KBRA Rating: AA+

Outlook: Stable

Assured Guaranty Municipal Corp. (AGM)

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Executive Summary

Kroll Bond Rating Agency (KBRA) has assigned an insurance financial strength rating of AA+, Stable Outlook, to Assured Guaranty Municipal Corp. (AGM).

As a major part of our analysis, KBRA determined a level of stress losses to be applied to AGM's insured portfolio based upon assumptions that are consistent with a AA+ rating. AGM satisfied all claims in full and on time in this stress case scenario and their ability to do so supports this rating in our opinion.

AGM has written primarily US municipal business since the credit crisis (with a small amount of international infrastructure). It retains a significant legacy exposure to structured finance although it has been declining in absolute terms. Within this structured finance portfolio the company has exposure to $6.3 billion of global residential mortgage backed securities (RMBS). This sector has produced the majority of the company's paid losses in recent years and represents the most significant expected source of paid losses going forward. Therefore, it was a focus of KBRA's analysis. In developing stress case losses for this sector, KBRA's RMBS team reviewed each RMBS exposure individually and applied assumptions regarding a decline in residential property values and other stresses consistent with a KBRA AA+ rating.

Similarly conservative assumptions were applied to the other segments of the company's insured portfolio to develop an aggregate level of stress case losses. AGM's ability to pay these claims, together with other expenses, was assessed in KBRA's Bond Insurer Financial Model and AGM met all requirements with a comfortable balance remaining.

KBRA also conducted a detailed review of AGM's governance, credit and risk management and found them to be strong and reflecting best practices. AGM has a proven management team and a well-developed governance framework.

AGM's financial operations continue to show stabilization and improvement following the substantial losses incurred as a result of the credit crisis. Further detail is provided in the "Claims Paying Resources and Financial Profile" section.

This rating is based on KBRA's **Financial Guaranty Rating Methodology** published on June 19, 2013.

Key Rating Strengths
• AGM demonstrates an ability to withstand KBRA's conservative stress case loss assumptions across the breadth of its insured portfolio.
• The substantial and continuing runoff in structured finance components of the company's portfolio should continue to moderate risk. Structured finance exposure is now $29.4 billion, down from $91.4 billion at year end 2009.
• A mature and high-functioning operating platform supported by strong governance and risk management systems.
• A tested management team that is well positioned to address future portfolio risk issues should they develop given their experience through the credit crisis.

Key Rating Concerns

- The strained components of AGM's portfolio could experience losses approaching or exceeding the levels of stress case losses that KBRA assumed.
- Significant industry risks are created by narrow credit spreads, low interest rates, vigorous competition and the increased loss profile manifesting itself in the public finance market.
- AGM has been paying dividends in recent years to its parent at the maximum regulatory level. This could place downward pressure on the rating if portfolio risk levels increase rapidly or are not clearly visible in time to limit management's dividend practices.

Rating Summary

A key element of KBRA's analysis of AGM is testing the company's ability to provide for all claims under conservative stress case assumptions. These stress case losses do not represent KBRA's forecast but were developed to reflect KBRA's best estimate of the level of losses that a AA+ rated entity should be able to cover so that an investor holding a bond insured by AGM would not suffer losses under these assumed conditions.

KBRA's principal means to develop stress case losses is our Monte Carlo simulation model. Its specific application to AGM is described in more detail below. In addition, as noted in KBRA's methodology, we may substitute specific loss estimates for certain distressed exposures or sectors for losses generated by the simulation model for these exposures, and we did so for segments of AGM's portfolio. In KBRA's view, this produces a more conservative and targeted outcome than using solely the Monte Carlo simulation to analyze the portfolio's risk. This approach is more appropriate when considering a portfolio of distressed RMBS which has exhibited high levels of intra-asset correlation historically.

The table below summarizes how KBRA segmented AGM's portfolio and stressed the several components to estimate the AA+ stress loss levels for each component. The portfolio segments were (i) global RMBS, (ii) Puerto Rico, (iii) reinsurers, (iv) several distressed credits and potential liquidity claim events, and (v) the balance of the insured portfolio. The table shows the net par outstanding of each of these segments and the AA+ stress losses on a future value basis associated with each in our analysis.

AGM Portfolio Segmentation, Stress Losses and Treatment by Segment ($ in billions)			
Portfolio segment	**Net Par insured**	**AA+ Stress Losses[1] (Future Value)**	**Comments**
Global RMBS	$6.3	$1.7	RMBS individually analyzed with KBRA's RMBS methodology
Puerto Rico	$2.3	$0.8	Losses estimated for both issuers subject to Recovery Act and not subject to Recovery Act
Reinsurers (ceded par, not included in total below)	$147.5	--	Reinsurer stress losses included in stress losses of other segments
Distressed credits & liquidity claims	$2.0	$0.1	Losses, net of expected recoveries
Balance of portfolio	$153.4	$2.5	Monte Carlo simulation losses
Totals	**$164.0**	**$5.1**	**Aggregate stress losses tested in Bond Insurer Financial model**

[1] These are stress case loss assumptions, KBRA is not forecasting this level of losses for AGM

In our opinion, the aggregate of stress losses shown above ($5.1 billion on a future value basis) represents that level of losses that AGM would need to cover to achieve a AA+ financial strength rating. We assessed AGM's ability to meet these losses in the KBRA Bond Insurer Financial Model. The financial model begins with an asset base equal to AGM's claims paying resources according to KBRA's definition. These resources, plus a conservative estimate of installment premiums and interest earnings, must be sufficient to provide for the stress level claims and all other expenses. AGM was able to pay all claims and expenses in full and on time under this scenario with a comfortable balance remaining, which is an outcome consistent with the AA+ KBRA rating.

In developing the level of stress losses necessary to achieve the AA+ KBRA rating, the bulk of AGM's insured portfolio (93.5%) was analyzed with KBRA's Monte Carlo simulation model. As we described in our methodology, the model uses the assigned rating and sector of each insured credit to simulate default and severity performance over the remaining life of the portfolio. We generally used AGM's internal ratings but before doing so, KBRA reviewed the ratings across the portfolio and found them to be appropriate. KBRA ratings were used on those credits that we rate or are internally assessed by KBRA.

KBRA's Monte Carlo simulation model runs a series of 100,000 paths where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults in a particular path, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time and a loss amount is calculated. The model runs 100,000 paths to produce a broad distribution of results. We focus on the tail of this distribution to construct a stress analysis. The annual loss profile of this stress analysis was combined with the annual stress loss outflows from the other sectors in the table on the preceding page, and AGM's ability to pay all of these stress losses was analyzed and confirmed, along with operating expenses, in KBRA's Bond Insurer Financial Model.

KBRA will review AGM's rating and its performance related to industry trends and management's forecasts annually.

Outlook: Stable

AGM's declining portfolio risk and improving leverage ratios provide a stable framework for the AA+ rating. Furthermore, KBRA's stress case loss analysis incorporates significant deterioration in the distressed sectors of AGM's portfolio from current performance which should contribute to stability if ultimate losses do not approach or exceed these modeled levels. Although these factors suggest continuing improvement going forward, they need to be balanced against the possible offsetting effects of any potential portfolio acquisitions should they develop.

In KBRA's view, the following factors may contribute to a rating upgrade:

- Market factors that support consistent growth in claims-paying resources that include, for example, widening credit spreads, firmer pricing conditions, and improved and sustainable profitability.
- Further development of a low-risk insured portfolio with limited losses relative to claims-paying resources when subjected to KBRA's loss simulation and financial stress model.

In KBRA's view, the following factors may contribute to a rating downgrade:

- Market-wide increases in municipal default and severity rates and deterioration in the default and severity rates expected by KBRA within AGM's insured portfolio.
- Prolonged credit defaults over time that have the potential to exceed KBRA's modeled stress case expectations
- Significant changes in AGM's senior management team.
- Up-streaming of dividends from AGM in a manner which negatively impacts claims-paying resources.
- Portfolio acquisitions that, in KBRA's opinion, introduce excessive risk into AGM.

