The Company's portfolio of fixed-maturity securities consists primarily of high-quality, liquid instruments.

The amortized cost and estimated fair value of the Company's available-for-sale fixed-maturity securities, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities  
by Contractual Maturity  
As of September 30, 2018

|                                       | Amortized<br>Cost | Estimated<br>Fair Value |
|---------------------------------------|-------------------|-------------------------|
|                                       | (in millions)     |                         |
| Due within one year                   | \$229             | \$229                   |
| Due after one year through five years | 1,499             | 1,492                   |
| Due after five years through 10 years | 2,426             | 2,411                   |
| Due after 10 years                    | 4,348             | 4,584                   |
| Mortgage-backed securities:           |                   |                         |
| RMBS                                  | 967               | 948                     |
| CMBS                                  | 537               | 528                     |
| Total                                 | \$10,006          | \$10,192                |

The following table summarizes the ratings distributions of the Company's investment portfolio as of September 30, 2018 and December 31, 2017. Ratings reflect the lower of the Moody's Investors Service, Inc. (Moody's) and S&P Global Ratings, a division of Standard & Poor's Financial Services LLC (S&P) classifications, except for bonds purchased for loss mitigation or other risk management strategies, which use Assured Guaranty's internal ratings classifications.

Distribution of  
Fixed-Maturity Securities by Rating

| Rating  | As of<br>September 30,<br>2018 |   | As of<br>December 31,<br>2017 |   |
|---------|--------------------------------|---|-------------------------------|---|
| AAA     | 15.6                           | % | 14.3                          | % |
| AA      | 48.5                           |   | 52.4                          |   |
| A       | 19.9                           |   | 18.9                          |   |
| BBB     | 4.4                            |   | 3.4                           |   |
| BIG (1) | 11.1                           |   | 10.5                          |   |

|           |       |   |       |   |
|-----------|-------|---|-------|---|
| Not rated | 0.5   |   | 0.5   |   |
| Total     | 100.0 | % | 100.0 | % |

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(1) Includes primarily loss mitigation and other risk management assets. See Part I, Item I, Financial Statements, Note 10, Investments and Cash, for additional information.

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Based on fair value, investments and restricted cash that are either held in trust for the benefit of third party ceding insurers in accordance with statutory requirements, placed on deposit to fulfill state licensing requirements, or otherwise pledged or restricted total \$262 million and \$287 million, as of September 30, 2018 and December 31, 2017, respectively. The investment portfolio also contains securities that are held in trust by certain AGL subsidiaries for the benefit of other AGL subsidiaries in accordance with statutory and regulatory requirements in the amount of \$1,725 million and \$1,677 million, based on fair value, as of September 30, 2018 and December 31, 2017, respectively.

In the first quarter of 2018, the Company terminated all of the CDS contracts with a counterparty as to which it had collateral posting obligations, and the collateral that the Company had been posting to that counterparty was all returned to the Company. The Company still has collateral posting obligations with respect to one counterparty. See Part I, Item I, Financial Statements, Note 8, Contracts Accounted for as Credit Derivatives, for additional information.

### Liquidity Arrangements with respect to AGMH's former Financial Products Business

AGMH's former financial products segment had been in the business of borrowing funds through the issuance of guaranteed investment contracts (GICs) and medium term notes and reinvesting the proceeds in investments that met AGMH's investment criteria. The financial products business also included the equity payment undertaking agreement portion of the leveraged lease business, described under "--Insurance Company Subsidiaries" above.

### The GIC Business

Until November 2008, AGMH, through its financial products business, offered GICs to municipalities and other market participants. The GICs were issued through certain non-insurance subsidiaries of AGMH. In return for an initial payment, each GIC entitles its holder to receive the return of the holder's invested principal plus interest at a specified rate, and to withdraw principal from the GIC as permitted by its terms. AGM insures the payment obligations on all these GICs.

The proceeds of GICs were loaned to AGMH's former subsidiary FSA Asset Management LLC (FSAM). FSAM in turn invested these funds in fixed-income obligations (the FSAM assets).

As of September 30, 2018, approximately 32% of the FSAM assets (measured by aggregate principal balance) were in cash or were obligations backed by the full faith and credit of the U.S. Although AGMH no longer holds any ownership interest in FSAM or the GIC issuers, AGM's insurance policies on the GICs remain in place, and must remain in place until each GIC is terminated.

In June 2009, in connection with the Company's acquisition of AGMH from Dexia Holdings Inc., Dexia SA, the ultimate parent of Dexia Holdings Inc., and certain of its affiliates, entered into a number of agreements intended to mitigate the credit, interest rate and liquidity risks associated with the GIC business and the related AGM insurance policies. Some of those agreements have since terminated or expired, or been modified.

