Assured Guaranty Re Ltd.

(a wholly-owned subsidiary of Assured Guaranty Ltd.)

2017 Financial Condition Report

Assured Guaranty Re Ltd.

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Definitions

Term	Definition
AGC	Assured Guaranty Corp.
AGL	Assured Guaranty Ltd.
AGM	Assured Guaranty Municipal Corp.
AGOUS	Assured Guaranty Overseas US Holdings Inc.
AG Re	Assured Guaranty Re Ltd.
AGRO	Assured Guaranty Re Overseas Ltd.
AG Services	AG US Group Services Inc.
Affiliated Ceding Companies	AGC and AGM
Assured Guaranty or Group	AGL together with its subsidiaries
Best Estimate Technical Provisions	Gross best estimate portion of the technical provisions value
BIG	Below-investment-grade
BMA or the Authority	Bermuda Monetary Authority
Board	Board of Directors
BSCR	Basic Solvency Capital Requirement
The Company	AG Re together with its subsidiaries
CDS	Credit default swap
CISSA	Commercial Insurers' Solvency Self-Assessment
CMBS	Commercial mortgage-backed securities
Code of Conduct	Insurance Code of Conduct issued by the Bermuda Monetary Authority
Companies Act	Bermuda Companies Act 1981
ECM	Economic capital model
ECR	Enhanced capital requirement
Expense Load	Present value of projected future operating expenses
Fitch	Fitch Ratings
GPO	Gross par outstanding
IG	Investment Grade
Insurance Act	Bermuda Insurance Act 1978, as amended, and related rules and regulations
IPO	Initial Public Offering
IT	Information Technology
KRIs	Key risk indicators
LAE	Loss adjustment expense
Moody’s	Moody’s Investors Service Inc.
MSM	Minimum Margin of Solvency
NPO	Net par outstanding
PVP	Present Value of New Business Production
Rating Agencies	S&P, Moody’s or Fitch
Reduction	Present value of all future premiums expected to be received by the Company after consideration of potential non–payment on premiums due to future defaults of guaranteed transactions
RMBS	Residential Mortgage-Backed Securities
RMC	Risk Management Committee
RVI	Residual Value Insurance

Definitions
(continued)

Term	Definition
S&P	S&P Global Ratings, a division of Standard & Poor's Financial Services LLC
Solvency Regulations	BMA's Insurance (Prudential Standards) (Class 4 and 3B Solvency Requirement) Rules
Standard Formula	Standard formula to calculate the Basic Solvency Capital Requirement provided by the BMA
U.S.	United States of America
U.S. GAAP	Accounting Principles Generally Accepted in the United States of America
USD	U.S. Dollars
VaR	Value-at-risk

INTRODUCTION

Business Overview

AG Re is wholly owned by AGL, a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the U.S. and international public finance (including infrastructure) and structured finance markets.

AG Re was incorporated as a Bermuda exempted company under the Companies Act and is licensed as a Class 3B Insurer under the Insurance Act. AG Re owns AGOUS, a Delaware corporation, which owns the entire share capital of a Bermuda reinsurer, AGRO. AGRO was incorporated as a Bermuda exempted company under the Companies Act and is licensed as a Class 3A Insurer and a Class C Long-Term Insurer under the Insurance Act. AGRO owns AG Intermediary Inc., a New York insurance intermediary company.

AG Re and AGRO write business as reinsurers of third-party primary insurers and as reinsurers/retrocessionaires of certain affiliated companies. Under a reinsurance agreement, the reinsurer, in consideration of a premium paid to it, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more insurance policies that the ceding company has issued. The Company reinsures financial guaranty insurance contracts under quota share and excess of loss reinsurance treaties and, through AGRO, provides certain other types of reinsurance. AG Re and AGRO may also write insurance directly, but their current insurance portfolios consist primarily of reinsurance.

AG Re primarily underwrites financial guaranty reinsurance. Financial guaranty insurance policies provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Upon an obligor's default on scheduled principal or interest payments due on the obligation, the primary insurer is required under the financial guaranty policy to pay the principal or interest shortfall.

AGRO provides financial guaranty and non-financial guaranty reinsurance. The non-financial guaranty reinsurance that the Company provides has similar risk profiles to the structured finance exposures written in financial guaranty form. The Company currently provides non-financial guaranty reinsurance mainly for U.S. based insurance capital relief transactions (Triple X) and aircraft RVI transactions. Triple-X transactions provide U.S. life insurers and reinsurers capital relief from the excess statutory reserves they are required to hold by U.S. state regulators over what the respective life insurers and reinsurers believe are necessary for level premium term life insurance policies. RVI policies guarantee that a specific, properly maintained asset will have a specified value at a specified future date.

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

The Company's affiliates, AGC and AGM, account for nearly all of the new financial guaranty reinsurance business written by the Company in 2017 and 2016.

The financial information in this report is presented on a consolidated basis.

i. BUSINESS AND PERFORMANCE

a. Name of Insurer

AG Re was incorporated in 1996 under the Companies Act as a Bermuda exempted company limited by shares. AG Re is licensed as a Class 3B Insurer under the Insurance Act.

The registered office of the Company is:
Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

b. Supervisors

The Company's insurance supervisor at the Bermuda Monetary Authority is:

Collin Anderson
Assistant Director, Insurance
Bermuda Monetary Authority
BMA House
43 Victoria Street
Hamilton
Bermuda
Phone: 441-278-0217
Email: CJAnderson@bma.bm

The Company's group insurance supervisor is:

The New York State Department of Financial Services
1 State Street
New York, New York 10004
United States of America
Attention: Margot Small, Supervising Risk Management Specialist
Phone: 212-709-1625
Email: margot.small@dfs.ny.gov

c. Approved Auditor

The Company's approved auditor is:

<u>Statutory Reporting</u>
PricewaterhouseCoopers Ltd.
P. O. Box HM 1171
Hamilton HM EX
Bermuda

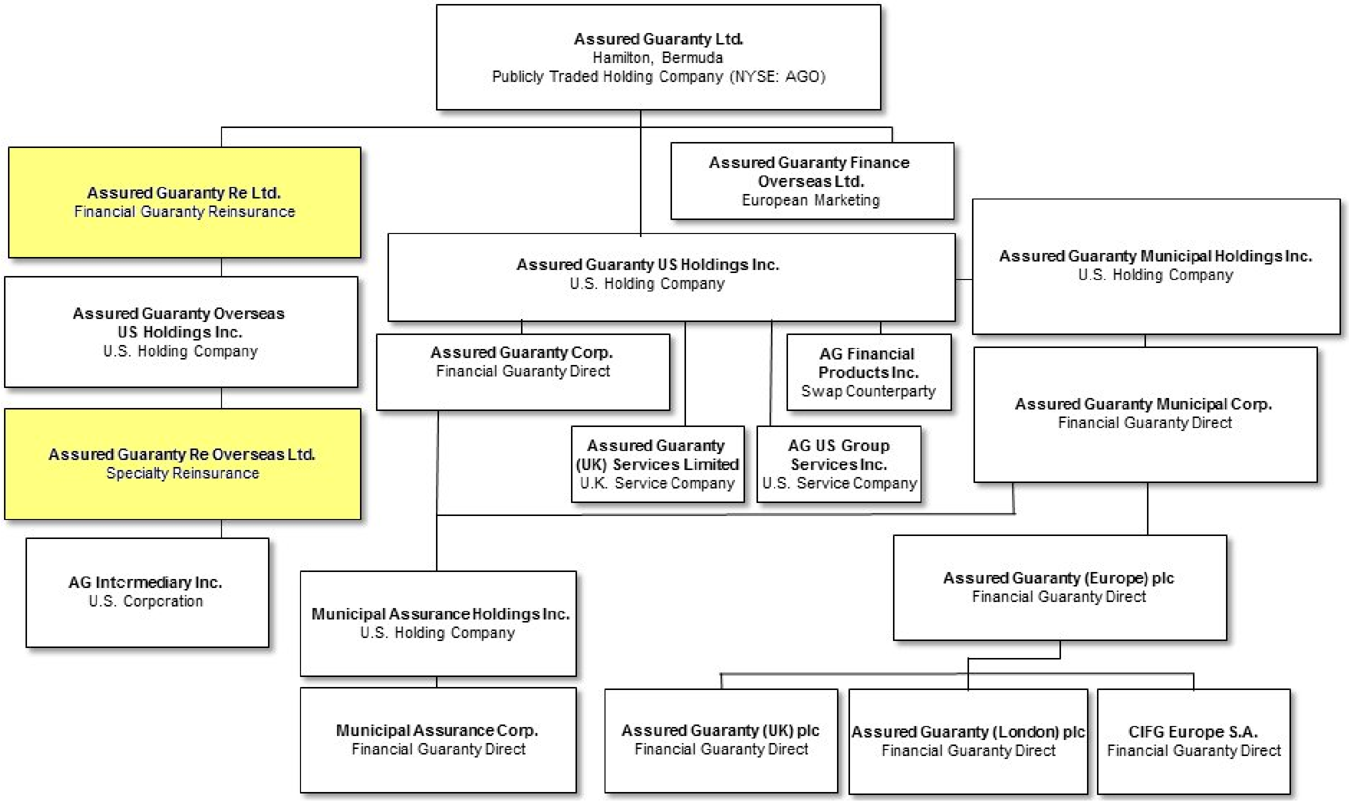
<u>GAAP Reporting</u>
PricewaterhouseCoopers LLP
300 Madison Avenue
New York, New York 10017
United States of America

d. Ownership Details

AG Re is a direct, wholly-owned subsidiary of AGL, a Bermuda-based holding company, which was organized in 2003. AGL is publicly traded on the New York Stock Exchange and is registered with the U.S. Securities and Exchange Commission.

e. Group Structure

The abbreviated organizational chart below shows the position of the Company within the Group as of December 31, 2017.



f. Insurance Business Written by Business Segment and by Geographical Region

The Company writes financial guaranty and other lines of reinsurance and insurance.

Financial Guaranty Business

The Company's outstanding exposure comprises primarily direct and assumed financial guaranty contracts, which are written primarily in insurance form. Until 2009, the Company also reinsured some of its financial guaranty contracts in credit derivative form. Whether written as an insurance contract or as a credit derivative, the Company considers them both financial guaranty contracts. The Company's insurance portfolio also includes a relatively small amount of non-financial guaranty insurance. The Company seeks to limit its exposure to losses by underwriting obligations that it views as IG at inception, diversifying its insured portfolio across asset classes and, in the structured finance portfolio, requiring rigorous subordination or collateralization requirements.

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

Structured finance obligations assumed by the Company are generally issued by special purpose entities and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations.

Financial Guaranty
Portfolio Summary

	As of December 31, 2017			As of December 31, 2016		
	GPO	Ceded to 3rd Party	NPO	GPO	Ceded to 3rd Party	NPO
			(in thousands)			
Public finance	$ 68,380,681	$ —	$ 68,380,681	$ 76,612,342	$ —	$ 76,612,342
Structured finance	3,456,537	389,250	3,067,287	4,526,224	18,620	4,507,604
Total	$ 71,837,218	$ 389,250	$ 71,447,968	$ 81,138,566	$ 18,620	$ 81,119,946
IG (1)	$ 68,848,864	$ 389,250	$ 68,459,614	$ 77,825,613	$ 18,620	$ 77,806,993
BIG (1)	$ 2,988,354	$ —	$ 2,988,354	$ 3,312,953	$ —	$ 3,312,953

(1) Ratings on the Company's insured portfolio reflect its internal ratings.

