Assured Guaranty Ltd. (AGO)
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Q4 2014 Earnings Call

Robert Tucker
Managing Director, Corporate Communications and Investor Relations

Thank you operator.

Good morning and thank you for joining Assured Guaranty for our fourth quarter and year-end 2014 financial results conference call.

Today's presentation is made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. The presentation may contain forward-looking statements about our new business and credit outlooks, market conditions, credit spreads, financial ratings, loss reserves, financial results, future reps and warranty settlement agreements or other items that may affect our future results.

These statements are subject to change due to new information or future events. Therefore, you should not place undue reliance on them as we do not undertake any obligation to publicly update or revise them, except as required by law. If you are listening to the replay of this call, or if you are reading the transcript of the call, please note that our statements made today may have been updated since this call.

Please refer to the Investor Information section of our website for our recent presentations, SEC filings, most current financial filings and for the risk factors.

In turning to the presentation, our speakers today are Dominic Frederico, President and Chief Executive Officer of Assured Guaranty Limited; and Rob Bailenson, our Chief Financial Officer. After their remarks, we'll open the call to your questions. As the webcast is not enabled for Q&A, please dial into the call if you'd like to ask a question.

I will now turn the call over to Dominic.

Dominic Frederico
President and Chief Executive Officer

Thank you, Robert, and welcome to everyone joining today's earnings call.

I am pleased to report that Assured Guaranty had another successful year in 2014. In the tenth full year since our initial public offering, our operating shareholders' equity per share reached $37.48, the highest level in our history. During the year, our adjusted book value per share increased 8.2%, ending the year at $53.66, and we earned $491 million of operating income.

Additionally, we accomplished the four strategic objectives I listed during our earnings call a year ago. Specifically:

- We further optimized our capital management, primarily by continuing our share repurchases;

- We increased new business production, with contributions from our U.S. public finance, international infrastructure and global structured finance businesses;

- We reached an agreement to acquire a legacy insurer - Radian Asset Assurance Incorporated - and further augmented our unearned premium reserve by reassuming previously ceded business;

- And we extracted value from our own insured portfolio through loss mitigation and alternative strategies.

Let me describe how we succeeded at each of these objectives.

First, capital management: As I have said on previous calls, Assured Guaranty has been generating more capital than we can put to work at acceptable returns in the current low interest rate environment. To address this excess capital position, during 2014, we repurchased 24.4 million common shares for $590 million, or an average of $24.17 per share, representing a substantial discount to both operating shareholders' equity per share and adjusted book value per share. We also increased our quarterly dividend per share by 10% in February of 2014, and earlier this month, we increased it by an additional 9%.

Over the two years from January 2013 through the end of 2014, we returned $1 billion of excess capital through the repurchasing of 37 million shares, or 19% of our January 1, 2013 share count, and through our quarterly dividends.

We took some additional steps during 2014 to improve our capital flexibility and optimize our capital structure. First, we were able to increase unencumbered assets by approximately $275 million at Bermuda-based AG Re by obtaining approvals for AGM and AGC to reassume certain contingency reserves from AG Re. Second, we requested and, in the fourth quarter, received regulatory approval to release more than $1.1 billion from contingency reserves into policyholders' surplus at AGM and AGC, therefore increasing the dividend capacity of these two subsidiaries.

And third, we issued $500 million of 10-year, 5% senior notes. In a powerful market endorsement, this issue was eight times oversubscribed at its original target of $300 million, with bids from 130 investors.

Our second objective for 2014 was to grow our new business activity, and we recorded a present value of new business production, or PVP, of $168 million, 19% more than in 2013, with contributions from each business segment.

In the U.S. public finance market, industry insurance penetration of new-issue par sold climbed to 5.9% from 3.9% the previous year. Assured Guaranty insured 43% more par volume of new issues sold than in 2013. This is impressive progress considering the strong headwinds during 2014. Thirty-year municipal bond yields dropped 133 basis points over the course of the year, and credit spreads were as tight as at any time since 2008. Additionally, there was no meaningful growth in the primary market volume.

We continued to lead the market with a 58% share of primary-market insured par sold, even as we conceded numerous small and mid-size issues that were insured by our competition at prices we found unacceptable.

While small and mid-size issues represented the majority of our 2014 municipal business, we also guaranteed 41 new issues sold with insured par of more than $50 million each, of which 12 exceeded $100 million. The comparable figures in 2013 were 26 transactions over $50 million, of which 8 exceeded $100 million. The growth in the number of larger transactions reflects improved demand for our insurance from institutional investors.

We attribute the increased demand for our insurance to the proven value of our guarantees. Investors have seen us pay claims and relieve insured bondholders of the burden of prolonged restructuring negotiations and bankruptcy litigation.

They have also seen the clear evidence that Assured Guaranty insured bonds hold their trading value much better than comparable uninsured bonds of a troubled issuer. And with over $400 million of our insured bonds trading every day, investors can see that bonds with our guaranty enjoy enhanced market liquidity.