Background-Assured Guaranty

AGM's ultimate parent is Assured Guaranty Ltd., or AGL. AGL, together with its subsidiaries, Assured Guaranty or Assured, is a Bermuda based holding company incorporated in 2003 that provides financial guaranty products, through its subsidiaries, to the U.S. and international public finance, infrastructure and structured finance markets.

During 2007, the mortgage crisis developed into a worldwide financial crisis and resulted in significant downgrades and subsequent collapse of the financial guaranty industry. By September 2008, most financial guarantors were no longer writing new issue policies. Assured Guaranty, the lone industry survivor not subject to restructuring, continued to write new financial guaranty policies in the municipal market and has been the most active provider of financial guaranty products in this market from 2008 to the present**.**

On July 1, 2009, Assured acquired Financial Security Assurance Holdings Ltd., whose principal insurance subsidiary was Financial Security Assurance Inc. (FSA). KBRA understands that the purpose of the acquisition was to enable Assured to expand its franchise in the bond insurance industry. Assured continued to operate FSA and changed its name to Assured Guaranty Municipal Corp. (AGM).

Assured Guaranty now conducts its financial guaranty business principally through five insurance companies. The most active writer is AGM which also owns Assured Guaranty Europe (AGE) based in the UK. Together they provide financial guaranty policies on global public finance and infrastructure debt obligations. AGM insured $9 billion of direct par in 2013. The other operating companies are Assured Guaranty Corp. (AGC), Assured Guaranty Re Ltd. (AG Re) and Municipal Assurance Corp. (MAC), the latter rated **AA+, Stable Outlook** by KBRA. The new business activity of AGC and AG Re is more limited. AGC insured $203 million of par in 2013 and AG Re did not write any new business in 2013 except as a reinsurer of its affiliates, AGM and AGC.

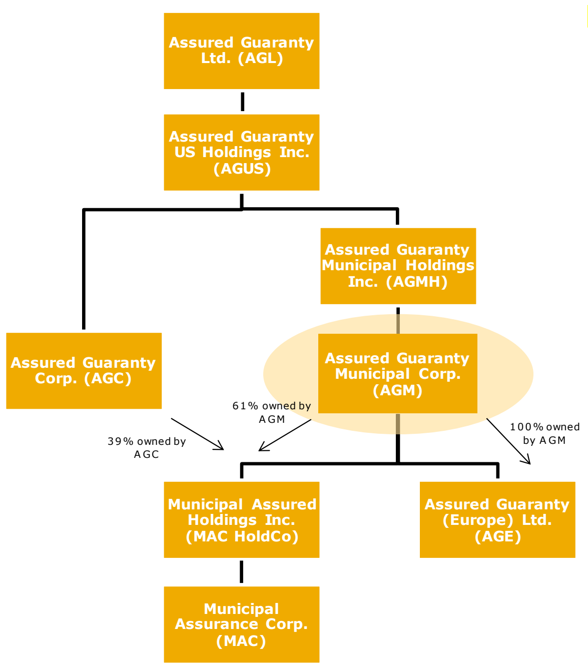
Key Rating Determinants

Rating Determinant 1: Corporate Assessment

Ownership Structure

AGM is a wholly-owned subsidiary of Assured Guaranty Municipal Holdings Inc. (AGMH), an intermediate holding company and a wholly owned subsidiary of AGL. AGM was founded in 1985 and is domiciled in New York. It is the largest operating subsidiary of AGL. AGM owns 100% of the common stock of AGE and supports its operations through a series of support agreements. AGM also owns 61% of Municipal Assurance Holdings Inc. while its affiliate AGC owns 39%.

AGM is highlighted in the corporate organizational chart below which shows its relationship with these entities.



Strategy

AGM's strategy is integrated with that of the other operating companies of Assured Guaranty. Each of the operating companies is organized to originate financial guaranty business in distinct market segments although there is some overlap, including regarding legacy exposures. AGM underwrites US municipal and international infrastructure business. MAC also underwrites municipal business, but does US municipal business exclusively and focuses upon smaller to medium size transactions in lower risk sectors. AGC underwrites primarily structured finance business but has done only a few transactions since the credit crisis. AG Re provides reinsurance capacity in all of these areas. KBRA notes that AGM and AGC have legacy exposures that differ from the risk profile of their current strategies.

AGM has been the most active writer of new business within the group with minimal new business underwritten by the other operating companies. In KBRA's opinion, AGM is more familiar than MAC to most municipal market professionals and has larger single deal capacity. AGM's origination in the US municipal market has been complicated by its legacy structured finance exposures but management expects this to diminish over time. The number of international infrastructure transactions underwritten by AGM has been few in recent years but management expects to play an increasing role in this sector in coming years.

Management indicates they expect the financial guaranty market to gradually grow in each of these three segments—US municipal, international infrastructure and structured finance and they believe the group is well positioned to participate in this growth.

Management has also publicly expressed interest in acquiring outstanding financial guaranty portfolios of run off companies. These initiatives could take the form of an acquisition or reinsurance of the insured portfolio by one or more of Assured's operating companies.

Corporate Governance

The governance framework of AGM mirrors that of the other operating companies. In KBRA's opinion, there are well-defined roles and line of communication between the Board and management. The Assured Guaranty Board of Directors is responsible for defining the business strategy for the overall group of companies. This incorporates the business objectives for each of the operating companies. The Assured Guaranty Board meets quarterly to review progress towards meeting the stated objectives and for purposes of strategic planning. There are also separate sessions to discuss current or emerging issues that might impact the business. Assured Guaranty Board members also play a key role in the company's Enterprise Risk Management process.

On an annual basis, the Assured Guaranty Board reviews and approves the corporate-wide risk appetite statement which incorporates AGM and AGM's Board also reviews and approves its own consistent risk appetite statement each year. Assured Guaranty's current risk appetite statement was reviewed and approved in May 2014. Assured Guaranty continues to identify preservation of capital, maintenance of the highest possible financial strength ratings and consistent market access as key corporate objectives. To achieve these objectives, it defines appropriate credit risk to include asset classes for which the company has substantial experience and credits that are considered to be of investment grade. There is also an emphasis on ensuring transactions have clear and enforceable rights and remedies which give the company the right to direct loss mitigation activities. As part of the current risk appetite statement, Assured Guaranty further clarified its risk philosophy in certain Public Finance sectors, emphasizing the need to ensure security supported by clearly identified funding sources and the need to maintain stringent underwriting criteria for certain higher risk sectors like general fund obligations, first budget obligation and annual appropriation leases. These clarifications reflect recent experience within the public finance market and at the company.

The Assured Guaranty Board has established a number of committees to assist in the review and oversight of areas considered to be critical to meeting business objectives. These include an Audit Committee, a Finance Committee and a Risk Oversight Committee. The Risk Oversight Committee assists the Board in establishing the risk appetite statement and reports to the Board on management's implementation of stated credit and remediation policies. It interacts directly with members of the Portfolio Risk Management Committee (PRMC). The Risk Oversight Committee is also involved in non-credit related matters such as enterprise risk management. The Audit Committee assists the Board in matters regarding financial statements and reporting. It is also responsible for ensuring that risk controls accurately monitor and allow for reporting against portfolio exposures.

The Company is also required to maintain a Nominating & Governance Committee and a Compensation Committee to ensure the Board and Management are comprised of qualified individuals and that compensation policies are consistent with the long-term objectives of the company. Each of the operating companies also has an independent Board of Directors that oversees compliance with the corporate policies and execution of individual business goals.

Assured Guaranty's PRMC is the primary management-level risk committee. It is responsible for establishing and enforcing Assured Guaranty's risk objectives. This includes setting risk limits, approving policies and procedures for new issue underwriting, surveillance and risk remediation and approving the composition of risk management committees at the other Assured companies. Any exceptions to stated policies or risk limits must be approved by the PRMC. PRMC's role encompasses each of the operating companies and the group of companies as a whole.