Financial Guaranty
Exposure by Geographical Area

	As of December 31, 2017		As of December 31, 2016	
Country / State	GPO	NPO	GPO	NPO
		(in thousands)		
Public finance:				
California	$ 10,610,075	$ 10,610,075	$ 12,276,632	$ 12,276,632
Texas	5,818,736	5,818,736	5,924,807	5,924,807
United Kingdom	5,562,545	5,562,545	5,046,878	5,046,878
Pennsylvania	5,169,550	5,169,550	5,676,450	5,676,450
Illinois	5,092,129	5,092,129	5,168,535	5,168,535
Other (1)	36,127,646	36,127,646	42,519,040	42,519,040
Total public finance	68,380,681	68,380,681	76,612,342	76,612,342
Structured finance (2)	3,456,537	3,067,287	4,526,224	4,507,604
Total	$ 71,837,218	$ 71,447,968	$ 81,138,566	$ 81,119,946

(1) The GPO and NPO of the Company's exposure to Puerto Rico was $1,072 million as of December 31, 2017 and $1,104 million as of December 31, 2016. The exposure was internally rated BIG.

(2) Primarily all structured finance exposure is in multiple states that cannot be broken out by individual state.

Non-Financial Guaranty Business

Through AGRO, the Company also provides non-financial guaranty reinsurance in transactions with similar risk profiles to its structured finance exposures written in financial guaranty form. Current outstanding exposure to non-financial guaranty business includes:

- Triple-X reinsurance on approximately $773 million of gross exposure and $675 million of net exposure as of December 31, 2017, which is expected to increase to approximately $1.2 billion on a gross basis ($1.0 billion on a net basis) prior to September 30, 2036. The exposure is internally rated IG.

- RVI policies, which the Company started reinsuring in the first quarter of 2017, and comprise gross exposure of $201 million and net exposure of $140 million as of December 31, 2017. The exposure is internally rated IG.

PVP (New Business)

PVP, the Company's key metric for new business production, is defined as gross upfront premiums received and the present value of gross estimated future installment premiums, on contracts written in the current year, discounted at 6% per year. The Company believes PVP is a useful measure for management and other users of the financial statements because it enables the evaluation of the value of new business production by the Company by taking into account the value of estimated future installment premiums on all new contracts underwritten in a reporting period.

New Business Written

	Year Ended December 31,					
	2017			2016		
Sector	Gross Exposure Written	PVP	Number of Transactions	Gross Exposure Written	PVP	Number of Transactions
	(in thousands, except number of transactions)					
Financial Guaranty	$ 6,482,386	$ 101,364	1,024	$ 6,228,382	$ 71,548	1,267
Non-Financial Guaranty	645,715	25,303	11	1,038,506	22,288	1
Total	$ 7,128,101	$ 126,667	1,035	$ 7,266,888	$ 93,836	1,268

g. Performance of Investments & Material Income & Expenses for the Reporting Period

The table below presents the results of operations of the Company on a consolidated basis.

Consolidated Statements of Operations

	Year Ended December 31,	
	2017	2016
	(in thousands)	
Revenues		
Net earned premiums	$ 144,444	$ 161,885
Net investment income	67,768	68,271
Net realized investment gains (losses)	(230)	2,792
Net change in fair value of credit derivatives	13,824	22,085
Other income	5,075	3,798
Total revenues	230,881	258,831
Expenses		
Loss and LAE	15,568	50,138
Amortization of deferred acquisition costs	42,010	46,850
Other operating expenses	17,170	18,076
Total expenses	74,748	115,064
Income before income taxes	**156,133**	**143,767**
Provision for income taxes	(729)	(5,090)
Net income	**$ 155,404**	**$ 138,677**

Performance of Investments

The investment portfolio consists of fixed income securities and short-term investments. The weighted-average duration of the investment portfolio as of December 31, 2017 and 2016 was 5.4 years and 5.5 years, respectively. The following tables present the investment portfolio by asset class and contractual maturity.

Investment Portfolio
by Asset Class

Asset Class	As of December 31, 2017 Estimated Fair Value	As of December 31, 2017 Weighted Average Credit Rating(1)	As of December 31, 2016 Estimated Fair Value	As of December 31, 2016 Weighted Average Credit Rating(1)
	(in thousands)			
Fixed-maturity securities:				
Corporate securities	$ 847,720	A	$ 770,206	A+
RMBS	414,320	AA+	460,041	AA+
Obligations of state and political subdivisions	317,126	AA	290,500	AA
CMBS	229,487	AAA	239,317	AAA
Asset-backed securities	61,668	AAA	93,214	AAA
U.S. government and agencies	57,597	AA+	116,385	AA+
Non-U.S. government securities	162	AA	167	AA
Total fixed-maturity securities	1,928,080	AA-	1,969,830	AA
Short-term investments	32,302	AAA	51,006	AAA
Total investment portfolio	$ 1,960,382	AA-	$ 2,020,836	AA

(1) Ratings in the table above represent the lower of the Moody's and S&P classifications. The Company's portfolio consists primarily of high-quality, liquid instruments.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of December 31, 2017

	Estimated Fair Value
	(in thousands)
Due within one year	$ 18,922
Year two	49,147
Year three	174,575
Year four	46,502
Year five	51,432
Due after five years through 10 years	595,032
Due after 10 years	348,663
RMBS	414,320
CMBS	229,487
Total	$ 1,928,080

Investment Return

	Year Ended December 31, 2017	Year Ended December 31, 2016
	(in thousands)	
Investment income:		
Fixed-maturity securities:		
Corporate securities	$ 27,389	$ 24,452
RMBS	15,083	15,686
Obligations of state and political subdivisions	10,963	10,396
CMBS	7,303	8,528
U.S. government and agencies	3,540	5,186
Asset-backed securities	1,857	2,203
Non-U.S. government securities	10	10
Total fixed-maturity securities	66,145	66,461
Short-term investments	396	250
Interest income from loan receivable from affiliate	3,036	3,411
Gross investment income	69,577	70,122
Investment expenses and charges	(1,809)	(1,851)
Net investment income	67,768	68,271
Net realized investment gains (losses)	(230)	2,792
Total investment return	$ 67,538	$ 71,063

Material Income and Expenses

The Company's main source of income relates to earned premiums on its outstanding book of business. In 2017 and 2016 the Company's net earned premium were $144 million and $162 million, respectively. The breakdown of this was as follows:

Net Earned Premiums

	Year Ended December 31, 2017	Year Ended December 31, 2016
	(in thousands)	
Scheduled net earned premiums	$ 74,945	$ 77,284
Accelerations		
Refundings	62,824	70,804
Terminations	1,164	9,498
Total Accelerations	63,988	80,302
Accretion of discount on net premiums receivable	3,898	4,003
Financial guaranty insurance net earned premiums	142,831	161,589
Non-financial guaranty insurance net earned premiums	1,613	296
Net earned premiums	$ 144,444	$ 161,885

The majority of the Company's expenses relate to loss and LAE and the amortization of deferred acquisition costs.

In 2017 and 2016, loss and LAE were $16 million and $50 million, respectively, and primarily related certain Puerto Rico exposures. In 2017, loss and LAE were partially offset by settlements related to insurance securitization transactions.

In 2017, the Company recorded a provisional tax benefit in the amount of $2 million attributable to the 2017 Tax Cuts and Jobs Act.

h. Any Other Material Information

Lease Payments

The Company has the following future minimum lease payments under non-cancellable lease rentals:

Future Minimum Rental Payments

	2017 (in thousands)
Not later than one year	$ 408
Later than one year and not later than five years	953
Total	$ 1,361

ii. GOVERNANCE STRUCTURE

a. Board and Senior Executive

i. Board and Senior Executive Structure, role, responsibilities and segregation of responsibilities.

The Company's affairs are managed by its Board and officers in Bermuda in accordance with the Code of Conduct and the Company's Bermuda Operating Guidelines. The Code of Conduct requires Bermuda insurers to have good corporate governance and risk management procedures in place and to be able to evidence the same, based generally on a principle of proportionality. The Company's Board has the ultimate responsibility for the sound and prudent management of the Company. The Board is responsible for ensuring that the Company's business (along with its corporate governance policies and practices) is effectively directed, managed and conducted in a sound and prudent manner, with integrity, due care and the professional skills that are relative to the nature, scale and complexity of its business.

The Board is responsible for setting appropriate strategies and policies, and for providing suitable prudential oversight of the Company’s risk management and internal controls framework. In carrying out their duties, the Company's directors will act in accordance with all relevant and applicable legislative and regulatory rules, including the Insurance Act and the Companies Act, in particular, as well a with the Company's own Bermuda Operating Guidelines and constitutional framework (e.g., its bye-laws).

The Board convenes quarterly in Bermuda at the offices of the Company and on an *ad hoc* basis as required.

The members of the Board are comprised of members of senior management of the Company or AGL, or other qualified individuals, in each case, who have been selected by AGL, in accordance with AGL's Bye-Laws.

The directors and officers of, and other appointed persons providing services to, the Company are detailed below:

<u>Directors</u>

Howard Albert
Robert Bailenson
Russell Brewer II
Gary Burnet
Ling Chow (Non-executive Deputy Chairman)
Stephen Donnarumma
Dominic Frederico (Non-executive Chairman)
Walter Scott

<u>Officers</u>

Conyers Corporate Services (Bermuda) Limited	Assistant Secretary
Gary Burnet	President
Susie Tindall	Secretary
Darrin Futter	Vice President and Financial Controller
Serena Smith	Assistant Vice President, Surveillance
Manish Thareja	Vice President

<u>Loss Reserve Specialist</u>

Benjamin Rosenblum

<u>Principal Representative</u>

Gary Burnet

ii. Remuneration Policy

The description of the remuneration policy contained herein applies (i) to employees of the Company, (ii) employees of AGL and of the Group's U.S. employees, including those who serve as directors of the Board and as the Principal

Representative and Loss Reserve Specialist of the Company. Directors and officers of the Company who are not employees of the Company or of affiliates within the Group receive a fixed fee.

As noted above, the Company's affairs are managed by its Board and officers in Bermuda. The Company also contracts with affiliates to provide certain administrative support services. Employees of the Company's affiliates that provide such services are compensated according to AGL’s remuneration philosophy.

AGL's remuneration philosophy is grounded in the concept of attracting and retaining talented and experienced business leaders who can drive financial and strategic growth objectives intended to protect policyholders and build long-term shareholder value. AGL's remuneration policy is designed with the guiding principles of:

- pay for performance by providing an incentive for exceptional performance and the possibility of reduced compensation for underperformance,
- accountability for short and long-term performance,
- alignment to shareholder interests, and
- retention of highly qualified and successful employees.

The remuneration policy is designed to assess performance, using pre-established measures of success that are tied to the Group’s (including the Company's) key business strategies. The policy encourages balanced performance, measured relative to financial and non-financial goals, and discourages excessive risk taking or undue leverage by avoiding too much emphasis on any one metric or on short-term performance.

AGL's remuneration policy has been designed to reward performance by providing more variable and performance-based remuneration to senior management. The policy employs a mix of variable incentive compensation with various pay-out forms paid over staggered time horizons to provide an incentive for annual and sustained performance over the longer term. Most of the remuneration of the Company’s directors and most senior personnel consists of variable incentive compensation, in the form of an annual cash incentive as well as long-term deferred compensation.