In international infrastructure, where transactions can take a year or more to complete, we insured an innovative United Kingdom social housing project during 2014. In the last two years, we have demonstrated the viability of our capital market solutions for new infrastructure projects, and we also continue to pursue opportunities related to international transactions previously wrapped by other legacy financial guaranty insurers.

In structured finance, we found opportunities for growth. We reopened the market for insured diversified payment rights transactions and found other opportunities in state-sponsored new market tax credits and private transactions to provide capital relief for large institutions, such as life insurance companies. Our 2014 structured finance PVP of $33 million was more than four times that of the prior year.

We also made progress on our third objective - to add to our results through reassumptions and acquisitions.

In addition to reassuming previously ceded business totaling $1.2 billion of par in 2014, we agreed to purchase Radian Asset from the Radian Group for $810 million, subject to certain closing adjustments. We expect to close the transaction in the first half of 2015, subject to regulatory approval. When the transaction is completed, Radian Asset will be merged into AGC, and its book of business will become part of AGC's insured portfolio. As of December 31, 2014, Radian Asset's statutory capital was approximately $1.3 billion, and its insured statutory net par outstanding was $18.0 billion. Since the beginning of this year, its structured finance net par outstanding has declined by $3.8 billion as a result of terminations of seven AAA pooled corporate transactions. We expect the Radian transaction to be accretive to earnings, operating shareholders' equity and adjusted book value. It should also increase AGC's capital base and policyholders' surplus and therefore AGC's dividend capabilities. The transaction will benefit not only our shareholders and policyholders but also holders of bonds insured by Radian Asset, which will gain enhanced valuation and increased market liquidity.

Finally, our fourth objective for 2014 was to create value through loss mitigation and other alternative strategies. We clearly succeeded, with a $30 million benefit in our total net economic loss development and a $2 billion, or 27%, reduction in our below investment grade RMBS exposure. These positive results were largely due to a number of agreements we reached during the year with providers of representations and warranties on RMBS we insured, including one with Credit Suisse. Through these agreements, we caused rep and warranty providers and other responsible parties to make or agree to make payments or to terminate certain insured transactions that had projected future losses.

Additionally, in 2014, we purchased $355 million of our wrapped bonds for $309 million, mitigating expected losses and contributing to adjusted book value. We also terminated over $4 billion of net par outstanding, including transactions terminated under certain agreements reached with rep and warranty counterparties, thereby reducing rating agency capital charges and accelerating premiums earned.

Another way we mitigate losses is by working with troubled credits to resolve their fiscal difficulties, preferably before a default occurs, and by asserting our rights in distressed situations when necessary. In 2014, the bankruptcies of Detroit and Stockton were resolved with outcomes considerably better for us than the original offers. In these and other cases, we have shown that by consolidating the interests of insured investors under our guarantor's umbrella, and by pursuing a constructive approach to developing solutions, we are in a position to reach a more favorable settlement in a shorter time than could investors negotiating independently. We have consistently defied early speculations of large losses, and we have defended fundamental principles of municipal bond security, as we did by requiring that the secured status of unlimited tax general obligation bonds be stipulated in our Detroit ULTGO settlement.

While we have successfully resolved a significant number of troubled exposures in our public finance insured portfolio, the Puerto Rico credits remain an area of concern, for which we established additional reserves in the fourth quarter.

Earlier this month, the U.S. District Court for Puerto Rico ruled that the legislation enacted by the Commonwealth to establish a restructuring procedure for certain public corporations is void because it is preempted by the federal Bankruptcy Code, which explicitly excludes Puerto Rico's public corporations and municipalities from chapter 9 bankruptcy protection. The Commonwealth is appealing the decision. Today, coincidentally, a subcommittee of the U.S. House Judiciary Committee is scheduled to hold a hearing on proposed legislation that would extend to Puerto Rico the right to allow its public corporations and municipalities to reorganize under chapter 9.

Within our Puerto Rico exposures, the most vulnerable credit is the Puerto Rico Electric Power Authority, or PREPA, which is developing its restructuring plan. Through a forbearance agreement, we and other creditors have agreed to allow PREPA time to develop a plan to restore its financial stability. Simultaneously, we are exploring possible ways to work with the Puerto Rico Highway and Transportation Authority.

As we have continued to meet our operating objectives and build financial strength, rating agencies have begun to take notice. S&P upgraded our operating subsidiaries' ratings to AA from AA- and confirmed their stable outlook in March of 2014. Significantly, this was the first upgrade we have received since the start of the Great Recession. Additionally, in November, Kroll Bond Rating Agency initiated its coverage of AGM with a rating of AA+ stable, giving both AGM and MAC the highest rating assigned to any active bond insurer by a nationally recognized statistical rating organization.