The PRMC is headed by Howard Albert, the Chief Risk Officer (CRO), and includes representatives from each of Assured Guaranty's operating divisions as well as the President/CEO. Mr. Albert has over 20 years of experience in the Financial Guaranty industry. The CRO function is supported by a Risk Department, which is responsible for providing the PRMC with research and data used to establish, monitor and reassess policies and procedures on a regular basis. The Risk Department is also responsible for the execution of policies established by the PRMC. The PRMC meets at least four times a year to review the company's insured portfolio and market trends. All decisions made by the PRMC are reported to Assured Guaranty's Risk Oversight Committee. This ensures that representatives of Assured Guaranty's Board are adequately informed about risk positions and industry trends.

KBRA also reviewed Assured's public disclosure and the January 2014 report from the independent consultant engaged by the Compensation Committee of AGL's Board of Directors to confirm that compensation policies continue to be consistent with the Company's long-term objectives regarding risk. Based on a review of the company's incentive policies and enterprise risk assessment, the independent consultant found no material change in the company's overall risk profile or its compensation policies and concluded that, in its opinion, the company continues to maintain an appropriate balance between business risks and compensation programs. The company also complies with all SEC requirements regarding disclosure of its compensation risk assessment process.

The AGL Board of Directors is currently composed of 11 members. Robin Monro-Davies serves as the chairman. Mr. Monro-Davies was elected Chairman of AGL in May 2013. He became a director in August 2005. Mr. Monro-Davies was Chief Executive Officer at Fitch Ratings from 1997 to 2001. Dominic Frederico, AGL's President and Chief Executive Officer, sits on the Board.

The funds managed by WL Ross & Co. LLC have liquidated and exited their investment in the common equity of AGL. Wilbur Ross, Jr. remains a member of the AGL Board of Directors as he has been for over six years but KBRA notes that he no longer has an economic interest in maintaining this position.

Management

The Executive and Senior Management Teams are highly experienced, having many combined years in the financial guaranty business and insurance industry.

Dominic Frederico, President and CEO of AGL, has held his position since 2003. Prior to his current position, Mr. Frederico was the Chairman of ACE Financial Services and supervised the operations of Assured Guaranty after its acquisition by ACE Limited in 1999. Prior to joining ACE, Mr. Frederico spent 13 years working for various subsidiaries of the American International Group.

Robert Mills, Chief Operating Officer of AGL, joined AGL in 2004 as Chief Financial Officer. Prior to joining Assured Guaranty, Mr. Mills was Managing Director, Chief Financial Officer and Operating Officer of UBS for the Americas and a member of the Board of Directors of UBS Investment Bank. Mr. Mills was previously with KPMG Peat Marwick as a partner and the National Practice Director for Investment Banking and Capital Markets.

James Michener, General Counsel and Secretary of AGL, joined Assured Guaranty in 2004. Mr. Michener was General Counsel and Secretary of Travelers Property Casualty Corp. from 2002 to 2004.

Robert Bailenson is Chief Financial Officer of AGL. He has been Managing Director and Chief Accounting Officer of AGL since 2005 and has been with Assured Guaranty and its predecessor companies since 1990. Prior to joining Assured Guaranty in 1990, Mr. Bailenson was with Ernst and Young LLP.

Howard Albert is Chief Risk Officer for AGL. Previously, he was Chief Credit Officer of AGL from 2004 to April 2011. He joined Assured Guaranty in September 1999 as Chief Underwriting Officer of AGC. Prior to joining Assured Guaranty, Mr. Albert was with Rothschild Inc. and Financial Guaranty Insurance Company.

Russell Brewer II is Chief Surveillance Officer of AGL. Mr. Brewer manages the risk profile of the insured portfolios of the Assured Guaranty companies and supervises both surveillance and certain risk mitigation activities. Prior to joining FSA in 1986, Mr. Brewer was an Associate Director of Moody's Investors Service, Inc.

Bruce Stern has been Executive Officer of Assured Guaranty Corp. and Assured Guaranty Municipal Corp. since 2009. Mr. Stern was General Counsel, Managing Director, Secretary and Executive Committee member of Assured Guaranty Municipal Corp. from 1987 until July 2009. Prior to coming to FSA, Mr. Stern was with the law firm of Cravath, Swaine & Moore.

Enterprise Risk Management

Assured maintains a comprehensive Enterprise Risk Management (ERM) process that is well integrated in its policies and procedures and serves to reinforce and extend Assured's risk focus to all departments within the organization. There are clear roles and responsibilities, and the process is designed to ensure existing and emerging risks are appropriately identified and addressed. Information generated through the ERM process is used by Senior Management and the Assured Guaranty Board to refine its risk appetite statement and modify existing policies and procedures, as necessary. Assured's approach to ERM should position it well to meet emerging state and industry requirements relating to risk management.

The ERM process is led by the CRO and the Risk Department and requires input from the risk owners in each department. Risks are grouped into one of the five key areas that support the company's risk objectives, including: i) credit, ii) market, iii) liquidity, iv) operations and v) strategic planning/business risk. A Risk Register is maintained to reflect risks that have been identified in day-to-day operations. The adequacy of current systems to address each risk is assessed. For those risks with material and measurable residual risks that are not adequately covered by management actions, Key Risk Indicators (KRI) are developed to allow for consistent measurement over time. KRI's are ranked based on the likelihood of occurrence and the potential impact to the company upon an occurrence. KRI's are used to create quarterly Own Risk & Solvency Assessment (ORSA) reports for each operating company and the enterprise as a whole. This process ensures consistent review and management of all risks considered to be material across the enterprise. Quarterly ORSA reports, and more detailed annual reports, are presented to the Assured Guaranty Board and used to refine risk controls and objectives, as necessary. The last quarterly review for AGM KBRA reviewed was completed in August 2014. The overall risk profile for the company was cited as stable, although the ORSA identified uncertainty of recoveries and loss estimates as a significant risk factor for the company. This reflects recent experience in the Public Finance market.

Assured periodically reviews its KRI's to determine if they are still relevant, and if a new KRI needs to be added. In 2013, Assured Guaranty added a number of KRI for review. These reflect certain specific risks relating to the company's Bond Purchase Program, compliance with existing or prospective accounting, tax and regulatory policies and monitoring of specified economic and market indicators. The Company also assesses emerging risks at least quarterly and presents any relevant issues to the Risk Oversight Committee for review.

Assured Guaranty has completed an inventory of all models as well as a review of what it considers high-risk models. It expects to complete its review of all risk models by mid-2015. As part of this process, the company approved and implemented a model Governance Policy that lays out its risk management framework for model development, documentation and related operational and security requirements.

ERM also considers the effectiveness of capital management across the company. Assured Guaranty reviews capital allocation relative to each operating company and the lines of business within the company. The company conducts regular reviews of assumptions in the economic capital model. In 2013, as part of this process, the capital charges for certain Public Finance sectors were increased. Stress testing and discrete scenario testing of model assumptions is performed on a quarterly basis to ensure maintenance of capital adequacy at various confidence levels, given various changes to key model assumptions such as loss, correlation and rating changes. Reports on stress testing are provided to the Assured Guaranty Board Risk Oversight Committee at least annually.

In KBRA's opinion, the integration of ERM policies in Assured Guaranty's governance structure is a key rating strength. It ensures consistency in the risk management processes and helps to support better risk avoidance and risk mitigation for unforeseen events. In addition, the consistent flow of information from the operating company to the Assured Guaranty Board provides for more accurate decision-making and strategic planning.

Credit Risk Management

KBRA's assessment of credit risk management focused on the following: (i) the company's stated risk appetite, (ii) internal policies and procedures supporting risk underwriting and portfolio management, and (iii) the adequacy of controls to identify and mitigate risk of loss. AGM's credit risk management framework mirrors that of the other U.S. operating companies. Existing policies also incorporate enterprise risk management and strategic planning, which are managed by the CRO as part of the Portfolio Risk Management process.

The PRMC establishes and governs credit policy. This includes defining the composition, authority and responsibilities for each of the company's credit committees, approving the credit review and approval process and approving underwriting guidelines. The credit policies are required to be reviewed on an annual basis. The most recent update is dated March 2014 which KBRA has reviewed.