In developing its remuneration philosophy, AGL worked to identify areas of risk or potential for unintended consequences that could exist in the design of the philosophy and evaluated the incentive plans relative to enterprise risks. AGL concluded that its remuneration philosophy is designed and administered with the appropriate balance of risk and reward in relation to the overall business strategy and does not encourage executives to take unnecessary or excessive risks that could have a material adverse impact on AGL and its subsidiaries, including the Company.

Remuneration consists of three principal elements: base salary, cash incentive remuneration and long-term incentive compensation. The Company's remuneration policy is structured with upside potential for superior achievements, but also the possibility of reduced remuneration if individuals are unable to successfully execute group strategies or meet their business or regulatory obligations. The remuneration policy includes a recoupment (claw back) policy pursuant to which certain of the remuneration of the Chief Executive Officer of AGL and those individuals who report directly to him may be rescinded or recouped if such person engages in misconduct related to a restatement of AGL’s financial results or of objectively quantifiable performance goals, and the achievement of those goals is later determined to have been overstated.

iii. Pension or Early Retirement Schemes for Members, Board and Senior Employees

The Company participates in defined contribution retirement plans maintained by AGL, which are available to eligible full-time employees upon hire. Bermuda National employees can contribute 5% percent of their pensionable earnings to the Bermuda Retirement Plan. Employee contributions are matched by the Company at a rate of 100% up to 5% of the employee's compensation. Bermuda employees may also contribute an additional 1% into the International Retirement Plan which are matched by the Company at a rate of 100%. International employees based in Bermuda may contribute up to 6% of their pensionable earnings to the International Retirement Plan. Employee contributions are matched by the Company at a rate of 100% up to 6% of the employee's compensation. The Company also makes a "core contribution" of 6% of the employee's compensation into the International Retirement Plan, regardless of whether the employee contributes to the plans. Employees become fully vested in Company contributions after one year of service, as defined in the plans. The Company recognized defined contribution expenses of $0.9 million and $0.9 million for the year ended December 31, 2017 and December 31, 2016, respectively.

The Company's U.S. affiliate, AGC, a Maryland domiciled financial guaranty insurer (effective January 1, 2017, AG Services, as described in more detail below), also maintained defined contribution retirement plans. Employees of AGC (effective January 1, 2017, AG Services) who serve as directors of, or other appointed persons providing services to, the

Company are entitled to participate in AGC's (effective January 1, 2017, AG Services) retirement plans. AGC (effective January 1, 2017, AG Services) matches an employee's contribution at a rate of 100% up to 6% of the employee's annual compensation. AGC (effective January 1, 2017, AG Services) also contributes an additional 6% "core contribution" regardless of whether the employee contributes to the plan. Employees become fully vested in Company contributions after one year of service, as defined in the plans.

The Company does not provide any supplementary pension or retirement schemes for non-executive members of the Board or non-Group employees who serve as Company officers or other representatives.

iv. Shareholder Controllers, Persons who Exercise Significant Influence, the Board or Senior Executive Material Transactions

In accordance with AGL's bye-laws, if AGL is required or entitled to vote at a general meeting of AG Re, AGL's directors must refer the matter to the shareholders of AGL and seek authority from AGL's shareholders for AGL's representative or proxy to vote in favor of the resolution proposed by AG Re. AGL's directors must cause AGL's representative or proxy to vote AGL's shares in AG Re pro rata to the votes received at the general meeting of AGL and AGL's Board has a discretionary power under AGL's bye-laws to resolve any ambiguity in this regard.

During the financial period, the Company declared quarterly dividends of $40 million paid on March 15, 2017, $40 million paid on May 31, 2017 and $45 million paid on August 28, 2017.

Until December 31, 2016, the Company's U.S. affiliate, AGC, provided services to the Company and AGL pursuant to two separate service agreements, each effective as of January 1, 2006 (each as amended by Amendment No. 1 thereto, effective June 1, 2013 (Bermuda Service Agreements). Under the Bermuda Service Agreements, AGC provided certain services to the Company and AGL, as applicable and as needed and requested by such companies, including, but not limited to, insurance, investor relations, actuarial, data collection and analysis, claims related services, legal, information technology, human resources, accounting, tax, financial reporting, regulatory and investment planning services. In the first quarter of 2017, AGC's parent, Assured Guaranty US Holdings Inc., formed and capitalized AG Services, a Delaware corporation, to act as the payroll company and employer for all U.S. personnel and the central, dedicated service provider within the Group in place of AGC. This structure is consistent with the way in which numerous other insurance holding companies provide inter-company staff and services. Accordingly, effective January 1, 2017, AGC transferred its employees and their employee benefit, retirement and health plans to AG Services. In connection with such transfer, the Bermuda Service Agreements were terminated effective as of 11:59 p.m. on December 31, 2016 and, effective January 1, 2017, AG Services entered into one new service agreement with the Company and AGL, which agreement is substantially identical to the Bermuda Service Agreements.

b. Fitness and Proprietary Requirements

i. Fit and Proper Process in assessing the Board and Senior Executives

In connection with the Company's annual general meeting, the Company assesses the fitness and propriety of all of its Board members, officers, Principal Representative and Loss Reserve Specialist to confirm, prior to their appointment or reappointment, that all such individuals possess appropriate qualifications and experience to perform their designated role(s) and responsibilities.

ii. Board and Senior Executives Professional Qualifications, Skills and Expertise

The Company ensures that all Board members and executive officers possess the characteristics set out below, and therefore are able to provide competent and prudent management through their professional qualifications, knowledge, experience and integrity.

- relevant qualifications and experience for each position,
- sound judgment,
- understanding of the financial guaranty and other relevant insurance businesses,
- honesty and integrity,
- a good reputation,
- competency and capacity to perform key functions, and
- financial soundness.

Below are details of the Board and executive officer qualifications, skills and experience:

Dominic J. Frederico has been a director, and the President and Chief Executive Officer of AGL since its IPO in 2004. Mr. Frederico served as Vice Chairman of ACE Ltd. from 2003 until 2004 and served as President and Chief Operating Officer of ACE Ltd. and Chairman of ACE INA Holdings, Inc. from 1999 to 2003. Mr. Frederico was a director of ACE Ltd. from 2001 through May 2005. From 1995 to 1999 Mr. Frederico served in a number of executive positions with ACE Ltd. Prior to joining ACE, Mr. Frederico spent 13 years working for various subsidiaries of the American International Group. Mr. Frederico currently serves as a Director and Chairman of the Board of AG Re and AGRO.

Ling Chow is General Counsel and Secretary of AGL. She previously served as Deputy General Counsel and Assistant Secretary of the company. Ms. Chow is also the General Counsel and Secretary of AGL's U.S. subsidiaries and previously served as U.S. General Counsel of such subsidiaries since June 2016. She also served as Counsel of such subsidiaries in several capacities since April 2002. Previously, she worked as a corporate lawyer at three New York City law firms. Ms. Chow currently serves as a Director and Deputy Chairman of the Board of AG Re and AGRO, and also serves as the General Counsel and Assistant Secretary of AGRO.

Robert A. Bailenson has been the Chief Financial Officer of AGL since June 2011. Prior to that, he had been the Chief Accounting Officer of AGL since May 2005 and has been with AGL and its predecessor companies since 1990. Mr. Bailenson also serves as the Chief Financial Officer of Assured's U.S. subsidiaries. He was Chief Financial Officer and Treasurer of AG Re from 1999 until 2003 and was previously the Assistant Controller of Capital Re Corp., which was acquired by ACE in 1999 and the parent holding company of AGC until the IPO. Mr. Bailenson currently serves as a Director of AG Re and AGRO, as well as Chief Financial Officer and Managing Director of AGRO.

Gary Burnet has been President of AG Re and AGRO since August 2012. Mr. Burnet also serves as a Director and as Principal Representative of these companies. Prior to this, Mr. Burnet was the Managing Director - Chief Credit Officer of AG Re since 2006 and served as the Vice President - Risk Management and Operations of AG Re from 2002 to 2005. Prior to joining Assured, Mr. Burnet's previous experience included two years at ACE Asset Management, where he was Investment Officer with responsibility for developing and modeling the ACE group's consolidated investment and insurance credit risk. Prior to ACE Asset Management, he was an Assistant Vice President-Investments at ACE Bermuda. Mr. Burnet trained as a Chartered Accountant with Geoghegan & Co. CA from 1993 to 1996 in Edinburgh, Scotland and also worked as an audit senior for Coopers & Lybrand from 1996 to 1998 in Bermuda.

Howard W. Albert has been Chief Risk Officer of AGL since May 2011. Prior to that, he was Chief Credit Officer of AGL from 2004 to April 2011. Mr. Albert joined Assured Guaranty in September 1999 as Chief Underwriting Officer of Capital Re Company, the predecessor to AGC. Before joining Assured Guaranty, he was a Senior Vice President with Rothschild Inc. from February 1997 to August 1999. Prior to that, he spent eight years at Financial Guaranty Insurance Company from May 1989 to February 1997, where he was responsible for underwriting guaranties of asset-backed securities and international infrastructure transactions. Prior to that, he was employed by Prudential Capital, an investment arm of The Prudential Insurance Company of America, from September 1984 to April 1989, where he underwrote investments in asset-backed securities, corporate loans and project financings. Mr. Albert currently serves as a Director of AG Re and AGRO.

Russell B. Brewer II has been Chief Surveillance Officer of AGL since November 2009 and Chief Surveillance Officer of AGC and AGM since July 2009. Mr. Brewer has been with AGM since 1986. Mr. Brewer was Chief Risk Management Officer of AGM from September 2003 until July 2009 and Chief Underwriting Officer of AGM from September 1990 until September 2003. Mr. Brewer was also a member of the Executive Management Committee of AGM. He was a Managing Director of AGMH from May 1999 until July 2009. From March 1989 to August 1990, Mr. Brewer was Managing Director, Asset Finance Group, of AGM. Prior to joining AGM, Mr. Brewer was an Associate Director of Moody's Investors Service, Inc. Mr. Brewer currently serves as a Director of AG Re and AGRO.

Stephen Donnarumma was appointed as a Director of AG Re and AGRO in September 2012 and has been with Assured Guaranty since 1993. Mr. Donnarumma has been the Chief Credit Officer of AGC since 2007, of AGM since its 2009 acquisition, and of Municipal Assurance Corp. since its 2012 capitalization. Over the past 25 years, Mr. Donnarumma has held a number of positions at Assured Guaranty, including Deputy Chief Credit Officer of AGL, Chief Operating Officer and Chief Underwriting Officer of AG Re, Chief Risk Officer of AGC, and Senior Managing Director, Head of Mortgage and Asset-backed Securities of AGC. Prior to joining Assured Guaranty, Mr. Donnarumma was with Financial Guaranty Insurance Company from 1989 until 1993, where his responsibilities included underwriting domestic and international financial guaranty transactions. Prior to that, he served as a Director of Credit Risk Analysis at Fannie Mae from 1987 until 1989.
Mr. Donnarumma was also an analyst with Moody's Investors Services from 1985 until 1987.