Moody's continues to rate us at levels below our S&P and Kroll ratings, but their reasons have essentially nothing to do with our capital adequacy. Moody's recently moved the goalpost again when it revised its bond insurer rating criteria. While Moody's then published an article maintaining our existing ratings under the new methodology, the revised criteria are clearly designed to cap the potential ratings of any bond insurer at a level below AA by relying, for example, on an unrealistic requirement of $2 billion for the industry's aggregate annual present value premiums - a measure that says little, if anything, about an insurer's ability to meet its obligations or about its financial strength in general.

Before concluding, I want to thank two important individuals for their service to Assured Guaranty. First, we are grateful to Wilbur L. Ross, Jr., who, in the midst of the global financial crisis, saw an opportunity to join with the premier financial guarantor and provided capital, through his investment funds, and valuable guidance. He recently left our board to comply with regulations governing his new role as a director of a European bank. I am also very grateful to Bob Mills, our Chief Operating Officer, who will be leaving Assured Guaranty at the end of March. His counsel and leadership were essential to the success of our IPO, the acquisition of AGM, our RMBS recovery program and so many other initiatives.

At the end of our tenth full year since our initial public offering, we can look back with satisfaction on a decade that included some of the most difficult economic years in living memory. Through it all, Assured Guaranty has been consistently profitable and one of the strongest financial companies, with a proven record of reducing issuers' borrowing costs and keeping investors whole in distressed situations, while building value for our shareholders. In these ten years, we more than doubled adjusted book value, insured $358 billion par of new business, earned $3.7 billion of operating income and built the industry's leading franchise.

I am confident about the future because we continue to adhere to the core principles behind that success. I do not know when interest rates will ultimately rise from their current near-record lows, but we are the best positioned guarantor to benefit from rising rates when they come.

There is pent-up demand for capital to rebuild and expand governmental infrastructure. The asset-backed market continues to revive, and we see many applications of our guaranty for banks and insurance companies. With the challenges of many of our troubled exposures behind us, and with our legacy structured finance portfolio amortizing rapidly, we will continue to focus on building our financial guaranty franchise, optimizing our capital structure and managing risk intelligently. As we pursue the opportunities the market provides, we will continue, above all, to be responsible stewards of capital on behalf of our policyholders and shareholders.

Now I'll turn the call over to Rob.

Robert Bailenson
Chief Financial Officer

Thank you, Dominic, and good morning to everyone on the call.

Operating income was $81 million, $0.50 per share, in the fourth quarter of 2014, bringing full year operating income to $491 million or $2.83 per share.

Compared to the fourth quarter of 2013, operating income was down due primarily to lower earned premiums and credit derivative revenues, and a higher effective tax rate. Interest expense was higher than fourth quarter 2013 due to the $500 million debt issuance last June. Operating expenses were also up slightly due to severance accruals as a result of a workforce reduction that will cut annual compensation expenses by approximately $9 million, beginning in the second quarter of 2015.

Pretax economic loss development for the fourth quarter of 2014 was a benefit of $2 million. This included a $108 million R&W benefit primarily attributable to settlements, offset in part by loss development on Puerto Rico, legacy Triple-X life insurance transactions and the effect of lower risk-free rates. The effect of changing discount rates in the fourth quarter of 2014 was a loss of approximately $60 million. However, this amount does not represent credit impairment.

I will now highlight the economic benefits of the strategic initiatives that Dominic just discussed.

First, new business production and reassumptions of previously ceded books of business have added $137 million, after tax, to adjusted book value this year.

Second, share repurchases over the past two years have resulted in an additional $2.78 of operating shareholders equity per share, and $5.84 of adjusted book value per share as of December 31, 2014. Share repurchases have also increased operating income by $0.32 per share for full year 2014.

Finally, we reached R&W settlements with the majority of the remaining counterparties in 2014 and we now have most of our R&W asset covered, and collateralized, under contractual agreements. As a result of the success of the RMBS loss mitigation efforts, the majority of the workforce reduction affected RMBS workout professionals whose primary objective was to support this strategic initiative.

I would also like to highlight a few things that we did to improve our capital position and flexibility.

We had two significant events in AGRe that resulted in releases of assets held in trust and therefore increased the unencumbered asset balance.

First, AGRe released $275 million from the trust accounts when AGC and AGM reassumed contingency reserves that they had ceded. This represents the second of three contingency reserve reassumptions that were previously approved by the New York and Maryland insurance regulators. In 2015, we expect AGC and AGM to reassume the third and final installment of contingency reserves of approximately $88 million.

Second, AGRe released $104 million in connection with the commutation of our assumed Detroit exposure from a non-affiliated primary insurer. As of December 31, 2014, unencumbered assets at AGRe were $651 million, which substantially exceeds AGRe's 2015 maximum dividend capacity of $271 million, and represents a significant improvement over the December 31, 2013 balance of $238 million.