To support the primary payment obligations under the GICs, each of Dexia SA and Dexia Crédit Local S.A. are party to a put contract. Pursuant to the put contract, FSAM may put an amount of its FSAM assets to Dexia SA and Dexia Crédit Local S.A. in exchange for funds that FSAM would in turn make available to meet demands for payment under the GICs. To secure their obligations under this put contract, Dexia SA and Dexia Crédit Local S.A. are required to post eligible highly liquid collateral having an aggregate value (subject to agreed reductions and advance rates) equal to at least the excess of (i) the aggregate principal amount of all outstanding GICs over (ii) the aggregate mark-to-market value of FSAM's assets.

As of September 30, 2018, the aggregate accreted GIC balance was approximately \$1.2 billion, compared with approximately \$10.2 billion as of December 31, 2009. As of September 30, 2018, the aggregate fair market value of the assets supporting the GIC business (disregarding the agreed upon reductions) plus cash and positive derivative value exceeded by nearly \$0.6 billion the aggregate principal amount of all outstanding GICs and certain other business and hedging costs of the GIC business. Even after applying the agreed upon reductions to the fair market value of the assets, the aggregate value of the assets supporting the GIC business plus cash and positive derivative value exceeded the aggregate principal amount of all outstanding GICs and certain other business and hedging costs of the GIC business. Accordingly, no posting of collateral was required under the primary put contract.

To provide additional support, Dexia Crédit Local S.A. provides a liquidity commitment to FSAM to lend against FSAM assets under a revolving credit agreement. As of September 30, 2018 the commitment totaled \$1.1 billion, of which approximately \$0.7 billion was drawn. The agreement requires that the commitment remain in place, generally until the GICs have been paid in full.

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Despite the put contract and revolving credit agreement, and the significant portion of FSAM assets composed of highly liquid securities backed by the full faith and credit of the U.S., AGM remains subject to the risk that Dexia SA and its affiliates may not fulfill their contractual obligations. In that case, the GIC issuers may not have the financial ability to pay upon the withdrawal of GIC funds or post collateral or make other payments in respect of the GICs, thereby resulting in claims upon the AGM financial guaranty insurance policies.

A downgrade of the financial strength rating of AGM could trigger a payment obligation of AGM with respect to AGMH's former GIC business. Most GICs insured by AGM allow for the termination of the GIC contract and a withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM below a specified threshold, generally below A- by S&P or A3 by Moody's. FSAM is expected to have sufficient eligible and liquid assets to satisfy any expected withdrawal and collateral posting obligations resulting from any future rating actions affecting AGM.

The Medium Term Notes Business

In connection with the acquisition of AGMH, Dexia Crédit Local S.A. agreed to fund, on behalf of AGM, 100% of all policy claims made under financial guaranty insurance policies issued by AGM in relation to the medium term notes issuance program of FSA Global Funding Limited. As of September 30, 2018, FSA Global Funding Limited had approximately \$176 million of medium term notes outstanding.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in the market risks that the Company is exposed to since December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Assured Guaranty's management, with the participation of AGL's President and Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are effective in recording, processing, summarizing and reporting, within the time periods specified in the Securities and Exchange Commission's rules and forms, information required to be disclosed by AGL in the reports that it files or submits under the Exchange Act and ensuring that such information is accumulated and communicated to management, including the President and Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

Management of the Company, with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2018. Based on their evaluation as of September 30, 2018 covered by this Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective.



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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is subject to legal proceedings and claims, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, in the Company's Quarterly Report on Form 10-Q for the quarters ended March 31, 2018, and June 30, 2018, and in Part I, Item 1, Financial Statements, Note 14, Commitments and Contingencies – Legal Proceedings contained in this Form 10-Q. Material developments to such proceedings during the three months ended September 30, 2018, are described below and in the "Litigation" section of Note 14, Commitments and Contingencies, of the Financial Statements.