Walter Scott was the Chairman of the AGL Board of Directors from May 2005 until his retirement in May 2013, and a director of AGL from 2004 through 2013. Mr. Scott was Chairman, President and Chief Executive Officer of ACE from 1991 until his retirement in 1994, and President and Chief Executive Officer of ACE from 1989 to 1991. Subsequent to his retirement he served as a consultant to ACE until 1996. Mr. Scott was a director of ACE from 1989 through May 2005. Prior to joining ACE, Mr. Scott was President and Chief Executive Officer of Primerica's financial services operations. Mr. Scott was also the Chairman of Vermont Hard Cider Company, LLC from 2003 until 2012, when that company was sold. Mr. Scott is an Emeritus Trustee of Lafayette College and a founding trustee of the Bermuda Foundation for Insurance Studies. Mr. Scott maintains a residence in Bermuda and has offered to serve on the board of AG Re. Management believes Mr. Scott’s long experience with Assured Guaranty and Bermuda insurance companies will assist the AG Re board in its deliberations and with Bermuda regulatory matters.

Darrin Futter was elected Financial Controller of AG Re and AGRO in 2007, prior to which he worked for Deloitte Ltd. in the Bermuda office and worked as a consultant to AG Re. Mr. Futter has worked in various senior audit roles with Ernst and Young LLP in the US and KPMG in Zimbabwe, where he completed his Articles of Clerkship in 2000. He holds a Bachelor of Accounting Science (Hon.) degree from the University of South Africa and is also a Chartered Accountant and a member of the Institute of Chartered Accountants of Zimbabwe.

c. Risk Management and Solvency Self-Assessment

Enterprise Risk Management

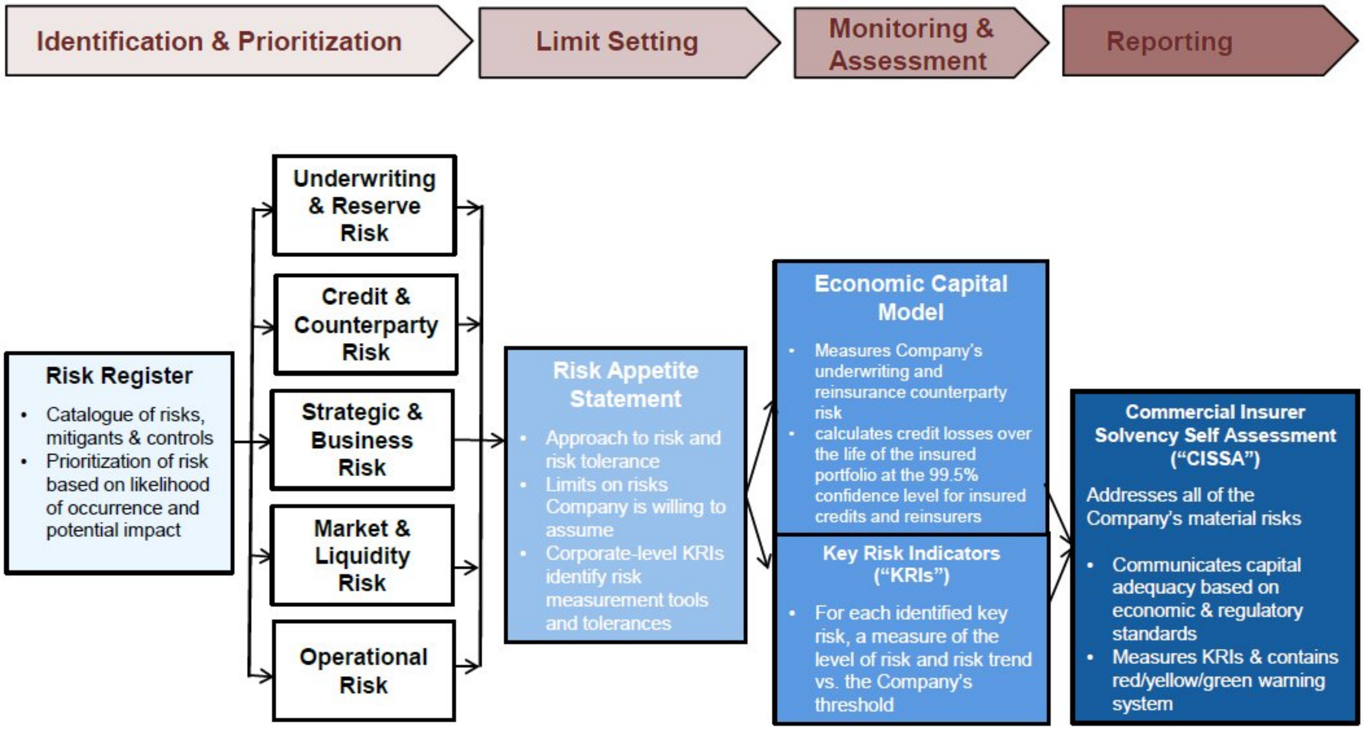
The Board plays a critical role in enterprise risk management. The Board is responsible for addressing the linkage between risk, capital planning and business decisions. The Board oversees the creation and maintenance of the risk register, risk appetite statement and CISSA, the ECM and the design of stress and sensitivity testing. Regular CISSA reporting keeps management and its governing body continually aware of the information needed to develop informed business strategy and capital management plans, as well as to refine the Company’s risk appetite to reflect actual or potential capital constraints.

The risk management function is responsible for the operational aspects of risk management including:

- implementing the risk management framework
- assessing the risk profile
- maintaining the risk register
- updating the risk appetite statement
- developing and preparing the CISSA
- maintaining the ECM
- performing scenario and stress testing on the Company’s capital adequacy
- analyzing the impact of potential emerging issues
- identifying and reporting on any material risk issues to the Board
- determining the impact on the ECM of proposed investments and changes in reinsurance arrangements

1. Risk Management Framework

The Company's risk management framework is set out in the flowchart below and each major component of the framework is summarized below the flowchart.



2. The Risk Register

The Company's CISSA process begins with a complete assessment of the Company's universe of risks. The risk management function works with business unit leaders throughout the Group to ensure that all known risks are identified and to work cooperatively on determining the importance of these risks and the most effective ways to measure them. The business units maintain ownership, accountability and responsibility for the risks arising in their respective areas. The results of the risk identification process are documented in the Company's Risk Register which provides, for each risk, the risk indicators or drivers; the likelihood of the risk occurring and its impact, both as an inherent risk and a residual risk, i.e., after consideration of controls and risk mitigants in place at the Company to minimize the risk; and the area responsible for the risk. The Risk Register is updated by the risk management function annually. The Risk Register is subject to review, challenge and approval by the Board.

3. The Risk Appetite Statement

The Company's Risk Appetite Statement describes the types of risks the Company is willing to accept and sets forth risk tolerances as appropriate. The Risk Appetite Statement prohibits the execution of certain kinds of transactions and sets certain portfolio concentration limits. The risk management function updates the Risk Appetite Statement annually, and it is subject to review, challenge and approval by the Board.

4. The Key Risk Indicators

The CISSA process includes a series of KRIs, which are measured quarterly, that were developed in consultation with the business unit managers throughout the Company to ensure that they both properly capture the Company's material risks as set forth in the Risk Register and use effective techniques for risk measurement. The KRIs are prioritized by the likelihood of the risk occurring over the Company's business planning horizon or beyond, and the potential severity of the impact that each risk would have on the Company if it were to occur. In addition, the KRIs address trends in the Company's business, e.g., financial, economic and credit, that would be leading indicators, positive or negative, of possible changes in solvency over time. The Company measures each of its KRIs quarterly and assigns a rating of green (comfortably within the Company's risk tolerance), yellow (within the Company's risk tolerance but warrants attention) or red (outside the Company's risk tolerance), and reviews and updates its KRIs at least annually to ensure that they continue to provide a relevant, appropriate and comprehensive assessment of the Company's risk. Management actions are identified to address any yellow or red KRIs.

5. *Standard Formula, CISSA Capital Requirement & ECM*

The Company uses the Standard Formula to measure its capital adequacy under the ECR. To calculate what it believes to be its true economic risk for its CISSA, the Company calculates its own internal CISSA capital requirement. The CISSA capital requirement employs a model created by the Company, its ECM, to measure its key risk, credit/underwriting risk. It also measures the related reinsurance counterparty risk. It uses the Standard Formula for calculation of its less material risks: market & liquidity risks and operational risks.

The Company believes that the CISSA capital requirement, which is based on the ECM, provides a more realistic assessment of the Company's capital needs and resources because:

- The ECM views the Company's risks over the lifetime of its transactions, rather than the one-year time horizon prescribed by the Solvency Regulations. The Company believes that a lifetime approach to capital resources and requirements is a more appropriate measure of the Company's solvency because the Company's policies tend to be very long dated and non-cancellable. Further, they cannot be re-priced over their terms.

- The ECM measures the Company's credit and counterparty risks together. This is critical in assessing the Company's key risks because the Company is not exposed to claim payments on its ceded risk unless the obligor in a given transaction defaults, the related reinsurer fails to pay and any collateral posted by the reinsurer to support its obligation has been exhausted.

- The ECM uses the Company's assumptions, developed based on its own experience and published studies, to establish sector-specific assumptions for probability of loss, loss severity and correlation that allow for more robust loss modeling than the Standard Formula provides.

The Company's ECM was designed to measure the Company's credit/underwriting risk and reinsurance counterparty risk, by calculating projected stress losses across the portfolio in a 1-in-200 lifetime loss scenario (the 99.5% lifetime VaR), instead of the 1-in-200 one year loss scenario required under the Standard Formula, and through the use of scenario and stress testing at even more stressful levels. The Company has a limited number of discrete risks, making it possible to review and model the risk related to each individual exposure using its risk rating, type and size of risk, projected term and reinsurance in force, generating capital requirements by calculating the individual contribution to required capital for each transaction. The model has the ability to rank the transactions by risk, aggregate risk by sector and quantify the impact of the Company's risk mitigation activities (e.g., reinsurance). Stress testing of the ECM results is completed at least annually to help management understand the Company's vulnerability to various material potential capital events.

The risk management function is responsible for the design, testing, validation and implementation of the Company's CISSA capital requirement, including its ECM. In designing parameters and assumptions for the ECM, risk management consulted with senior managers throughout the Company (and its ceding companies). At the time of initial design, and from time to time and after material methodology changes, the ECM has been validated by an outside consulting firm, finding that the core methodology appeared sound and broadly in line with industry practices for credit economic capital modeling. Risk management regularly works with senior managers in the Company to re-evaluate and update the CISSA capital requirement and ECM to ensure that they continue to satisfactorily address the Company's key risks.