In the U.S. subsidiaries, we received regulatory approval to release $1.1 billion in contingency reserves from AGC and AGM, which now brings their 2015 dividend capacity to a total of $317 million - comprised of $227 million from AGM and $90 million from AGC.

As of December 31, 2014, we had a total of $377 million in cash and liquid assets at the holding companies. Since the beginning of 2015, we have spent $92 million to repurchase another 3.6 million shares and we still have $118 million in share authorization remaining as of today.

As we look at 2015, we are excited about closing the Radian acquisition, which will increase our future premium earnings and boost the statutory capital position of AGC. We are well positioned to:

- continue our share repurchase program under the current authorization;

- grow our future revenue stream - whether through new business, reassumptions or further acquisitions; and

- pursue loss mitigation opportunities that arise.

I'll now turn the call over to the operator, to give you the instructions for the Q&A period.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. And our first question is from Sean Dargan of Macquarie. Please go ahead.

Sean Dargan - Macquarie

Thank you. If I look at Slide 9 on the slide presentation in which you break out the dividend limitation calculation, which I think is very helpful. So if I get this right, you are going to more than double stat surplus at AGC?

Rob Bailenson - CFO

Yes.

Sean Dargan - Macquarie

With Radian, okay?

Rob Bailenson - CFO

No, no. Not with Radian. I just said that we released our contingency reserve $1.1 billion, $540 million of that was from AGC and $580 million was roughly from AGM. When you release the contingency reserve, it comes out of – it's still inside capital, but it goes right into surplus and increases your policyholder surplus.

Sean Dargan - Macquarie

Okay. But in other words, when Radian is layered in there, you'll have a lot more policyholder surplus than you're showing here though, right?

Rob Bailenson - CFO

Yes.

Dominic Frederico - President, CEO

Yes.

Sean Dargan - Macquarie

Okay. And will a similar, I guess pro forma adjustment be made to investment income?

Rob Bailenson - CFO

Yes. Bringing in the Radian investment portfolio will actually increase investment income which will help in dividend capacity, that's correct.

Sean Dargan - Macquarie

Okay. And just a bigger picture question, you did reserve for expected Puerto Rico losses on certain exposures. Several quarters ago Dominic gave kind of a worst-case scenario impact to adjusted book value per share from Puerto Rico losses. Now, I assume current adjusted book reflects a higher level of expected losses, but I was wondering if you could give us kind of an update to what you think that impact would be now.

Dominic Frederico - President, CEO

That is a great question, Sean. And I'm not that prepped on that number, but I can tell you whatever the number was then, it's less now because as you pointed out, we put up additional reserves. Number two, as you understand, the Puerto Rico situation is continuing to develop. We would say that over the last couple of months, I think developments have improved slightly in our benefit especially with the voiding of the Recovery Act. We have always been supportive of any negotiation that really represents and respects the rights of all parties and leads to a proper solution that really does assist Puerto Rico and getting its financial house in order.

If you go back over the PREPA exposure which is the most significant of the troubled credits, we had 770 million round numbers outstanding. The total debt service on an annual basis over ten years, if I remember correctly, was in the 160 million range which I would say is easily absorbed within our liquidity and current investment income. We have strength in reserves principally, off of the restructuring officer's report that was released in the fourth quarter so in terms of total number impairment, I think from an adjusted book value on a new share count of 160 million -- 150 million shares maybe it's $4 at worst, so that's kind of the number I can remember. That's pretax, of course, so after tax would be significantly less than that. So for us, we got liquidity, the annual debt service is not overwhelming even if you look at 100% severity. And obviously, we continue work very hard with the Puerto Rican officials to try to get to an amicable solution that recognizes all rights and especially those of the bondholders.

Sean Dargan - Macquarie

Thank you.

Operator

Our next question is from Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Dunn - Dowling & Partners

Thanks. Good morning.

Rob Bailenson - CFO

Good morning, Geoff.

Geoffrey Dunn - Dowling & Partners

You went a little too quick for me, Rob. Could you just repeat the holding company cash and I think you mentioned some subsequent share repurchase?

Rob Bailenson - CFO

Yes. The holding company cash – wait a second, -- holding company cash is – hold on. It's $250 million -- $251 million at AGM and AG withholdings. So the total to U.S. holding company is $250 million and at AGO, we have $125 million bringing the total to about $376 million.

Geoffrey Dunn - Dowling & Partners

All right, perfect. And then, it was there subsequent share repurchase?

Rob Bailenson - CFO

Yes, there were. We did subsequent share repurchases of --

Dominic Frederico - President, CEO

The brains behind the company is writing 3.6 million shares for $92 million.

Rob Bailenson - CFO

3.6 million and we paid $92 million.