In KBRA's view, AGM's credit policies and procedures are sufficiently detailed and help to ensure that insured transactions are consistent with the company's risk tolerance objectives. The underwriting process requires a quorum of voting members from the appropriate Credit Committee and must include at least two credit officers. Credit officer designations are made by the PRMC. The underwriting review and approval threshold increases to reflect higher levels of risk exposure. Risk limits reflect both issuer and sector loss assessments. Underwriters and internal legal counsel assigned to a transaction must also certify that the insured transaction is consistent with the transaction that was approved. This increases accountability and reinforces the need to keep management aware of any changes in the portfolio risk profile.

Assured's underwriting guidelines are well defined and consistent with industry standards. The guidelines provide a useful context for each sector as well as a discussion of any recent developments that might affect the risk parameters. The guidelines include a detailed discussion of all relevant credit factors and clearly define the information required for review of each sector. They also define the company's criteria for insurable risk in such terms as security, bond structure, economics and demographics, debt burden, financial performance, liquidity and overall issuer governance and management.

Single risk limits are established based on statutory capital levels and relative risk. AGM has established internal maximum single risk limits based upon sector. Riskier bond types with an expected higher risk of loss will have lower single risk limits. Each operating company's single risk limit reflects the lowest of the internally derived limit or any externally imposed limit. Limits are calculated by the Risk Management Department on a quarterly basis and available to staff on Assured Guaranty's intranet site. There are also overall risk limits imposed at the Assured Guaranty level to manage aggregate risk from the operating companies. In some instances, there are also sector limitations that reflect an internal assessment of intra-sector correlation. The single risk limit associated with average annual debt service is 10% of statutory capital, which is consistent with regulatory limits.

There are also several management-level committees that are integral to day-to-day operations. These include the following:

i. The U.S. Management Committee, which establishes strategic policy and reviews implementation of strategic initiatives and business progress for the U.S. operating companies. This committee is chaired by the Chief Operating Officer.
ii. The U.S. Credit Committee, which manages new issue underwriting for the U.S. operating companies and is chaired by the Chief Credit Officer.
iii. The U.S. Risk Management Committee, which is responsible for monitoring all transactions in the insured portfolio for the U.S. operating companies and is chaired by the Chief Surveillance Officer.
iv. The U.S. Workout Committee, which manages the risk remediation process for the U.S operating companies and is chaired by the Executive Officer.
v. The U.S. Reserve Committee which is responsible for establishing required reserves on the insured portfolio for the U.S. operating companies. In its role, the Committee reviews the reserving methodology and assumptions associated with each sector as well as the loss projection and probability scenarios associated with each impaired transaction. It is chaired by the Chief Financial Officer.

The charters for each of the noted committees encompass all of the U.S. operating companies. There is substantial redundancy in the committee membership, which helps to provide for the continuous flow of information from the business groups to management and Boards of the operating companies.

Rating Determinant 2: Insured Portfolio and Modeling Analysis

Overview

The section starts with a detailed review of AGM's insured portfolio followed by a discussion of KBRA's modeling and stress analysis of the portfolio. All par exposure numbers shown below are as of June 30, 2014 and are on a statutory basis as opposed to GAAP.[2]

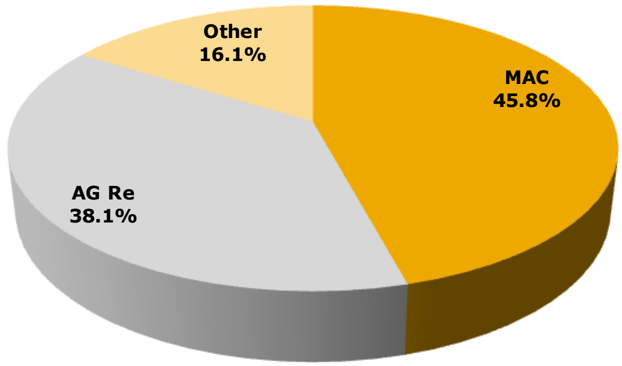
Insured Portfolio, Gross and Net Par

The AGM insured portfolio has a total of $311.5 billion in gross par and $164.0 billion in net par outstanding as of June 30, 2014. Although a substantial amount of gross par is reinsured, $147.5 billion or 47.4% of gross par, the bulk of this is to AGM's affiliates, MAC and AG Re. MAC has reinsured 45.8% and AG Re has reinsured 38.1% of ceded par, respectively, or a total of 83.9% of total cessions. KBRA's analytical assessment of AGM's exposure to its reinsurers is discussed below under "Portfolio Stress Analysis, Reinsurers".

[2] The most significant difference for AGM between Statutory and GAAP accounting with regard to net par outstanding is that all par reinsured to MAC is deducted from net par outstanding under Statutory reporting while for GAAP 100% of MAC's net par is added back to AGM's net par. In addition, only legally defeased bonds are deducted from GAAP net par while both legally and economically defeased bonds are deducted from Statutory net par.

AGM Portfolio (As of June 30, 2014) ($ billions)		**Net Par Outstanding**
Gross Par		$ 311.5
Ceded Par		
MAC	$ 67.6	
AG Re	56.2	
Other	23.7	
Total Ceded Par		147.5
Net Par		$ 164.0

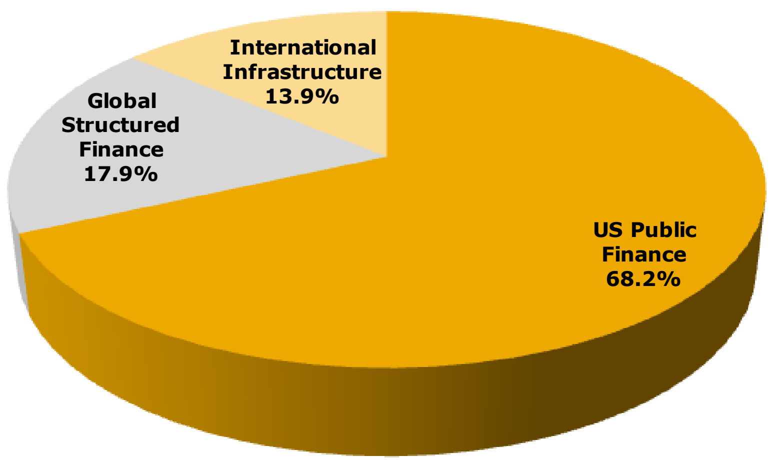
Distribution of AGM Ceded Par



Net Par Exposure by Type

The net retained insured portfolio consists of both public finance and structured finance obligations. Of total net par of $164.0 billion, 68% or $111.9 billion consists of U.S. public finance exposures, 18% or $29.4 billion consists of global structured finance exposures, and 14% or $22.8 billion is international infrastructure (includes international public finance), as shown in the pie chart below.