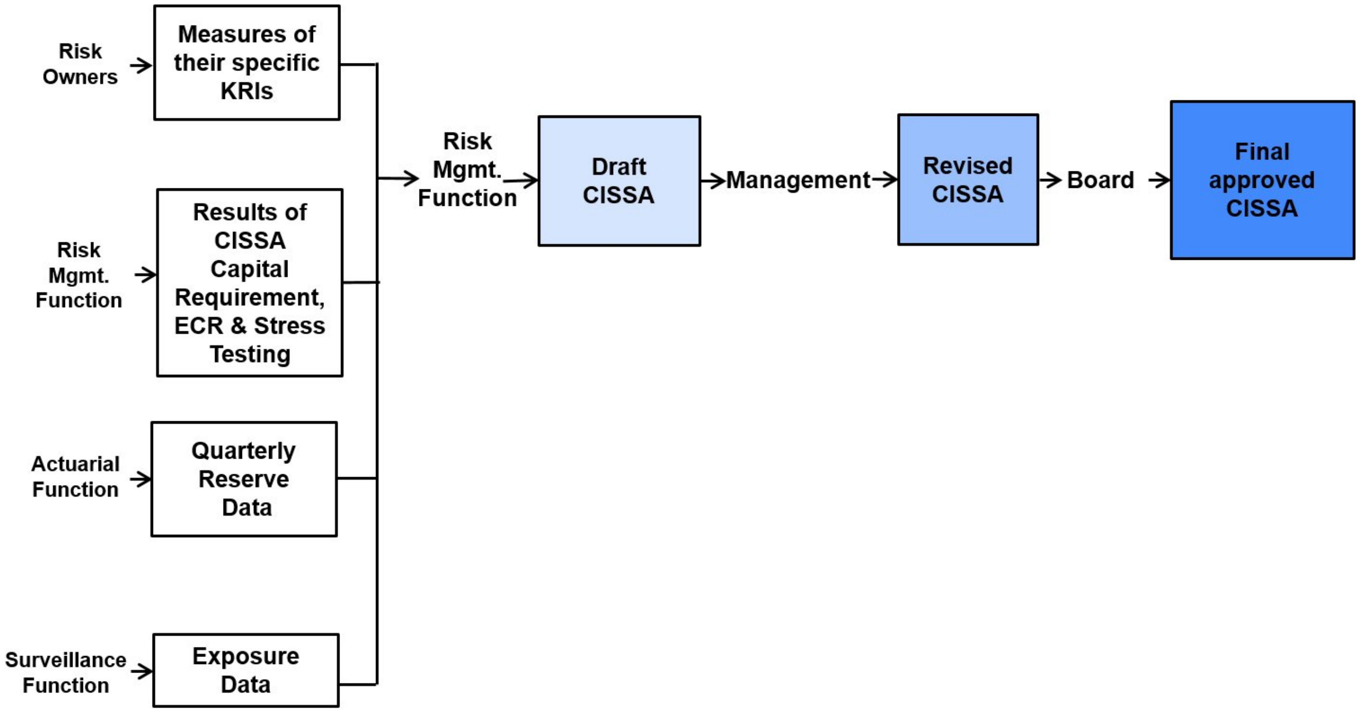
6. *CISSA Report*

As part of its risk management framework and system, the Company documents the results of the risk management activities described above in its CISSA report, the main vehicle the Company uses to inform management and the Board about all reasonably foreseeable and relevant material risks to the Company, both quantitative and qualitative. The CISSA is intended to provide a complete picture of the Company's risk profile and capital adequacy relative to these risks, present the overall solvency needs and solvency condition of the Company taking into account its risk profile, risk appetite and business strategy, and demonstrate compliance, on a continuing basis, with internal and regulatory capital requirements.

The CISSA is part of the business strategy and is taken into account on an ongoing basis in the strategic decisions of the Company. Accordingly, the results of the CISSA are presented to the Board on a quarterly basis, or more frequently if the Company and the risk management function deem that there has been a material change in the Company's risk profile that warrants a special run of the model and preparation of a special CISSA.

The business units have ownership, accountability and responsibility for the risks arising in their respective areas that form the basis for the CISSA. The risk management function has responsibility for monitoring, measuring and reporting on these risks. The CISSA is subject to review, challenge and approval by the Board.

The CISSA Process



The CISSA report includes the following information:

- Results of the CISSA capital requirement (including the ECM)
- MSM and ECR
- Compliance with regulatory capital requirements
- Risk attribution - major contributors to VaR, by sector, exposure and reinsurer
- Performance against KRIs, which are ranked by importance and likelihood of occurrence
- Assessment of non-quantitative risks
- Results of any stress scenario tests or sensitivity analyses conducted during the reporting period

The features of the CISSA make it a valuable tool for business planning and assessing capital needs of the Company over time, related to both potential changes in the composition of the insured portfolio and for proposed new business undertakings over the course of the business planning horizon, such as:

- New capital strategies
- Material or extreme events
- Expansion of business sectors and/or addition of new businesses
- Proposed regulatory changes

It also highlights for management and the Board actual and potential areas of concern across the Company, and includes potential management actions where appropriate.

The risk management function is responsible for the design, development, maintenance and reporting of the CISSA. The risk management function examines the CISSA framework and related components at least annually to ensure that they continue to properly identify and assess the Company's risks.

Transaction Level Risk Management

Surveillance Activities

The Company's insured portfolio consists primarily of exposures obtained through quota share, excess of loss and facultative reinsurance agreements, generally with its affiliates, under which the relevant ceding companies maintain direct responsibility for monitoring the performance of individual transactions. Generally, the Company is entitled to receive transaction level performance information from its ceding companies and uses this information to monitor the performance of each transaction level risk in its portfolio, identify early warning signs of deteriorating performance and track the aggregation of risk. In performing surveillance activities, the Company may receive administrative support provided by certain of its affiliates under service level agreements. All decisions with respect to reinsurance agreements are made by AG Re.

The Company assigns each transaction in the insured portfolio an internal rating, which is updated, as appropriate, based on changes in transaction risk profile. Internal ratings are based on internal assessments of the likelihood of loss and loss severity in the event of loss. Internal ratings are expressed on a ratings scale similar to that used by the Rating Agencies and are generally reflective of an approach similar to that employed by the rating agencies, except that the Company's internal ratings focus on future performance rather than lifetime performance. The Company's affiliated ceding companies may make internal rating recommendations to the Company. All internal ratings and rating changes must be approved by the Company's RMC.

The Company's review cycle and scope for transactions varies based upon transaction type and risk profile as discussed below. Generally, transactions are reviewed and presented in sector reports, which group together transactions that share common risk characteristics. Reviewing exposures by sector facilitates comparison of performance, risk ranking and early identification of underperforming transactions. In addition, each quarter, surveillance prepares and presents a quarterly risk management review to the Board.

The Company's insured portfolio is segregated into IG and BIG surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. BIG exposures include all exposures with internal ratings below "BBB-".

Surveillance monitors its IG exposures to determine whether any need to be internally downgraded to BIG and refreshes its internal ratings on individual exposures in quarterly, semi-annual or annual cycles based on the Company's view of the exposure's risk profile, loss potential, volatility and sector. Ratings on exposures identified as under the most stress or with the most potential volatility are reviewed every quarter.

Exposures identified as BIG are subjected to further review to determine the probability of a loss. Surveillance personnel assign each BIG transaction to the appropriate BIG surveillance category based upon whether a future loss is expected and whether a claim has been paid.

The Company occasionally provides direct insurance for a transaction, either directly or through its subsidiary, AGRO. In such instances, the Company collects and analyzes information from various sources, including trustee and servicer reports, financial statements, general industry or sector news and analyses, and rating agency reports, and might also use quantitative tools and models to assess transaction performance and identify situations where there may have been a change in credit quality. Surveillance activities also may include discussions with or site visits to issuers, servicers or other parties to a transaction.

Workout Activities

Typically, the ceding companies maintain control over the development and implementation of workout and loss mitigation strategies on troubled transactions that are experiencing losses or could be at risk of losses. The Company is responsible for tracking workout activities, reporting on these activities to the Board in its quarterly surveillance report to the Board and for making any required decisions related to loss mitigation.

The most significant work-out activities currently being undertaken for the Company relate to its aggregate $1,072 million net par exposure as of December 31, 2017, to the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations. Most of the Puerto Rican entities with obligations insured by the Company have defaulted on their debt service payments, and the Company has paid claims on them.

On June 30, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law by the President of the United States. PROMESA established a seven-member federal financial oversight board (Oversight

Board) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. PROMESA provides a legal framework under which the debt of the Commonwealth and its related authorities and public corporations may be voluntarily restructured, and grants the Oversight Board the sole authority to file restructuring petitions in a federal court to restructure the debt of the Commonwealth and its related authorities and public corporations if voluntary negotiations fail, provided that any such restructuring must be in accordance with an Oversight Board approved fiscal plan that respects the liens and priorities provided under Puerto Rico law.

On September 20, 2017, Hurricane Maria made landfall in Puerto Rico as a Category 4 hurricane on the Saffir-Simpson scale, causing loss of life and widespread devastation. Damage to the Commonwealth's infrastructure, including the power grid, water system and transportation system, was extensive, and has impacted the ability and willingness of Puerto Rican obligors to make timely and full debt service payments and participants' efforts to resolve the Commonwealth's financial issues under PROMESA.

The Commonwealth released fiscal plans for itself and for a number of its authorities and public corporations, and in response to notices of violation from the Oversight Board and the enactment of a significant federal disaster relief package by the U.S. Congress, Puerto Rico released one or more revised fiscal plans for the Commonwealth and a number of its authorities and public corporations. The most recent fiscal plans submitted by the Commonwealth for the Commonwealth, PREPA, PRASA and PRHTA were released on April 5, 2018. The Commonwealth and the Oversight Board did not agree on final fiscal plans, and on April 18 and April 19, 2018, the Oversight Board released its own versions of fiscal plans for the Commonwealth, PREPA, PRASA and PRHTA, which it certified on April 19 or 20, 2018. The current governor of Puerto Rico (Governor) has announced that he will refuse to implement certain aspects of the fiscal plans certified by the Oversight Board, and there has been speculation in the press that the differences between the Governor and the Oversight Board will be litigated.

The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to obligations it insures are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters. Any adverse decisions in litigation relating to Puerto Rico may impact both the Company's exposure in Puerto Rico as well as the strength of its legal protections in other exposures. For example, on January 30, 2018, the Federal District Court in Puerto Rico held, in an action initiated by the Company relating to the Puerto Rico Highways and Transportation Authority, among other things, that (i) even though the special revenue provisions of the Bankruptcy Code protect a lien on pledged special revenues, those provisions do not mandate the turnover of pledged special revenues to the payment of bonds and (ii) actions to enforce liens on pledged special revenues remain stayed. On February 9, 2018, the Company filed a notice of appeal of the Court's decision to the United States Court of Appeals for the First Circuit.

The final shape, timing and validity of responses to Puerto Rico's distress eventually enacted or implemented under the auspices of PROMESA and the Oversight Board or otherwise, and the impact, after resolution of any legal challenges, of any such responses on obligations insured by the Company, are uncertain, but could be significant.

Underwriting Risk Management

The Company has a framework and procedures in place for establishing and implementing underwriting guidelines and single risk and risk concentration limits across the insured portfolio, as well as procedures for ensuring that they are adhered to in the transaction approval process.

The Company sets the single risk limits and underwriting guidelines within the limits that are allocated to the Company by the Group Portfolio Risk Management Committee, subject to the Company's underwriting and approval process.

1. Underwriting Policy

Most of the Company's business comes to it through quota share and other reinsurance treaties from its affiliated ceding companies. The Company does not underwrite individual exposures under these treaties.

The Company performs diligence on potential ceding companies prior to entering into reinsurance treaties to assess, among other things, the ceding company's business strategy, underwriting abilities, surveillance and workout functions, data integrity, internal audit findings and accounting and payment processes. In the conduct of its business, the Company applies its risk underwriting judgment, risk management skills and capital markets experience.

In general, transactions ceded under insurance treaties are comprised of U.S. public finance, international infrastructure transactions, and structured finance transactions. In negotiating treaties, the Company may seek to limit its exposure to losses by, among other things, limiting covered transactions to ones that are rated IG at inception by the ceding company and /or fit within the Company's diversification goals; or prohibiting certain types of transactions that the Company has not approved as insurable risks.

In the event the Company does directly underwrite and provide insurance on a transaction, it undertakes a complete review and analysis of the transaction and all of the material risks identified during the process, including underwriting risks, structural risks, legal and other risks as described in the Company's Risk Appetite Statement.