Geoffrey Dunn - Dowling & Partners

All right, great. And then I wanted to ask about the reserve and development this quarter. I think what you originally put up reserves a year ago, it was rating agency motivated linked to liquidity concerns for Puerto Rico. What was the incremental development this quarter that drove the Puerto Rico reserving? Is it PREPA specific or is it island specific or what's going on?

Dominic Frederico - President, CEO

It's PREPA specific, Geoff. As we looked at the restructuring report, we were concerned that there was really not much addressing the inefficiency of certain of the operations. There was not much addressing, what we'll consider the issue relative to both staff count and potential benefits. So it was really PREPA specific and it really looked through the restructuring report that was put out in the fourth quarter.

Geoffrey Dunn - Dowling & Partners

Okay. And then same question on Triple-X, what's changing there that is creating the additions? And I hope you can specify if it's Orkney or Ballantyne.

Rob Bailenson - CFO

I mean there are two things, Geoff. I mean the Triple-X, we had a change in assumptions based on laps rates on life insurance policies, in addition to which a significant portion of that adjustment was related to risk-free rates because the loss reserve is very long dated so as you change that loss reserve, the risk-free rate has a significant impact. So I would say $20 million to $25 million of that 60 million was related to the risk free rate on the Triple-X securitization.

Dominic Frederico - President, CEO

Geoff just remember when we were talking about the Triple-X deals, these are the legacy life insurance reinsurance deals that we did. They are subject to a litigation as you may remember on the asset management side over those two deals where the assets were put way back went into residential mortgage back securities almost entirely which we think violated the underlying asset management agreement.

So we still have to put reserves up as we see fit regards to whether the entire economic valuation of these two exposures resulted in net payment by us ultimately based on the current litigation. Number two, as Rob points out, the change in the discount rate, effective incurred losses this quarter by $60 million. When you look at our losses incurred, there is no change in real underlying credit experience or economic impairments to the underlying assets, but the change in the discount rate cost us $60 million.

Geoffrey Dunn - Dowling & Partners

Okay, great. Thank you.

Dominic Frederico - President, CEO

You're welcome.

Operator

Our next question is from Brian Meredith of UBS. Please go ahead.

Brian Meredith - UBS

Hey, good morning, Dominic.

Dominic Frederico - President, CEO

Hey, Brian.

Brian Meredith - UBS

Just a couple of quick questions here. First, possibilities here did you take a special dividend once you get the Radian transaction closed?

Dominic Frederico - President, CEO

I have got about 18 people shaking their head. So let me answer this my way. I got my General Counsel throwing crap at me. Important and foremost, we actually anticipated a special dividend at some point of time. Being realistic though we don't believe a special dividend request would garner much attention until Puerto Rico is resolved. The size of the exposure from the New York State Insurance Department or the Maryland State Insurance Department, I would be very conservative as they should be and therefore, I think they're going to look for resolution of Puerto Rico, which I believe hopefully, happens in 2015.

So as we kind of prep ourselves, continue the capital management strategy that we have, that's something that's on our radar as you know we keep a lot of things on radars for periods of time and we work very hard to execute them in the timeframe that we think is applicable. And that's there. And as I said as we work through 2015, we've got liquidity now. We have enhanced capital on the kind of organic basis through the release of the contingency reserves, recapturing of the contingency reinsurance reserves, purchasing of Radian asset. So I think we're in good shape.

And then as we clear Puerto Rico that will then clear the decks I think as we continue to run off our exposures for us to be able to think about and therefore request a special dividend.

Brian Meredith - UBS

Got you. Thanks. And then the second question, Dominic, I mean the last quarter, we talked a little bit about the effect of the declining oil prices on Puerto Rico and the credit there. I'm just curious as you look across your portfolio, are there any other areas or any other credits that you know kind of raise heightened concerns given the drop in oil prices?

Dominic Frederico - President, CEO

Not really. I mean the crazy thing is we have always believed the drop in oil prices is a positive for the economy, yet it had been treated very differently and specifically in Puerto Rico, it should be a huge benefit that we hope that the government takes advantage of in providing additional opportunity for them to increase revenue and therefore be able to further meet the debt service requirements of PREPA specifically.

It could have an impact in our Texas exposure, which is a large exposure for the company, but not at the level that we play at and the credits that we're currently exposed to. We take a hard look at every economic macro change in the marketplace. And this one hasn't really caused us any concerns whatsoever.

Brian Meredith - UBS

Got you. And then just a last question looking at your reps and warranties potential here going forward, I know you give some numbers. Is there anything else that would you look as potential for R&W recovery here aside from the number in the hand-out supplement?

Dominic Frederico - President, CEO

Well, Mr. Mills has done such a great job that I think we have only got two left. The unencumbered asset now is about $61 million or $71 million?

Rob Bailenson - CFO

Yes.

Dominic Frederico - President, CEO

So if you think about what our asset was back in that day, was its Bob?

Rob Bailenson - CFO

$68 million.