Distribution of AGM Net Par

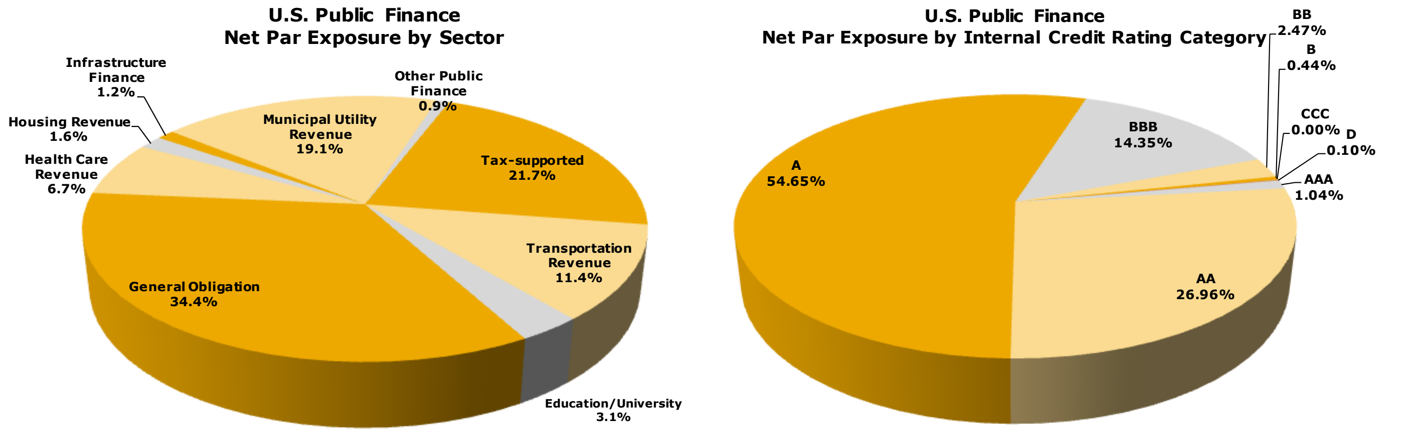


U.S. Public Finance

U.S. Public Finance is the largest segment of AGM's portfolio with a total of $111.9 billion in net par outstanding as of June 30, 2014. In this sector the insured net exposures consist of: 34.4% General Obligation sector, 21.7% Tax-Supported sector, 19.1% Municipal Utility Revenue sector, 11.4% Transportation Revenue sector, 6.7% Health Care Revenue sector, 3.1% Education/University sector, 1.6% Housing Revenue sector, 1.2% Infrastructure Finance sector, and a small percentage of miscellaneous public finance exposures. In AGM's U.S. Public Finance insured portfolio, 82.6% of net par exposures have credit ratings within the 'A' category or above, as indicated by AGM's internal rating assessment. More specifically, 1% of net par falls within the 'AAA' category, 27% of net par falls within the 'AA' category, and 54.6% of net par falls within the 'A' category. A total of 3% of net par exposure, or

$3.3 billion, falls within the 'BB' category or lower. AGM's U.S. Public Finance insured portfolio weighted average rating is 'A'.

The bulk of the public finance portfolio was assessed in the KBRA Monte Carlo simulation model except for certain expected or potential defaults where losses are reasonably estimable. These include Detroit, Stockton, San Bernardino and Puerto Rico (discussed below). Loss estimates and stress losses in these cases were separately treated as outflows in the Bond Insurer Financial Model where they were aggregated with all other stress losses.



Structured Finance

AGM has not written any structured finance business since the beginning of the credit crisis and this segment of the portfolio has dropped significantly since that time. At year-end 2009, AGM's structured finance portfolio was $91.4 billion.[3] It now stands at $29.4 billion net par outstanding. Structured Finance exposures include both US and international risks.

For analytical purposes, KBRA assessed the structured finance portfolio in two components, Non-RMBS and RMBS.

Non-RMBS portfolio

The Non-RMBS portfolio is the larger of the two components at $23.1 billion, and largely consists of CLO's ($10.4 billion) and Investment Grade Synthetic CDO's ($10.1 billion). These sub sectors are characterized by shorter remaining tenors and higher credit quality. Substantially all exposure in these two sub sectors matures by year end 2017. Moreover, 85.4% of the CLO's and 100% of the investment grade corporate synthetic CDOs are rated AAA.[4]

The balance of the Non-RMBS portfolio includes structured finance credits with a broader distribution of credit ratings. They include a mix of commercial and consumer ABS, insurance securitizations and PERPs, or perpetual preferred securitizations. The underlying assets of PERPs securitizations are subordinate obligations of medium to larger sized international banks and other zero coupon debt. The single purpose debt issuing entity is expected to satisfy the insured debt once the zero coupon debt accretes to a level

[3] AGM Financial Supplement, December 31, 2009
[4] AGM's internal ratings

where its market value, together with the market value of the PERPs, is sufficient to call or otherwise satisfy the insured debt.

The Non-RMBS portfolio was assessed in KBRA's Monte Carlo simulation model.

Structured Finance, Non-RMBS (As of June 30, 2014) ($ billions)	**Net Par Outstanding**
CLO's	$ 10.4
Investment Grade Synthetic CDO	10.1
Other	2.0
PERPs	0.6
Total Structured Finance, Non-RMBS	$ 23.1

Global RMBS portfolio

The global RMBS portfolio is of a much lower credit quality than the Non-RMBS by KBRA and AGM's own internal assessments. The table below shows a breakout of the global RMBS portfolio by type as well as a weighted average rating for each type.

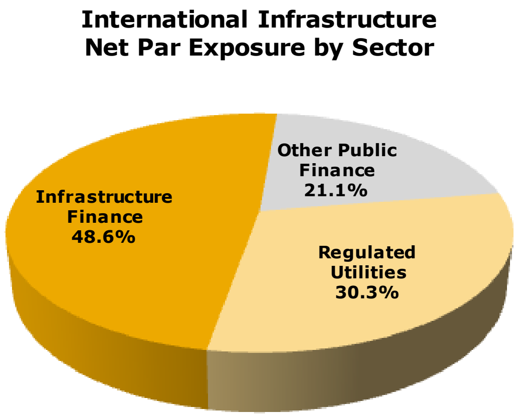
KBRA did not assess the global RMBS portfolio in the Monte Carlo simulation model but addressed it separately as discussed under "Portfolio Stress Analysis, Global RMBS".

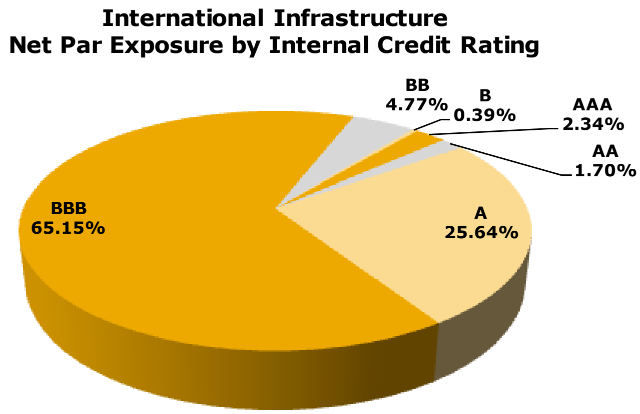
Global RMBS (As of June 30, 2014) ($ billions)	**Net Par Outstanding**	**AGM Internal Weighted Average Rating**
Subprime	$ 2.9	BBB+
HELOC	1.4	BB+
Alt A	0.9	B+
Options ARMs	0.3	BBB
CES	0.2	BBB+
Prime	0.7	A
Total Global RMBS	$ 6.3	

International Infrastructure

AGM's International Infrastructure insured portfolio, which includes International Public Finance, has a total of $22.8 billion in net par outstanding as of June 30, 2014. The insured net exposures consist of: 48.6% Infrastructure Finance, 30.3% Regulated Utilities, and 21.1% Other Public Finance. In AGM's International Infrastructure insured portfolio, 29.7% of net par exposures have credit ratings within the 'A' category or above, as indicated by AGM's internal rating assessment. More specifically, 2.3% of net par falls within the 'AAA' category, 1.7% of net par falls within the 'AA' category, and 25.6% of net par falls within the 'A' category. The majority of net par, 65.2%, falls within the 'BBB' category. A total of 5.2%, or $1.2 billion, falls within the 'BB' category or lower. The weighted average rating for this overall portfolio segment is 'BBB+'.

The International Infrastructure portfolio was assessed using KBRA's Monte Carlo simulation model.





Portfolio Stress Analysis

KBRA subjected four specific components of the portfolio to their own individual stress analysis because in our opinion, the risk warranted a different analytical treatment. The balance of the portfolio was analyzed using KBRA's Monte Carlo simulation model. The four components of the portfolio treated separately were as follows:

1. Global Residential Mortgage Backed Securities (RMBS) that account for $6.3 billion of net par outstanding at June 30, 2014.
2. The reinsurers of AGM which have been ceded a total of $147.5 billion of its gross insured portfolio as of June 30, 2014.
3. Exposure to Puerto Rico, including AGM's reinsurers of Puerto Rico exposure, that consist of $4.2 billion of gross par exposure and $2.3 billion of net par exposure as of June 30, 2014.
4. Distressed credits and liquidity claims under certain insured infrastructure transactions.

A discussion of the stress analysis applied to each of these four areas is presented below followed by a description of KBRA's Monte Carlo model.