2. Underwriting Procedure

All proposed new business opportunities are underwritten by the Company utilizing personnel with the appropriate background and experience, sometimes with administrative support from its affiliated companies. Upon completion of the underwriting analysis, the underwriter(s) prepares a formal report that is submitted to the Company's credit committee for review and approval.

3. Underwriting Approval Process

The Company's credit committee is composed of its senior officers who are responsible for making all underwriting decisions for the Company. Within the parameters delegated to it by the Board, the credit committee establishes underwriting standards and guidelines and processes and controls that govern transactions, and has the authority to review and approve or reject reinsurance cessions undertaken by the Company with its affiliates. All other transactions, including transactions with third parties, are subject to further approval by the Board. With regard to transactions underwritten by AG Re's subsidiary, AGRO, all transactions, other than small residual value insurance transactions and internal reinsurance cessions, require Board approval. As part of the approval process, the credit committee incorporates critical feedback on the performance of, and any problems related to, transactions in the Company's insured portfolio.

Prior to the closing of any transaction, a compliance certificate must be signed by the responsible underwriter and the responsible attorney confirming that the transaction conforms in all material respects to the terms of the transaction that was reviewed and approved by the credit committee and the Board, as applicable.

d. Internal Controls

i. Internal Control System

Financial Reporting Internal Controls

- The Company's annual financial statements are produced by the finance team, with support from the finance department of the affiliated ceding companies. The production process incorporates review for completeness and accuracy by senior management. The financial statements are subsequently reviewed by the Company's management prior to being presented to the Company's Board for final approval.
- Specific to the Company's 2017 Financial Condition Report, management designed and documented internal controls over the preparation of information contained in this Report. A Disclosure Committee reviews the Company's Financial Condition Report prior to filing.
- The persons responsible for these controls attest to executive management that they have properly executed these controls each reporting period.
- Members of the Group's management independently review the execution of the Group internal controls and report to the Group Board on the results of their testing.

Vendor Management Controls

- The Group has a vendor management policy that ranks vendors in terms of level of risk, and requires, for higher risk vendors, an annual review of internal control reports from those vendors.

Outsourcing Controls

- All of the Company's outsourcing arrangements are reviewed on an annual basis by the Board and more frequently if required. Any new Group or third party outsourcing arrangements, or changes to existing Group or third party outsourcing arrangements, are reviewed and approved by the Company's management and/or the Board, as appropriate.

IT Controls

The Company purchases IT services from its affiliate, AG Services, via an outsourcing arrangement and as a result utilizes the Group infrastructure, applications, data and services. The IT policies and procedures for the Company follow the Group policies and procedures as described in the IT Systems Governance Policy. IT system controls cover areas including:

- Roles and responsibilities
- Physical security
- Network security
- Access control
- Data center operations
- Employee use
- Testing
- Project management

A combination of preventive and detective controls are used to ensure the integrity, availability and confidentiality of IT systems.

ii. Compliance Function

Due to the relatively small size of the Company, the Company does not have a separate compliance department whose sole remit is monitoring compliance-related activities. The compliance function is carried out by the Company's President and Financial Controller, with oversight by the Group's General Counsel and the Group's Chief Compliance Officer.

The Group's General Counsel and the Group's Chief Compliance Officer are independent from any business or operational unit. The Group's General Counsel and the Group's Chief Compliance Officer report to the Board at its quarterly meetings.

The principal activities of the compliance function are as follows:

- Advising the Board on compliance with applicable laws and regulations and assessing the possible impact of new laws and regulations on the Company.
- Ensuring that new regulatory rules and internal guidelines are communicated to the affected business areas and providing guidance to those business areas in respect of such requirements.
- Maintaining an open dialog with the BMA, and other applicable regulators, and submitting the appropriate information to those regulators, including notice of matters that are of concern to the regulators.
- Ensuring that all relevant personnel complete training on their regulatory roles and responsibilities, and on compliance with applicable laws and regulations, on a regular basis (including anti-money laundering and anti-bribery/corruption training).
- Assessing, together with the internal audit function, the adequacy and effectiveness of the Company’s compliance controls.

The Group's General Counsel and the Group's Chief Compliance Officer work with the internal audit function to develop an internal audit plan that addresses, as appropriate, compliance by the Company with internal policies and procedures. The internal audit function is responsible for monitoring compliance with internal strategies, processes and reporting procedures. Refer to *Section ii.e Internal Audit* for additional information. The Company's compliance program also is integrated with the Group's compliance program, which includes providing the Group's Chief Compliance Officer with an inventory of all filings due by the Company throughout the year and reporting compliance violations or significant issues raised during the year. The compliance inventory is reviewed and significant issues are discussed on a quarterly basis at Group compliance meetings. The compliance process is established on a project-by-project basis or topic-by-topic basis using Group personnel with applicable experience and outside advisors, as appropriate.

e. Internal Audit

The Company has outsourced its Internal Audit function to an international public accounting firm. Internal Audit has unrestricted access to all areas and property of the organization, including personnel records, records held by third-party service providers, and also reports directly to the Board.

f. Actuarial Function

The Company's loss reserve specialist is responsible for the calculation of the technical provisions for the loss and loss expense best estimate. The loss reserve specialist works with the risk management and surveillance departments to create assumptions that are used to calculate the best estimate premium provision. The best estimate premium provision and the risk margin is calculated by the risk management department. The best estimate premium provision and the risk margin is reviewed by the loss reserve specialist to ensure it is reasonable.

The loss reserve is reviewed by the reserve committee and presented to the Board on a quarterly basis.

g. Outsourcing

i. Outsourcing Policy and Key Functions that have been Outsourced

Given the relatively small size of the Company and the Company's desire to focus on its core business, the Company has determined that certain of its functions should be outsourced to one or more affiliates, or third parties, to improve the efficiency and effectiveness of the Company's operations.

All of the Company's outsourcing arrangements are reviewed on an annual basis by the Board and more frequently if required. Any new Group or third party outsourcing arrangements, or changes to existing Group or third party outsourcing arrangements, are reviewed and approved by the Company's management and/or the Board, as appropriate.

Third-Parties Outsourcing Arrangements

Investment Management

The Company outsources the management of its investment portfolio to third party investment managers under a mandate designed to support the highest possible ratings, manage credit risk, ensure ample liquidity to cover losses in a stress scenario and maximize income. The investment managers manage the investment portfolio of the Company in accordance with the Company's investment guidelines. The investment managers are BlackRock Financial Management, Inc., Goldman Sachs Asset Management, L.P., New England Asset Management, Inc. and Wellington Management Company, LLP. For more information on 'prudent person principle' see *Section iii.b Market Risk*.

Internal Audit

The Company outsources the internal audit function to an international public accounting firm. Refer to *Section ii.e Internal Audit Function* above for additional information.

ii. Material Intra-Group Outsourcing

As described in *Section ii.a.ii Remuneration Policy and Section ii.a.iv Shareholder Controllers, Persons who Exercise Significant Influence, the Board or Senior Executive Material Transactions* above, the Company's affairs are managed by its Board and officers in Bermuda. In addition, the Company contracts with its affiliates to provide certain administrative support services. In 2016, the Company was a party to a service agreement with AGC pursuant to which AGC made available to the Company certain services, including actuarial, surveillance, marketing, claims handling, legal, information technologies, human resources, accounting, tax, financial reporting and investment planning services. Employees of AGC that are performing administrative services for AG Re were not empowered to make underwriting or other decisions on behalf of the Company or to bind the Company in any way. Effective January 1, 2017, the company providing services under the intercompany agreement is AG Services. The scope of the services provided under the agreement and the personnel providing the services have not changed.

h. Any Other Material Information

There was no other material information.

iii. RISK PROFILE

a. Underwriting Risk

The Company's most material risk is underwriting risk. The Company underwrites financial guaranty reinsurance under quota share and excess of loss treaties and, more recently, through its subsidiary AGRO, other types of insurance and reinsurance that have risk profiles similar to its structured finance business. Under a reinsurance agreement, the reinsurer, in consideration of a premium paid to it, agrees to indemnify another insurer, called the ceding company, for part or all of the liability of the ceding company under one or more insurance policies that the ceding company has issued.

A financial guaranty insurance policy provides an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Upon an obligor's default on scheduled principal or interest payments due on the obligation, the primary insurer is required under the financial guaranty policy to pay the principal or interest shortfall.

Measurement

The Company's main metrics for measuring its portfolio credit risk (in addition to its risk management and CISSA process, discussed in *Section ii.c Risk Management and Solvency Self-Assessment*) are par outstanding, sector and internal rating. The Company also considers geographic concentrations. At the closing of each transaction, the credit committee assigns the transaction to a sector (i.e., a group of transactions with similar risk characteristics) for purposes of evaluating risk and potential correlations. The credit committee also assigns an internal credit rating reflecting the credit quality of the transaction, with such rating subject to change over time. Surveillance is responsible for monitoring the performance of all insured transactions throughout their terms and recommending internal rating changes as appropriate. All rating changes must be approved by the RMC.

The sector composition of the financial guaranty insured portfolio and the breakdown of internal ratings, measured by GPO and NPO as of December 31, 2017 and 2016, are set forth below.

Sector Breakdown of the Financial Guaranty Insured Portfolio

Sector	As of December 31, 2017			As of December 31, 2016		
	Number of Risks	GPO	NPO	Number of Risks	GPO	NPO
	(in thousands, except number of risks)					
Public finance:						
General obligation	4,680	$ 26,415,004	$ 26,415,004	5,160	$ 30,193,788	$ 30,193,788
Tax backed	1,141	12,700,293	12,700,293	1,233	14,320,425	14,320,425
Municipal utilities	956	8,773,723	8,773,723	1,036	9,911,141	9,911,141
Transportation	174	4,743,595	4,743,595	188	5,464,867	5,464,867
Infrastructure finance	114	4,667,060	4,667,060	111	4,334,224	4,334,224
Regulated utilities	55	3,581,161	3,581,161	53	3,505,109	3,505,109
Higher education	245	2,733,871	2,733,871	278	3,204,246	3,204,246
Healthcare	133	2,323,494	2,323,494	157	3,037,852	3,037,852
Pooled infrastructure	3	780,400	780,400	3	810,308	810,308
Housing revenue	41	307,408	307,408	50	290,821	290,821
Investor-owned utilities	11	250,852	250,852	18	358,140	358,140
Other public finance	53	1,103,820	1,103,820	56	1,181,421	1,181,421
Total public finance	7,606	68,380,681	68,380,681	8,343	76,612,342	76,612,342
Structured finance:						
Insurance securitization	6	1,863,724	1,487,724	7	2,308,686	2,308,686
RMBS	294	545,264	532,014	323	674,943	656,323
Consumer receivables	16	540,003	540,003	15	560,641	560,641
Pooled corporate obligations	15	181,131	181,131	53	500,917	500,917
Commercial receivables	16	141,120	141,120	18	184,096	184,096
Structured credit	4	15,272	15,272	1	9,450	9,450
CMBS and other commercial real estate related exposures	1	555	555	8	6,180	6,180
Other structured finance	20	169,468	169,468	21	281,311	281,311
Total structured finance	372	3,456,537	3,067,287	446	4,526,224	4,507,604
Total portfolio	7,978	$ 71,837,218	$ 71,447,968	8,789	$ 81,138,566	$ 81,119,946

In addition to the financial guaranty par exposure shown in the table above, the Company offers, through AGRO, non-financial guaranty execution on either a direct or reinsurance basis. Current outstanding exposure to non-financial guaranty business includes:

- Triple-X reinsurance on approximately $773 million of gross exposure and $675 million of net exposure as of December 31, 2017, which is expected to increase to approximately $1.2 billion on a gross basis ($1.0 billion on a net basis) prior to September 30, 2036.