Dominic Frederico - President, CEO

$68 million is what we have got left in rep and warranty. I understand we have always had a conservative estimate of the asset. So as we look to get these last two deals done and hopefully we'll get done in the current year that will be once again for us puts to bed the residential mortgage-backed security kind of issue exposure, volatility all those nasty things. And more importantly, we continue to really focus on the below investment grade exposure that is out there and in these cases, you're really talking more about future losses as opposed to paying us back for past losses. So it's more of a capital play than it is an economic loss play.

Brian Meredith - UBS

Got you. Thank you. Appreciate it.

Dominic Frederico - President, CEO

No problem. Thanks.

Operator

[Operator Instructions] And our next question is from Brad Gibson of JPMorgan. Please go ahead.

Brad Gibson - JPMorgan

Very good. Thank you, gentlemen. I was wondering if you could discuss some of the exposures you will assuming from Radian. And how that affects risk at Assured Guaranty Corp., and specifically, if you could address thoughts on the risk from Zohar CLO and if there are any risks you think you are notable to call out?

Dominic Frederico - President, CEO

That is a nice question. Thank you very much. As we looked at the Radian book, we were very familiar with the book. If you remember, we provided about a third of the book ourselves to our reassurance. So it's a book we are very comfortable with. We have done two transactions with them to recover our reassurance and to look at other business they had.

So we have been through their portfolio. This is our third time through, so I think we know the risk pretty well. I think you have identified one of the risks that are a concern. There are two others. They have Puerto Rico. But some bids from us and not a lot and very little to PREPA. And they have a commercial real estate deal that has got a little hair on it, but we don't think it has an economic loss.

So basically there are three exposures out there, Zohar being the one of – probably the most significant as you know for their disclosure they have a hedge out there for a significant part – not major, but material, that would provide them some relief to attempt that transactions trigger. Obviously, they're in negotiations. There's litigation around that. So there's not a lot we can say other than we look at the protections that they have, the fundamental of the deal which you know is a second-to-pay deal. So the other primary insurer has not to pay it, which I think has consequences for that primary insurer before the Radian exposure would be then affected.

And as I said, the hedges of the discount and the purchase in our review of the risk itself, we were comfortable overall as including it into the portfolio repurchase.

Brad Gibson - JPMorgan

Great. Thank you, gentlemen.

Dominic Frederico - President, CEO

No problem.

Operator

Our next question is from Josh Bederman of Pyrrho. Please go ahead.

Josh Bederman – Pyrrho

Operator

Our next question is from Josh Bederman of Pyrrho. Please go ahead.

Josh Bederman - Pyrrho

Hey, guys. There have been some rumors out there of potentially you wrapping Puerto Rico issuance. I wanted to get your comments on what you guys would think about increasing exposure to Puerto Rico, potentially for the good and obviously get some returns out of it?

Dominic Frederico - President, CEO

Once again, appreciate the question. We're involved in some pretty confidential negotiations. All I will tell you is, we at Assured, and I would assume the other creditors as well, are working towards what we think is the best solution for Puerto Rico to stabilize their finances and get them on a period of growth and improvement as opposed to the current deterioration and financial distress. And therefore, anything we can do that improves the totality of our Puerto Rico exposures, we would consider.

So, read between the lines. To the extent that we think we can make us better, we obviously move very positively in addressing their concerns and their needs, but with the requirement that it's got to help the Assured, the Assured bondholders and the Assured stockholders.

Josh Bederman - Pyrrho

Great, thank you.

Dominic Frederico - President, CEO

You're welcome.

Operator

Our next question is from Larry Vitale of Moore Capital. Please go ahead.

Larry Vitale - Moore Capital

Hi. Good morning, gentlemen.

Rob Bailenson - CFO

Hi, Larry.

Larry Vitale - Moore Capital

Hi. Thanks for taking my question. I've got three or four of them. In the commentary and the press release on the quarter, you mentioned lower premium accelerations. Can you quantify the effect that that had on the top line?

Dominic Frederico - President, CEO

Once again, the brain behind the organization is getting the number for us.

Rob Bailenson - CFO

Well, we had fourth quarter premium accelerations Larry were about $57 million of refundings. So when you say top-line, it's just – you are talking about what was the effect on earned premium, correct?

Larry Vitale - Moore Capital

Yes. Yes.

Rob Bailenson - CFO

And last year, we had – year-to-date for 2014, it was $147 million.

Larry Vitale - Moore Capital

Okay. All right. That's helpful.

Dominic Frederico - President, CEO

Larry, remember the accelerations are two things, right? They're refundings and they're also related to terminations. So when we terminate a deal, typically, we're able to negotiate the retention of the premium, either paid or some payment for the representation with the future installment premiums due. Fourth quarter this year was not a large termination quarter relative to premium. We terminated some CDS. But remember the CDS is not up front. It's present value over time. So, the effect of terminations has a huge impact on that because our expectation for refundings is actually positive looking at 2015.