Global Residential Mortgage Backed Securities (RMBS)

Substantially, all of AGM's global RMBS portfolio was analyzed on an individual transaction basis by KBRA's RMBS analytical team. KBRA obtained transaction detail at the CUSIP and insured tranche level from AGM which represented the individual insured positions outstanding as of June 30, 2014. For each insured U.S. position, the loan level data of the underlying collateral pool was updated and loan level losses were projected consistent with KBRA's **U.S. RMBS Rating Methodology**. Collateral pools supporting each transaction were stressed by assuming economic conditions that produce a 40% decline in residential housing values from current levels with accompanying increases in delinquency, default and severity rates. KBRA's analysis then assigned the residential loan level losses to individual tranches based on the waterfall provisions of the RMBS trusts and further allocated losses to AGM on those positions they insure.[5] The representation and warranty agreements AGM has with several financial institutions were factored into this analysis on a transaction level basis and served to decrease the ultimate losses to AGM.

This analytical approach imposes a uniform, simultaneous shock on each transaction within the RMBS portfolio that KBRA believes is a more appropriate approach than Monte Carlo analysis when considering a portfolio of largely distressed RMBS which has exhibited high-levels of intra-asset correlation historically. In KBRA's opinion, this level of stress losses applied to the RMBS portfolio is consistent with a AA rating level for a diversified portfolio.

The losses attributed to each insured RMBS position of AGM were aggregated by year. Over the term of the insured RMBS the total amount of aggregate losses assessed against this exposure was $1.7 billion on a future value basis. This aggregate annual stream of loss payments was added to all other stress loss payments that became annual cash outflows in the KBRA Bond Insurer Financial Model.

AGM Reinsurers

AGM has $ 311.5 billion of gross par outstanding and $164 billion of net par outstanding. The difference between gross par and net par of $147.5 billion or 47% is the amount it has ceded to reinsurers. Since AGM is liable for the full amount of gross par insured in the event of a failure by any reinsurer to perform, KBRA believes that it is important that the credit strength of these reinsurers be incorporated in KBRA's stress analysis of AGM.

The table below shows AGM's gross and net par and the amount of risk ceded to each of its reinsurers. The largest two reinsurers by a wide margin are MAC and Assured Guaranty Re, two affiliates of AGM, with $67 billion and $56 billion of ceded par or 46% and 38% of the total amount ceded by AGM, respectively.

AGM Gross Par and Ceded Par, by Reinsurer, as of June 30, 2014	**Par outstanding ($ in millions)**	**% of Ceded Par (%)**
AGM, Gross Par	**$311,525**	
Ceded Par, Affiliates		
MAC	67,559	45.8
AG Re	56,263	38.1
Sub-total Ceded Par, Affiliates	**123,823**	**83.9**
Ceded Par, Non Affiliates		
Tokio Marine	5,817	3.9
American Overseas	5,684	3.9
Radian Asset Assurance	4,320	2.9
Syncora Guarantee	4,054	2.7
Mitsui Sumitomo	2,005	1.4
ACA Financial Guaranty	703	0.5
Others	1,105	0.8
Sub-total Ceded Par, Non Affiliates	**23,689**	**16.1**
AGM, Net Par	**$164,014**	

[5] AGM's HELOC exposure was not analyzed at the loan level. Stress losses were developed based upon similarly stressful assumptions applied to historical performance.

Affiliate reinsurers

MAC is rated **AA+, Stable Outlook** by KBRA. As noted in our report, KBRA views the ability of MAC to meet its obligations to AGM and its other policyholders to be of a very high quality so there was not a meaningful level of stress applied to AGM in our analysis resulting from losses it might incur from MAC's failure.

KBRA does not rate Assured Guaranty Re nor has it conducted a comprehensive review of its insurance financial strength. However, we did subject its claims paying resources to stress losses from its insured portfolio in the KBRA bond insurer financial model. These stress losses were imposed on many of the same credits that were incorporated in the stress loss attribution KBRA applied to AGM because there is a high degree of overlap in the insured exposures of the two companies. This analysis leads KBRA to a favorable level of comfort that Assured Guaranty Re will be able to perform on its reinsurance obligations to AGM in our stress case, although not to the same degree as MAC. In addition, AGM holds collateral under the reinsurance agreements with AG Re. These collateral amounts are $635 million as of June 30, 2014. Although these collateral amounts can fluctuate over time, KBRA believes they provide significant support to AG Re's reinsurance obligations to AGM.

Non Affiliate Reinsurers

The balance of AGM's reinsurance panel is non-affiliate reinsurers who are characterized by a diversity of credit quality. KBRA has conducted an internal review and assigned each one an internal credit rating category ranging from the upper levels of investment grade to well below investment grade.

These internal credit rating categories were used in the KBRA Monte Carlo model in a dual default approach. If an insured position that was reduced by reinsurance defaulted in a particular path, the model then assigned a default frequency and severity to the reinsured portion of that position based upon the reinsurer's rating. If the reinsurer also defaulted in that path, the portion of exposure ceded to that reinsurer was added back to AGM's net exposure to calculate the loss attributed to AGM. These total losses, from the underlying obligor and the reinsurer, were aggregated into the total annual losses in the AGM stress analysis.

Further stresses in the form of reinsurer failure were also incorporated into certain potential liquidity claims (policy claims where full recovery is expected) and with respect to the stress applied to Puerto Rico (discussed next).

Puerto Rico

AGM has substantial exposure to the various issuers of the Commonwealth of Puerto Rico. The Legislature of the Commonwealth passed the Puerto Rico Public Corporation Debt Enforcement and Recovery Act on June 28, 2014 which is designed to be one of the means to address the severe financial strain of the Commonwealth. This legislation provides a framework for restructuring the debt of several Commonwealth issuers including Puerto Rico Electric Power Authority (PREPA) and Puerto Rico Highway and Transportation Authority. AGM has significant exposure to these issuers eligible for restructuring and several that are not eligible, as shown in the table below.

AGM Puerto Rico Exposure, Gross and Net Par ($ in millions) As of June 30, 2014		
Subject to Recovery Act	Gross Par	Net Par
PREPA	$904	$478
PRHTA (Transportation)	438	317
PRHTA (Highway)	556	199
Subtotal, Subject to Recovery Act	1,898	994
Not Subject to Recovery Act	Gross Par	Net Par
GO's	$1,317	$754
COFINA	268	261
MFA	640	252
Building Authority	80	24
Subtotal, Not Subject to Recovery Act	2,305	1,291
Grand Total, PR Exposure	$4,203	$2,285

In light of the Commonwealth's significant financial strain that remains unresolved, KBRA applied stress losses resulting from AGM's insurance of Puerto Rico debt. We assumed the losses to AGM would be realized annually as insured principal and interest come due. Loss severities were applied to both those exposures eligible for the recovery act restructuring and those not eligible although the loss severity for the eligible securities was higher. KBRA further assumed that two of AGM's reinsurers would not perform under this scenario and those reinsured losses would have to be borne by AGM.

Under the assumptions applied by KBRA, total net losses to AGM were nearly $800 million on an undiscounted basis over the life of the insured Puerto Rico debt. We want to make clear that with this stress assumption, KBRA is not forecasting this level of losses for AGM or this overall outcome for the Commonwealth. Rather, it is KBRA's opinion that AGM should be able to withstand claims of this level from such a large and strained exposure to achieve a AA+, Stable Outlook rating.

Distressed credits and liquidity claims

For a number of high profile defaulted municipal credits KBRA estimated discrete losses and treated them as outflows in the financial model and did not include these exposures in the Monte Carlo model. These credits include AGM's exposure to Stockton, San Bernardino, and Detroit Unlimited GO (AGM's exposure to Detroit Water and Sewer remained in the Monte Carlo model). We estimated loss severities based upon our current understanding of their respective chapter 9 proceedings even though they are not all finalized.

We also treated separately the debt of certain AGM-insured infrastructure projects. In these cases the debt structures incorporated shorter term maturities with the expectation that these shorter term maturities would be refinanced prior to maturity. Current market conditions suggest such refinancings are unlikely which would subject AGM to claims on its policies in the near to mid-term. AGM expects a full recovery on these liquidity claims and no ultimate loss because of the fundamentals of the projects and the long term nature of the underlying concessions. KBRA applied stress assumptions to these liquidity events which incorporated the following: (i) no refinancing, (ii) failure of two reinsurers and (iii) a discount to the ultimate recoveries.