- The Company's RVI policies which had gross exposure of $201 million and net exposure of $140 million as of December 31, 2017.

- Both exposures have an IG average internal rating.

Risk Concentration

The Company’s top ten credit exposures measured by GPO represented 7.4% of GPO as of December 31, 2017. These exposures were in various sectors, including tax-supported, general obligation and insurance securitization.

Financial Guaranty
Portfolio Breakdown by Internal Credit Rating (1)

Internal Credit Rating	As of December 31, 2017 GPO	As of December 31, 2017 NPO	As of December 31, 2016 GPO	As of December 31, 2016 NPO
	(in thousands)			
AAA	$ 1,286,317	$ 1,286,317	$ 1,742,305	$ 1,742,305
AA	8,767,368	8,391,368	14,259,270	14,259,270
A	36,560,488	36,560,488	39,718,338	39,718,338
BBB	22,234,691	22,221,441	22,105,700	22,087,080
BIG	2,988,354	2,988,354	3,312,953	3,312,953
Total	$ 71,837,218	$ 71,447,968	$ 81,138,566	$ 81,119,946

(1) Ratings are the Company's internal rating classifications which may or may not differ from those of the Rating Agencies.

The table below sets forth the Company's BIG transactions as of December 31, 2017. There were no ceded BIG exposures.

Financial Guaranty
BIG Exposure by Sector
As of December 31, 2017

Sector	As of December 31, 2017 Number of Risks	As of December 31, 2017 Par	As of December 31, 2016 Number of Risks	As of December 31, 2016 Par
	(in thousands, except number of risks)			
General obligation	31	$ 893,380	30	$ 837,321
Insurance securitization	2	634,269	2	714,869
Tax backed	12	433,415	12	435,855
Municipal utilities	4	331,470	4	332,342
RMBS	142	279,415	151	342,564
Consumer receivables	6	112,532	5	110,084
Infrastructure finance	4	98,836	7	266,753
Commercial receivables	9	87,374	9	117,374
Pooled corporate obligations	3	40,028	4	92,586
Higher education	4	15,156	1	3,092
Transportation	2	12,170	2	12,007
Other public finance	6	50,309	6	48,106
Total BIG	225	$ 2,988,354	233	$ 3,312,953

For exposure by geographic distribution, see *Section i.f. Insurance Business Written by Business Segment and by Geographical Region, Financial Guaranty Business.*

Risk Mitigation

The Company's ceded exposure for its financial guaranty exposure was $389.3 million and $18.6 million as of December 31, 2017 and December 31, 2016 was rated IG and was to third party reinsurers.

In an effort to mitigate losses, the Company also may pursue specifically tailored loss mitigation strategies for underperforming transactions. See *Section ii.c Risk Management and Solvency Self-Assessment System*, *Workout Activities* for a description of the various strategies.

Risk Sensitivity

Underwriting risk exposure is tested for risk concentration to a specific region as well as identification of stress events that can lead to material losses across the portfolio. Examples of these concentrations are:

- Puerto Rico,
- U.S. Municipals,
- Infrastructure Finance

The Company runs stress tests for each of the concentrations noted above. Based on the latest stress testing results, management of the Company believes that the Company has sufficient capital to comply with its contractual obligations and regulatory requirements and remain within its risk tolerance.

b. Market Risk

The potential for market risk resides mainly in the Company's investment portfolio. As of both, December 31, 2017 and December 31, 2016, the Company's investment portfolio had a market value of $2.0 billion. Specific investment guidelines are agreed with the Company's outside investment managers and approved by the Company's Board, consistent with the 'prudent person principle' set out in Solvency Regulations, and setting forth credit rating standards, single risk and asset category limits and duration guidelines.

Currently, no purchase is permitted in a security rated lower than "A-"/"A3"/"A-", or in the case of corporate securities rated lower than "BBB"/"Baa2"/"BBB" by S&P, Moody's or Fitch, respectively. All securities purchased by external managers must be rated by one of S&P, Moody's or Fitch.

Currency Risk

The Company is exposed to currency risk in respect of assets under financial guarantees denominated in currencies other than USD, primarily the euro and pound sterling. The Company is exposed to currency risk in respect of liabilities under financial guarantees denominated in currencies other than USD. The most significant currency to which the Company is exposed is the pound sterling. The Company manages its exposure from time to time by maintaining balances denominated in those currencies in which it is exposed in order to meet liabilities that may become due.

Measurement

The Company measures the results of its investment portfolio by its compliance with investment guidelines, and by the portfolio performance, particularly book yield.

Risk Concentration

As of December 31, 2017 and December 31, 2016, the Company's investment portfolio had an average credit quality rating of "AA-" and "AA", respectively. Issuer constraints as well as sector limitations are also followed in managing the investment portfolio. The table below sets forth the sector concentrations across the portfolio.

Composition of Investment Portfolio by Security Type

Security Type	As of December 31, 2017	As of December 31, 2016
Fixed-maturity:		
Corporate securities	43.2%	38.1%
RMBS	21.1	22.8
Obligations of state and political subdivisions	16.2	14.4
CMBS	11.7	11.8
Asset-backed securities	3.2	4.6
U.S. government and agencies	2.9	5.8
Non-U.S. government securities	0.0	0.0
Total fixed-maturity	98.3	97.5
Short-term	1.7	2.5
Total	100.0%	100.0%

Risk Mitigation

In the event of any downgrade of any investment below the Company's requirements, the portfolio manager must contact the Company's management to discuss the course of action and may hold the position only if approved by the Company’s President and the Board, with oversight by the Group.

Risk Sensitivity

The main risk in the Company’s investment portfolio is interest rate risk on its fixed rate investments. Each quarter, as part of its CISSA, the Company stress tests the sensitivity of the investment portfolio to interest rate movements. Based on the latest stress testing results, management of the Company believes that it has sufficient resources to comply with its contractual obligations and regulatory requirements and remain within its risk tolerance.

c. Credit Risk

The Company’s most significant credit risks are the risk of non-payment by the obligors on the transactions that it reinsures which are discussed above in *Section iii.a. Underwriting Risk*. The only other counterparty credit risks the Company has relate to a small amount of exposure ceded to reinsurers, to an intra-Group loan, a small reinsurance recoverable and cash that the Company holds in its investment portfolio.

The Company’s reinsurance recoverables, loan receivable, and premiums receivable are tested to assess the impact on the Company of a counterparty’s ability to make payments in accordance with the contractual terms. Based on the latest stress testing results, management of the Company believes that it has sufficient resources to comply with its contractual obligations and regulatory requirements and remain within its risk tolerance.

d. Liquidity Risk

The Company manages its liquidity risk by maintaining a liquid, high quality investment portfolio, with a duration that is shorter than the duration of its insurance liabilities. Additionally, the Company is only required to pay principal and interest claims as they come due according to the original bond payment schedule, and the payments cannot be accelerated without the Company’s consent. For more information on 'prudent person principle' see *Section iii.b Market Risk*.

Measurement

The Company measures duration relative to its investment guideline range, discussed above, which is set in accordance with the Company’s investment guidelines. The portfolio had a duration of 5.4 years as of December 31, 2017 and 5.5 years and of December 31, 2016. For more information see *Section i.g Performance of Investments & Material Income & Expenses for the Reporting Period.*

Risk Sensitivity

Each quarter, as part of its CISSA, the Company performs liquidity stress testing to ensure that it has sufficient liquid assets over the next 12 month period to cover all of its liabilities that could arise in a stress scenario. When the Company performs the stress test, it considers only U.S. Government bonds, pre-refunded bonds, agency bonds and cash to be liquid assets. Based on the latest stress testing results, management of the Company believes that it has sufficient liquidity to comply with its contractual obligations and regulatory requirements and remain within its risk tolerance.

e. Operational Risk

The Company faces a variety of operational risks including those related to information technology, accounting, legal and regulatory matters, as well as risks related to performance by affiliated companies pursuant to a services agreement and third party service providers. Operational risks are limited by the Company's risk management policies, such as the policies governing the credit approval process, compliance, business continuity planning, and employee conduct. Additional mitigants to operational risk include that its service agreements are with stable affiliated companies, and the system of internal controls in place, which are described in *Section ii.d Internal Control System.*

With regard to legal risk, another aspect of operational risk, as of December 31, 2017, the Company was not a party in any litigation or subject to any regulatory investigation.

f. Any Other Material Information

None.

iv. SOLVENCY VALUATION

a. Valuation Bases, Assumptions and Methods to Derive the Value of Each Asset Class

The Company has used the valuation principles outlined by the BMA's "Guidance Note for Statutory Reporting Regime" for the reporting period's statutory filing. The economic valuation principles outlined in this document are to measure assets and liabilities on a fair value basis.

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

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

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness, and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During 2017 and 2016, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

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

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

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

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

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

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1 and Level 2. There were no transfers between Level 2 and Level 3 during 2017. There were transfers of fixed-maturity securities from Level 2 into Level 3 during 2016 because of a lack of observability relating to the valuation inputs and collateral pricing.

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-Term Investments

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

Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently or those that are distressed trades, and therefore may not be indicative of the market. The extent of the use of each input is dependent on the asset class and the market conditions. The valuation of fixed-maturity investments is more subjective when markets are less liquid due to the lack of market based inputs.

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

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

The Company, on a quarterly basis:

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

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

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

As of December 31, 2017, the Company used models to price 22 securities, which were 2.1% or $42 million of the Company's fixed-maturity securities and short-term investments at fair value. As of December 31, 2017, all Level 3 securities were priced with the assistance of an independent third-party. As of December 31, 2016, the Company used models to price 19 fixed-maturity securities, which were 1.2% or $24 million of the Company's fixed-maturity securities and short-term investments at fair value. As of December 31, 2016, most Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price appreciation/depreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Assets

- Advances to Affiliates - are recorded at fair value and balances receivable in more than one year have been discounted at the relevant risk free rate.
- Investment income due and accrued - is recorded at fair value.

- Premiums and reinsurance balances receivable - are current balances due and are recorded at fair value.
- Funds Held by Ceding Reinsurers- these amounts are recorded fair value and reflect actual amounts due to the Company.

b. Valuation Bases, Assumptions and Methods to Derive the Value of Technical Provisions

Technical Provisions under Economic Balance Sheet versus Financial Statements

Technical Provisions
As of December 31, 2017

	Financial Statement Balance Sheet	Economic Balance Sheet
	(in thousands)	
Best Estimate	$ —	$ 394,075
Risk margin	—	84,296
Gross unearned premium reserve	786,127	—
Gross loss and loss expense provisions	388,797	—
Total	$ 1,174,924	$ 478,371

As of December 31, 2017, the Best Estimate Technical Provisions for this line of business were $394.1 million and the risk margin was $84.3 million resulting in a total gross technical provision of $478.4 million. The gross and net best estimate technical provisions values are the present value of future cash outflows less the present value of future cash inflows. The present value of cash outflows includes the expected lifetime loss calculated using the Company's internally developed individual capital adequacy model plus an Expense Load. The present value of the cash inflows includes all future premiums expected to be received by the Company after consideration of potential non–payment on premiums due to future defaults of guaranteed transactions.