Larry Vitale - Moore Capital

Okay. That was actually my next question, so I'll thank you in advance for answering that one, Dominic, so I don't have to ask it. Your RMBS book, looked to have declined by about a billion par outstanding. And I'm wondering if there were any tear-ups or anything like that. I am looking at it relative to Q3.

Rob Bailenson - CFO

Yes. We had some terminations, and we also had R&W recoveries, which reduced the amount of our RMBS exposure.

Dominic Frederico - President, CEO

If you remember, Larry, we talked about back in the day, when we had the rep and warranty challenge, we first looked at the insured policies because that's where we had we thought better rights over the rep or warranties that were imbedded in those deals, and obviously, we were the bondholder, the super bondholder, from the insurance. And we worked to get those done first, and they were the focus of our efforts in the earlier years. Those are by and large gone.

So now everything we’re working on is in derivative form. So the derivative form, the relief is going to take one of two forms. It's either going to pay us for the past losses, or it's going to tear up the deal because we’re dealing with the counterparty who obviously could possibly be the rep and warranty provider as well.

And in that case, as you know, we have been working very hard with Deutsche Bank to eliminate the remainder of the swap portfolio book we have with them on RMBS. And they have been fantastic. They set out to first cure the problem with the direct business, which they did, the insurance business, and then committed to dealing with the derivatives kind of on a quarter- to-quarter basis. But, they are a little bit complicated to say the least and Bob and his team had to work diligently with them. So in the quarter what you’re seeing is a benefit of one of those tear-ups on the Deutsche Bank derivative side.

Larry Vitale - Moore Capital

Okay, all right. That's helpful. And my last question is, you're paying what $810 million for the Radian portfolio. It's got a stat book of $1.3 billion. Are we going to see on the order of a $500 million purchase accounting gain when this deal closes? Is that how the accounting is going to work?

Rob Bailenson - CFO

Well, on a GAAP basis, you're going to fair value both all the assets and liabilities. And obviously, there's going to be a fair value adjustment for some of the exposures and which would increase your UPR. So, you are going to see that benefit but some of them will come in over time in the form of earned premium as that UPR runs-off. You will fair value that UPR which increases the UPR and lowers your purchase discount, which lowers your negative goodwill. But you eventually do earn that premium over time.

So that's correct, there is a roughly $500 million benefit, but you might not see it immediately. You could see it over time. It will be an increase to adjusted book value as well.

Dominic Frederico - President, CEO

It's very similar to when we bought FSA at the discount, Larry, where we went back and under the purchase accounting you’ve got to fair value assets and liabilities. So, if you think of your assets as mostly marketable securities, they seem to be fairly fair valued anyway under the current rules.

So then you go to the liability section. There’s two major liabilities there. UPR, unearned premium reserve, and loss reserves. If you're comfortable with the loss reserve, then the theory of the discount is because you winded up getting these exposures or policies which were underpriced based on the current marketplace.

So going back to a thing like Zohar, you could assume that Zohar is underpriced in the current marketplace. If you understand what's going on today, and therefore you might then say part of this purchase discount relates to the underpayment of premium relative to that exposure on what we know and if we had to go out and buy protection today, right? And that's a second to pay behind MBIA. You know where the MBIA credit default swap spreads are today. So that's kind of how it works. So you basically allocate the negative goodwill principally into the unearned premium reserve and then you earn it over the exposures that you now apply it to.

Larry Vitale - Moore Capital

Okay. That's all very helpful. Thank you, guys.

Rob Bailenson - CFO

You’re welcome.

Dominic Frederico - President, CEO

Thanks Larry.

Operator

Our next question is from Bose George of KBW. Please go ahead.

Bose George - KBW

In terms of the legal ruling on the Recovery Act, since it happened after the end of the year, does that potentially impact economic loss development in any way?

Dominic Frederico - President, CEO

I don't believe it does. As I said, most of our economic loss development was really predicated to PREPA and really predicated to the work done by the restructuring officer and really looked at the fundamental economics of that. The Recovery Act being voided really talked to the process of how ultimately relief can be sought on behalf of the Puerto Rican corporations. And as we have said, anything that promotes an orderly process and recognizes the rights of all constituents, we're very happy and supportive of, and we believe that this is a step in the right direction, and whether it's chapter 9 or continued litigation within the Puerto Rican courts, it at least allows a process that has a little bit more structure to it.

Bose George - KBW

Thanks. That's helpful. And then actually, just going back to the question about the accretion from Radian, so roughly $500 million difference, I mean most of that goes into adjusted book value. And in terms of the benefit on the other side, or operating book, is it kind of divided, but some of it goes – will come into earnings but some of it will come in through operating book as well?

Rob Bailenson - CFO

Yes. That's correct.

Bose George - KBW

But in terms of figuring out that difference, I guess we have to sort of wait...