In the financial model, total net outflows in these cases were about $200 million.

Monte Carlo Simulation Model

As discussed in KBRA's Financial Guaranty Rating Methodology, KBRA performs a stochastic analysis of the insured portfolio risk by applying a Monte Carlo simulation model that produces a distribution of loss outcomes for that portfolio. KBRA views this as the most appropriate approach for modeling the large, diverse portfolios typical of the financial guaranty industry. As part of our analysis KBRA ran AGM's portfolio with details for each insured position as of June 30, 2014 through the KBRA Monte Carlo loss simulation model, not including those items discussed above that were separately stressed.

The model uses the assigned rating and sector of each insured credit to simulate default and severity performance over the remaining life of the portfolio. We generally used AGM's internal ratings but before doing so, KBRA reviewed the ratings for a select number of credits and found them to be consistent with our assessment. We also reviewed the ratings for all those credits in the three lowest surveillance rating categories and all loss reserve credits. KBRA ratings were used on those credits that are independently rated or by KBRA or have been internally assessed in some other context.

The Monte Carlo model runs a series of 100,000 paths where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time and a loss amount is calculated. The model runs 100,000 paths to produce a broad distribution of results. We focus on the tail of this distribution to construct a stress analysis. The aggregate of all annual loss payments in this loss profile of this stress analysis was $2.5 billion on a future value basis.

Bond Insurer Financial Model

KBRA assesses the ability of a financial guarantor to pay claims in a financial model. The model uses AGM's Claims Paying Resources (defined in the "Claims Paying Resources" section below) as a beginning base of assets. These assets earn interest at rates adjusted downward by KBRA from the company's current yield levels. In addition, the company's estimate of future installment premiums (KBRA haircut by 10%) provides additional resources.

The model assesses the ability of the company with these defined resources to pay annual stress losses and other expenses through the 35 year forecast period. For AGM, the stress losses (all on a future value basis) were the sum of (i) the aggregate annual losses generated in the loss profile KBRA developed from the tail distribution of the Monte Carlo simulation model of $2.5 billion, (ii) the RMBS stress losses of $1.7 billion, (iii) Puerto Rico stress losses of nearly $800 million, and (iv) other stress outflows of about $100 million described above under "Portfolio Stress Analysis".

Given the level of stress losses assumed in this analysis, the company is assumed by KBRA to go into run off immediately and expenses begin to decline after year 5.

AGM is able to pay all claims and other expenses in this analysis with a comfortable amount of assets remaining at the end of the 35 year forecast period. This result is consistent with a AA+ rating, in KBRA's opinion.

Surveillance

AGM's surveillance of its insured risk is integrated with the surveillance process for all of Assured. Surveillance follows a set of priorities that determine how frequently credits are reviewed. Upon review each credit is assigned to one of six surveillance categories ranging from 1 to 6 that also determine the level of ongoing review. Category 1 and 2 credits are considered to be performing in accordance with expectations and are generally reviewed on an annual or semi-annual basis. Category 3 generally requires quarterly reviews. At Category 4 the intensity of review increases further and generally requires the creation of a team that includes legal resources. Categories 5 and 6 are considered impaired and require the establishment of loss reserves. They are also monitored through both the Risk Management Committee and the Workout Committees. Further, a credit review can also be triggered by an event impacting individual or regional exposures, such as a natural disaster, or an event impacting an entire sector such as a change in Federal law.

Written credit reports document the surveillance review. KBRA reviewed the surveillance reports for all AGM credits in the three lowest surveillance categories (4, 5 and 6). In addition, for many sectors, AGM's entire exposure to the sector is reviewed in one report. KBRA reviewed the most recent reports for the following sectors:

1. Pooled Corporate
2. Consumer receivables
3. Aviation sector report
4. Other ABS sector report
5. Commercial Real Estate sector report
6. Financial Products sector report

Based upon this review, it is KBRA's opinion that AGM's surveillance process provides for a comprehensive and thorough approach for identifying, reporting and mitigating potential losses within the insured portfolio.

Rating Determinant 3: Claims Paying Resources and Financial Profile

Investments

As of June 30, 2014, total investments including $456 million of cash and short term investments were $4.7 billion. On a statutory basis the average pre-tax book yield is 4.06%. The largest segment of the investment portfolio is municipal bonds which consisted of 57% of the entire investment pool while mortgage-backed securities and corporate bonds contributed of 16% and 11% of the total book, respectively. The average security rating is AA-.

AGM investment portfolio on a statutory basis ($ Millions)					
SECTOR	**Amortized Cost**	**% or Portfolio**	**Pre-Tax Yield**	**Book Yield After-tax**	**Fair Value**
Obligations of state and political subdivisions	$2,635	57%	4.04%	3.79%	$2,762
US Government and agencies	42	1%	3.23%	2.10%	45
Corporate	524	11%	4.34%	2.82%	514
RMBS	515	11%	8.03%	5.22%	505
CMBS	225	5%	3.37%	2.19%	230
ABS	254	5%	3.62%	2.35%	258
Foreign Government	4	0%	4.03%	2.62%	4
Total Fixed Maturities	**$4,199**	**90%**	**4.50%**	**3.66%**	**$4,318**
Short term investments	456	10%	0.02%	0.02%	456
Total	**$4,655**	**100%**	**4.06%**	**3.30%**	**$4,774**

Investments as of June 30th, 2014. The average internal credit rating for these securities is AA-

Balance Sheet, Statutory Basis

The increase in contingency reserves from year end 2013 to June 30, 2014 was due to regular quarterly contingency reserve additions. At December 31, 2013, cash and cash equivalents was $647.1 million which is a 62% increase compared to a year ago. The positive movement in short term liquidity was due largely to the settlement with UBS and the unwinding of a pooling agreement with affiliates.

As of June 30, 2014, common and preferred stock of $628 million has increased by 17% from year end 2013, which represents 10% of the entire investment portfolio. The common stock reflects AGM's ownership of MAC (61%) and AGE (100%).

As of June 30, 2014 net unearned premium reserves (after deductions ceded to reinsurers of $1.08 billion) was $1.49 billion and is the largest component of the liabilities side of the balance sheet. Net unearned premium reserves were relatively flat as of June 30, 2014 compared to December 31, 2013 with only a $3.4 million increase. The change in the unearned premiums from last year was mainly a function of the net written premiums less the earnings as well as the adjustment for foreign exchange revaluation.

Select AGM Statutory Balance Sheet Data					
$ Thousands	**2Q2014**	**2Q2013**	**2013**	**2012**	**2011**
Bonds	4,198,734	2,960,824	3,921,116	2,800,547	2,778,466
Common Stock	582,574	851,400	535,666	820,936	626,259
Preferred Stock	45,000	0	0	0	0
Total Investments	**4,826,308**	**3,812,224**	**4,456,783**	**3,621,483**	**3,404,725**
Net underwriting Gains	61,948	170,489	251,102	31,599	249,108
Cash & short term investments	455,958	447,925	647,084	398,397	319,757
Other assets	441,687	327,744	419,449	309,383	341,000
Total cash and invested assets	**5,723,953**	**4,587,893**	**5,523,317**	**4,329,264**	**4,065,482**
Investment income due and accrued	41,196	30,138	37,916	29,416	32,205
Deferred tax assets	73,905	51,347	64,190	59,495	52,438
Total Assets	**$5,851,342**	**$4,683,813**	**$5,712,135**	**$4,498,510**	**$4,385,624**
Loss and LAE Reserves	364,650	144,174	339,719	(12,428)	212,042
Unearned Premium Reserve	1,493,238	1,250,922	1,489,865	1,344,889	1,398,564
Provisions For Reinsurance	4,390	8,700	0	0	0
Aggregate write-in for liabilities	1,900,616	1,207,162	1,784,055	1,128,616	1,381,874
Total Liabilities	**$4,111,817**	**$2,890,471**	**$3,978,986**	**$2,718,458**	**$3,176,320**
Common capital stock	15,000	15,000	15,000	15,000	15,000
Surplus Notes	50,000	100,000	75,000	125,000	175,000
Gross paid-in and contributed surplus	778,266	776,884	778,266	776,884	776,884
Unassigned Funds	896,259	901,473	864,883	863,167	242,420
Total Surplus	**$1,739,525**	**$1,793,358**	**$1,733,149**	**$1,780,051**	**$1,209,304**
% cash & short term assets	8%	10%	11%	9%	7%
% in fixed income	72%	63%	69%	62%	63%
Net Investment Yield	3.30%	3.84%	3.45%	3.91%	4.22%
Claims paying resources:					
Unearned premium reserves	1,493,238	1,250,922	1,489,865	1,344,889	1,398,564
Loss & LAE reserves	364,650	144,174	339,719	(12,428)	212,042
Contingency reserve	1,704,585	1,071,439	1,586,565	993,555	1,238,031
Policyholder surplus	1,739,525	1,793,358	1,733,149	1,780,051	1,209,304
Adjustments for affiliate capital	*(655,299)*	*(300,000)*	*(651,534)*	*(300,000)*	*(300,000)*
Total claims paying resources (KBRA definition)	**$4,646,699**	**$3,959,892**	**$4,497,765**	**$3,806,067**	**$3,757,940**
source: AGM statutory filings *Net investment yield for 2Q14 and 2Q13 was annualized.*					