On November 28, 2011, Lehman Brothers International (Europe) (in administration) (LBIE) sued AG Financial Products Inc. (AGFP), an affiliate of AGC which in the past had provided credit protection to counterparties under CDS. AGC acts as the credit support provider of AGFP under these CDS. LBIE's complaint, which was filed in the Supreme Court of the State of New York, asserted a claim for breach of the implied covenant of good faith and fair dealing based on AGFP's termination of nine credit derivative transactions between LBIE and AGFP and asserted claims for breach of contract and breach of the implied covenant of good faith fair dealing based on AGFP's termination of 28 other credit derivative transactions between LBIE and AGFP and AGFP's calculation of the termination payment in connection with those 28 other credit derivative transactions. Following defaults by LBIE, AGFP properly terminated the transactions in question in compliance with the agreement between AGFP and LBIE, and calculated the termination payment properly. AGFP calculated that LBIE owes AGFP approximately \$29 million in connection with the termination of the credit derivative transactions, whereas LBIE asserted in the complaint that AGFP owes LBIE a termination payment of approximately \$1.4 billion. AGFP filed a motion to dismiss the claims for breach of the implied covenant of good faith in LBIE's complaint, and on March 15, 2013, the court granted AGFP's motion to dismiss in respect of the count relating to the nine credit derivative transactions and narrowed LBIE's claim with respect to the 28 other credit derivative transactions. LBIE's administrators disclosed in an April 10, 2015 report to LBIE's unsecured creditors that LBIE's valuation expert has calculated LBIE's claim for damages in aggregate for the 28 transactions to range between a minimum of approximately \$200 million and a maximum of approximately \$500 million, depending on what adjustment, if any, is made for AGFP's credit risk and excluding any applicable interest. AGFP filed a motion for summary judgment on the remaining causes of action asserted by LBIE and on AGFP's counterclaims, and on July 2, 2018, the court granted in part and denied in part AGFP's motion. The court dismissed, in its entirety, LBIE's remaining claim for breach of the implied covenant of good faith and fair dealing and also dismissed LBIE's claim for breach of contract solely to the extent that it is based upon AGFP's conduct in connection with the auction. With respect to LBIE's claim for breach of contract, the court held that there are triable issues of fact regarding whether AGFP calculated its loss reasonably and in good faith. On October 1, 2018, AGFP filed an appeal with the the Appellate Division of the Supreme Court of the State of New York, First Judicial Department, seeking reversal of the portions of the lower court's ruling denying AGFP's motion for summary judgment with respect to LBIE's sole remaining claim for breach of contract.

ITEM 1A. RISK FACTORS

See the risk factors set forth in Part I, "Item 1A. Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. There have been no material changes to the risk factors disclosed in such Annual Report on Form 10-K during the nine months ended September 30, 2018.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## Issuer's Purchases of Equity Securities

The following table reflects purchases of AGL common shares made by the Company during Third Quarter 2018.

| Period                     | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program (1) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program (2) |
|----------------------------|----------------------------------|------------------------------|--|--|
| July 1 - July 31           | 1,357,121                        | \$ 36.84                     | 1,357,121  | \$ 47,873,101  |
| August 1 - August 31       | 975,318                          | \$ 41.15                     | 972,031  | \$ 257,873,136   |
| September 1 - September 30 | 972,677                          | \$ 41.24                     | 969,897  | \$ 217,873,170   |
| Total                      | 3,305,116                        | \$ 39.41                     | 3,299,049  |  |

After giving effect to repurchases since the beginning of 2013 through November 9, 2018, the Company has repurchased a total of 92.7 million common shares for approximately \$2,645 million, excluding commissions, at an (1) average price of \$28.52 per share. The Board of Directors authorized, on August 1, 2018, an additional \$250 million of share repurchases. As of November 9, 2018, after combining the remaining authorization and the new authorization, the Company was authorized to purchase \$169 million of its common shares, on a settlement basis.

(2)Excludes commissions.

## ITEM 6. EXHIBITS.

The following exhibits are filed with this report:

| Exhibit Number | Description of Document   |
|----------------|---|
| 31.1           | <u>Certification of CEO Pursuant to Exchange Act Rules 13A-14 and 15D-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>  |
| 31.2           | <u>Certification of CFO Pursuant to Exchange Act Rules 13A-14 and 15D-14, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>  |
| 32.1           | <u>Certification of CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>  |
| 32.2           | <u>Certification of CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>  |
| 101.1          | The following financial information from Assured Guaranty Ltd.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in XBRL: (i) Condensed Consolidated Balance Sheets at September 30, 2018 and December 31, 2017; (ii) Condensed Consolidated Statements of Operations for the Three and Nine Months ended September 30, 2018 and 2017; (iii) Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months ended September 30, 2018 and 2017; (iv) Condensed Consolidated Statement of Shareholders' Equity for the Nine Months ended September 30, 2018; (v) Condensed Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2018 and 2017; and |

(vi) Notes to Condensed Consolidated Financial Statements.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

ASSURED GUARANTY LTD.  
(Registrant)

Dated November 9, 2018 By: /s/ ROBERT A. BAIENSON

Robert A. Bailenson  
Chief Financial Officer (Principal Financial and  
Accounting Officer and Duly Authorized Officer)