Rob Bailenson - CFO

Well, you’ve got to figure out what you think you're going to allocate to the unearned premium reserve, as Dominic and I just mentioned. You're going to reallocate some of that $500 million difference to get the unearned premium reserve for different credits. They have exposures to Puerto Rico. Obviously, there's going to be an adjustment to the unearned premium reserve. Over time, that unearned premium will come down. You'll see that benefit coming through operating income as you earn that premium. But your adjusted book value, obviously, the minute you put that unearned premium, that's a benefit to your adjusted book value net of any losses that you expect.

Bose George - KBW

Okay, great. Thanks.

Dominic Frederico - President, CEO

You're welcome.

Rob Bailenson - CFO

You're welcome.

Operator

Our next question is from Harry Fong of MKM Partners. Please go ahead.

Harry Fong - MKM Partners

Good morning. I got a quick question for Rob. Rob, the – how much did the discount rate move this quarter, and when Janet Yellen begins to raise rates again, will the $60 million interest rate charge this quarter be reversed in total?

Rob Bailenson - CFO

It depends on where in the curve, Harry, but if you look at where it affects us significantly, between, say, 10 and 20 years, it's been down about 50 basis points, 50 to 60 basis points. So, and I don't expect, even if Janet Yellen changes rates, it's going to affect that part of the curve. It's probably going to be flattening. It's going to be on the shorter end of the curve, and I'm not expecting it to – rates to move out that significantly when she does it. But just to give you an answer about, if in fact, it does move out significantly, it moves out 50 basis points and yes, that $60 million would be – would just come back in the other direction.

Harry Fong - MKM Partners

Hopefully, it will come back before too long. Thanks.

Dominic Frederico - President, CEO

I hope more than that, yes.

Rob Bailenson - CFO

Well, at least you know if it goes to zero you have nominal numbers. So you don't have anywhere more to go. Okay. Thanks Harry.

Operator

Our next question is a follow-up from Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Dunn - Dowling & Partners

Thanks. Dominic, this is kind of a crystal ball question, but Puerto Rico, at the end of the day, they have problems regardless of what they can't and can do legally right now. Is this one of those situations going forward? I think you said in the past, when it becomes everybody's problem, it gets solved. You can see a scenario where under a Recovery Act, these things are segmented. I am just wondering if there is a risk that the lack of chapter 9, which probably doesn't get past the Republicans, or the lack of Recovery Act creates a bigger issue here. So just curious of your high level thoughts?

Dominic Frederico - President, CEO

Let me turn on my crystal ball for you Geoff. So my high level thoughts are, number one, is it contagion for the rest of the Puerto Rican exposures, losing their Recovery Act. I don't believe so. As we look at Puerto Rico, much as I thought they look at it, the general obligation-related credits are ultimately repayable. And if you look at the numbers, the numbers stayed relative to debt per capita, the taxes per individuals. So the numbers work on the general obligation side, I think.

One of Puerto Rico's biggest disappointments, they thought by segregating they were going to be able to preserve market access and the ratings for the general obligation side, which obviously didn't happen from our friends at the rating agencies. But by and large, those credits, to me, are still ultimately payable and therefore should be looked at differently.

As you look at the public corporations, obviously, the oil tax has a huge potential benefit relative to transportation, which for Assured that's our largest exposure. So we applaud very loudly the efforts that they have made in that regard and therefore very hopeful of anticipating the ultimate issuing of the debt off of the tax and therefore the repayment of the GDB loan out of the transportation, which for us improves transportation significantly, plus, we're taking that trolley exposure out, which saves us another fairly large amount of cash within transportation. So we think that's all positive.

And as I have always said, if it's your problem, it's a big problem. If it's everybody's problem, it's not really a big problem, it's really nobody's problem… and Puerto Rico still stands in that regard in my mind. And understand we're really talking about the survivability of Puerto Rico and its current kind of government and social form. So I think it's critically important for all parties, including for Puerto Rico itself, that these things get resolved in some amicable way relative to the totality of the marketplace.

As we always have been, we're pretty honest with ourselves and take a very strict view of how we look at the exposures, and as I said, we took a hard look at the restructuring officer report in the fourth quarter and because of the lack of closing down plants, et cetera, felt we needed to increase our reserve. But, we're very comfortable, relative to the exposure, with the reserves we now currently have, and obviously we work very hard with the Puerto Rico authorities to try to continue to improve the situation and move the ball forward. And we're optimistic that in 2015, we're going to start to see some real headway being made.

Geoffrey Dunn - Dowling & Partners

Okay. I appreciate the thoughts. Thanks.

Dominic Frederico - President, CEO

You're welcome.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Robert Tucker for any closing remarks.

Robert Tucker - MD, IR, Corporate Communications

Thank you, operator. I would like to thank everyone for joining us on today's call. If you have additional questions, please feel free to give us a call. Thank you very much.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.