Claims Paying Resources

KBRA defines claims paying resources (CPR) as the sum of policyholder surplus, contingency reserve, loss and loss adjustment reserve and unearned premium reserves which in AGM's case sums to $5.3 billion. However, we exclude certain investments in affiliates, namely the surplus notes of Assured Guaranty Corp. and MAC as well as the equity of MAC because they are illiquid and deeply subordinate.[6] We do include AGM's equity holdings in AGE in our definition of CPR because it is wholly owned by AGM and all net par of AGE is included in AGM's net par (and KBRA's portfolio analysis of AGM). Further, as a regulated

[6] KBRA does reflect the performance of the MAC surplus notes in accordance with their terms in our financial model because KBRA rates MAC at AA+ which is consistent with the view that they can fully provide for their surplus notes.

entity, AGE's total assets, which are several times the value of AGE equity on AGM's balance sheet, should be substantially restricted for the benefit of AGE's policy holders.

After these adjustments, AGM's CPR is $4.6 billion. As noted above in "Bond Insurer Financial Model", this adjusted CPR becomes the beginning base of assets in KBRA's Bond Insurer Financial Model.

Select AGM Statutory Balance Sheet Data					
$ Thousands	**2Q2014**	**2Q2013**	**2013**	**2012**	**2011**
Claims paying resources:					
Unearned premium reserves	1,493,238	1,250,922	1,489,865	1,344,889	1,398,564
Loss & LAE reserves	364,650	144,174	339,719	(12,428)	212,042
Contingency reserve	1,704,585	1,071,439	1,586,565	993,555	1,238,031
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Total claims paying resources (KBRA definition)	**$4,646,699**	**$3,959,892**	**$4,497,765**	**$3,806,067**	**$3,757,940**

source: AGM statutory filings
Net investment yield for 2Q14 and 2Q13 was annualized.

Income Statement

The 2013 annual income statement had an underwriting gain of $251.1 million compared to $31.6 million the same period a year ago. The underwriting gain was driven by a $137.9 million recovery of losses from UBS which were related to certain AGM insured RMBS transactions. This was somewhat offset by increased reserve due to bankruptcy proceedings of Detroit and Stockton and certain RMBS exposures. As of December 2013, although the Company wrote direct premiums of $227.4 million, they ceded $413.8 million to their reinsurer affiliates (reflecting the formation of MAC) resulting in a negative written premium of $191 million. Net investment income increased by $60 million to $230 million from the same period a year ago due to increased yields and asset growth resulting from the termination of the intercompany pooling agreement.

Return on surplus was a favorable 19% in 2013 on an after tax basis.

Select AGM Statutory Income Data					
$ Thousands	**2Q2014**	**2Q2013**	**2013**	**2012**	**2011**
Net Premiums Written	$88,577	$37,895	($191,293)	$196,094	$150,821
Net premiums earned	94,966	170,717	296,018	257,235	233,597
Loss & loss adjustment expenses	(16,916)	(49,079)	(56,914)	168,729	(68,514)
Other underwriting expenses	49,934	49,307	101,830	56,907	53,004
Total losses & operating expenses	33,018	227	44,916	225,636	(15,511)
Net underwriting gain (loss)	61,948	170,489	251,102	31,599	249,108
Net investment gain (loss)	90,378	96,421	230,009	169,468	103,209
Earnings Before Taxes	**155,261**	**263,114**	**461,744**	**243,501**	**268,135**
Net Income	$119,787	$180,185	$339,635	$203,314	$398,538
Expense ratio (op. exp. / Net. Prem. Written)	56%	130%	-53%	29%	35%
Loss ratio (L&LAE / Net Prem. Earned)	-18%	-29%	-19%	66%	-29%
Combined ratio	**39%**	**101%**	**-72%**	**95%**	**6%**
Return on Surplus (ROS) Pre-tax basis *	18%	29%	26%	16%	25%
Return on Surplus (ROS) After-tax basis *	14%	20%	19%	14%	37%
Return on Revenue (ROR) Pre-tax basis	84%	98%	88%	57%	80%

source: AGM statutory filings

** Return on Surplus was annualized for the 2Q 2014 by multiplying the earnings by 2.*

** Annual 2013 Expense ratio is based on a large ceded book of business to reinsurers which is why Premiums Written are a negative value. Loss ratio for 2Q14, 2Q13 and Annual 2013 also have a recovery in the losses as presented by a negative value.*

Dividends

AGM has up-streamed dividends at or near the maximum amount allowed over the past 2 years and KBRA expects this pattern to continue.

AGM's ability to pay dividends is subject to limitations imposed by New York insurance law, which provides that a New York financial guaranty insurer generally cannot pay a dividend except out of the portion of the insurer's earned surplus that represents the net earnings, gains or profits which that insurer has not otherwise utilized. Additionally, without regulatory approval, a New York financial guaranty insurer may not pay dividends in aggregate during any 12-month period in excess of the lesser of 10% of its surplus and 100% of its adjusted net investment income for such 12-month period. The contingency reserve established by a financial guaranty insurer further limits its dividends capacity as regulators require sufficient liquidity to protect policyholders against loss during periods of financial constraint. In 2013 the Company declared and paid dividends of $163 million. The collective amount of dividends available for AGM to distribute in the next twelve months without regulatory approval is estimated to be approximately $174 million as of June 30th 2014 and we expect the Company to pay the full amount allowed.

AGM does not expect AGE to distribute any dividends at this time. While UK insurance regulation impose no statutory restrictions on AGE's ability to declare a dividend, the Prudential Regulation Authority's capital requirements may in practice act as a restriction on dividends.

XOL Reinsurance

AGM, jointly with MAC and AGC has entered into an aggregate excess of loss reinsurance facility with a number of reinsurers rated AA- or higher or who have posted collateral. The facility attaches when the group's combined net losses in certain defined US municipal risk exceeds $1.5 billion in aggregate. It covers $450 million of the next $500 million of losses on a pro rata basis, while AGM, MAC, and AGC jointly retain the remaining $50 million. AGM, MAC and AGC have jointly paid $19 million of annual premium at the outset of 2014. The reinsurance agreement terminates on January 1, 2016 unless the Assured subsidiaries decide to extend it. Because of its joint nature and the potential for losses at MAC or AGC to limit the support available for AGM, this facility is not incorporated in KBRA's analysis of AGM's rating.

Conclusion

AGM demonstrates an ability to withstand KBRA's conservative stress case loss assumptions and benefits from a tested management team supported by strong governance and risk management systems.

The substantial and continuing runoff in structured finance segments of the company's portfolio should continue to moderate risk.

Balanced against these favorable trends are the company's expected dividend practices which could strain capital going forward and the significant industry risks created by narrow credit spreads, low interest rates, vigorous competition and the increased loss profile manifesting itself in the public finance market.