Expected lifetime losses under the Economic Balance Sheet are calculated using the Company’s ECM which uses its judgments for cumulative probability of default, loss given default and correlation to calculate the expected cash outflows that the Company will be required to pay over the lifetime of the Company’s insured exposures for both its net retained and its reinsured exposures. The Company considers both external and internal sources of data when setting its assumptions for probability of default, loss given default and correlation, including any relevant experience by members of the Group. The boundary of each insurance contract is assumed to be the period of time during which the principal on the debt underlying the financial guarantee contract is greater than $0. The Company uses its judgment to assess future inflation rates for guarantees that are linked to an inflation index.

For purposes of the Best Estimate Technical Provisions calculation, the Expense Load was projected based on the Company’s current operating costs and allocating these future expenses between existing contracts, which are included in the Best Estimate Technical Provisions, and future contacts, which are not included. The percentage used as the Reduction due to prospective defaults was developed by applying the Company’s judgment for default rates to the insured portfolio.

The risk margin was calculated as the present value of the Company’s future cost of capital in all future years as the Company’s insured exposure runs off. The risk margin captures the carrying cost of capital that a third party would be required to hold if the Company were to transfer its technical provisions to a third party.

For purposes of the risk margin calculation, the BMA specified the risk free rates for USD as of December 31, 2017 that were to be used for discounting. The ECR was calculated for each future year until maturity of the Company's final policy and the cost of capital percentage was assumed to be equal to 6%, as mandated by the BMA. The ECR is projected to decline over time based on projections of the individual BSCR components.

While the Company believes that the assumptions and methods used to develop the Technical Provisions are reasonable and consistent and that they provide for a calculation of future expectations in an appropriate manner, it remains possible that future experience in future premiums, projected operating expenses, default probabilities, severities, and correlations may not be in line with expectations. Since the Company guarantees against low probability events that have large nominal exposures despite the expectation that the severity of any loss would be low, the uncertainty within the Company’s projected losses used in the calculation of the Technical Provisions is high. The level of uncertainty in respect of future premiums, and projected operating expenses is expected to be low.

The Company also believes that the assumptions and methods used to develop the risk margin value are reasonable and consistent and that they provide for a calculation of the appropriate economic capital cushion required by the BMA.

The Best Estimate Technical Provisions must include the Company's expected future cash inflows and outflows, excluding investment income.

The following is a listing of the material differences between Technical Provisions under Solvency Regulations (Solvency) and under U.S. GAAP:

- Under Solvency, premiums that are due to be received after the balance sheet date are included in the calculation of Technical Provisions and include amounts receivable from both financial guaranty contracts written in insurance and CDS forms and exclude an amount that may not be received due to potential defaults on underlying transactions. The amount is discounted at the BMA specified risk free rate. Under U.S. GAAP, premiums that are due to be received after the balance sheet date only include amounts receivable from financial guaranty contracts written in insurance form and are included in the premiums receivable, net of commissions payable. The amount is discounted at the risk-free rate at inception and such discount rate is updated only when changes to prepayment assumptions are made that change the expected date of final maturity. In addition, there is no provision for amounts that may not be received unless such amounts are deemed uncollectible. For financial guaranty contracts written in CDS form, premiums that are due to be received after the balance sheet date are incorporated into the fair value of the CDS.

- Under Solvency, commissions that are due to be paid on assumed policies after the balance sheet date are included in the calculation of Technical Provisions and include amounts payable on both financial guaranty contracts written in insurance and CDS forms and exclude an amount that may not be payable due to potential defaults on underlying transactions, discounted at the BMA specified risk free rate. Under U.S. GAAP, commissions that are due to be paid on assumed policies after the balance sheet date are included in premiums receivable, net of commissions payable and only include amounts payable on financial guaranty contracts written in insurance form. The amount is discounted at the risk-free rate at inception and such discount rate is updated only when changes to prepayment assumptions are made that change the expected date of final maturity. For financial guaranty contracts written in CDS form, commissions that are due to be paid after the balance sheet date are incorporated into the fair value of the CDS.

- Under Solvency, projected losses are included in the calculation of Technical Provisions and are calculated on both financial guaranty contracts written in insurance and CDS forms and a loss value is ascribed to every exposure. The resulting amount is discounted at the BMA specified risk free rate. Under U.S. GAAP, a loss reserve is recorded only on financial guaranty contracts written in insurance form that have exhibited adverse development or that have a heightened loss potential due to their BIG rating and only to the extent that the loss reserve amount exceeds the unearned premium reserve on a contract by contract basis. The loss reserve amount is discounted at the risk free rates. For financial guaranty contracts written in CDS form, potential losses are incorporated into the fair value of the CDS.

- Under Solvency, an amount is included for the Projected Expense Load. Under U.S. GAAP, a loss adjustment expense amount, if applicable, is included only for financial guaranty contracts written in insurance form, but the loss adjustment expense amount does not include a projected expense load covering the Company's other expenses.

- Under Solvency, unearned premium reserve is not included in the Technical Provisions. Under U.S. GAAP, unearned premium reserve is recorded on financial guaranty contracts written in insurance form.

- Under Solvency, deferred acquisition costs are not included in the Technical Provisions. Under U.S. GAAP, deferred acquisition costs are recorded on financial guaranty contracts written in insurance form.

c. Description of Recoverables from Reinsurance Contracts

Recoverables From Reinsurance and Special Purpose Vehicles

The Company cedes some of its exposure to a non-affiliated reinsurer. In calculating the Technical Provisions and risk margin net of this reinsurance, the Company assumes that the reinsurer is contractually obligated to pay and will likewise be entitled to receive its share of any recoveries. Under Solvency, the Company's reinsurance recoverable for this transaction is the contractually obligated payments, less an amount which represents the reinsurer's share of its loss in excess of the amount of collateral available that it is unable to make. This amount is calculated based on the projected ceded expected losses to the reinsurer, the assumed cumulative default rate of the reinsurer and the amount of collateral posted by the reinsurer. Under U.S. GAAP, the Company does not include a provision for reinsurance counterparty default unless the reinsurance recoverable is deemed uncollectible.

There are no special purpose vehicle recoverables included in any of the calculations of Technical Provisions or risk margin.

d. Valuation Bases, Assumptions and Methods to Derive the Value of Other Liabilities

Similar to the valuation principles for assets, the Company's other liabilities follow the valuations principles outlined by the BMA's "Guidance Note for Statutory Reporting Regime", which values other liabilities at a fair value basis.

e. Any Other Material Information

None.

v. CAPITAL MANAGEMENT

a. Eligible Capital

i. Capital Management Policy and Process for Capital Needs, How Capital is Managed and Material Changes During the Reporting Period

The primary capital management objectives of the Company are to maintain a strong capital base to support the development of its business and to meet regulatory and rating agency capital requirements at all times. The Company recognizes the impact on shareholder returns of the level of equity capital employed and seeks to maintain a prudent balance. It strives for an appropriate capital structure that efficiently allocates the risk to the capital. The Company's capital and risk management strategy is unchanged over the prior year.

To maintain a strong capital base, the Company identifies, assesses, manages and monitors the various risk sources it faces in the course of business both currently and as anticipated over the life its insured obligations. This process culminates in an assessment of the capital necessary to maintain solvency at the threshold targeted by senior management given the Company's risk profile. The Company's risk profile includes an assessment of the current and anticipated future material risks faced by the Company, the strength of the organization's enterprise risk management, capital measures derived from proprietary and vendor models, qualitative risks, stress testing and liquidity. Surplus capital may be paid out in dividends, subject to statutory limitations as defined by the Insurance Act.

The Company has a low tolerance for liquidity risk and manages to that level of risk by maintaining a liquid high quality investment portfolio with a duration that is shorter than the duration of its insurance liabilities. The Company also performs liquidity stress testing every quarter. Given the Company's low tolerance for liquidity risk and the contingent and generally long-tail nature of its insurance exposures, the Company is willing to assume a modest amount of market risk as part of its strategy of minimizing liquidity risk. Specific investment guidelines are provided to the Company's outside investment managers, setting forth single risk and asset category limits, duration guidelines and rating standards. The Company's investment guidelines generally do not permit its outside investment managers to purchase securities rated lower than A- by S&P or A3 by Moody's, excluding a minimal allocation to corporate securities not rated lower than BBB by S&P or Baa2 by Moody's. Deviation from these investment guidelines may arise on an exception basis where the Company is managing its exposure to impaired insured transactions. Investment guidelines are discussed in more detail in *Section iii.b Market Risk*.

With regard to managing liabilities, the Company's Risk Appetite Statement dictates that risks accepted are estimated at inception to have low potential loss severity. Therefore, the Company aims to avoid risks that have or are projected to have a high severity in the event of a default.

There were no material changes to Eligible capital during the reporting period.

ii. Eligible Capital Categorized by Tiers in Accordance to the Eligible Capital Rules

As of December 31, 2017 and 2016, all of the Company's eligible capital was categorized as Tier 1:

Eligible Capital

	2017	2016
	(in thousands)	
Tier 1 Capital	$ 1,579,500	$ 1,467,592

The tier 1 capital consists of capital stock, contributed surplus and statutory surplus. The increase in the tier 1 capital in 2017 compared to prior year is due primarily to the decrease in technical provisions. The decline in technical provisions is due to (i) the decrease in loss provisions due to claims payments, (ii) the decrease in expected losses on non reserve exposures, and (iii) the increase in future premiums as a result of new business written during the year.

iii. Eligible Capital Categorized by Tiers in Accordance to the Eligible Capital Rules Used to Meet ECR and MSM Requirements of the Insurance Act

As of December 31, 2017 and 2016, the Company's eligible capital used to meet its MSM and ECR was categorized as follows:

Eligible Capital

	2017		2016	
	Applied to MSM	Applied to ECR	Applied to MSM	Applied to ECR
	(in thousands)			
Tier 1 Capital	$ 1,579,500	$ 1,579,500	$ 1,467,592	$ 1,467,592

iv. Confirmation of Eligible Capital That is Subject to Transitional Arrangements

None of the eligible capital is subject to transitional arrangements.

v. Identification of Any Factors Affecting Encumbrances on the Availability and Transferability of Capital to Meet the ECR

The Company has entered into contracts with cedants that require the Company to fully collateralize estimates of its obligations calculated by the cedants. Assets are held in trust accounts for the benefit of the cedant. These assets are released to the company on payment of the obligations.

vi. Identification of Ancillary Capital Instruments Approved by the Authority

The Company has no ancilliary capital instruments

vii. Identification of Differences in Shareholder's Equity as Stated in the Financial Statements Versus the Available Capital and Surplus

The differences in shareholder's equity, as stated in the U.S. GAAP financial statements versus the available statutory capital and surplus, relate to the impact of employing Solvency Regulation based technical provision valuation techniques as well as the reduction in available Solvency Regulation capital for non-admitted assets.

b. Regulatory Capital Requirements

i. ECR and MSM Requirements at the End of the Reporting Period

The following table presents the Company's MSM and ECR amounts.

MSM and ECR Amounts

	As of December 31, 2017	As of December 31, 2016
	(in thousands)	
MSM	$ 70,282	$ 70,008
ECR	281,129	280,031

ii. Identification of Any Non-Compliance with the MSM and the ECR

The company was compliant with the MSM and ECR requirement as of December 31, 2017 and 2016.

iii. A Description of the Amount and Circumstances Surrounding the Non-Compliance, the Remedial Measures and Their Effectiveness

Not Applicable

iv. Where the Non- Compliance is not Resolved, A Description of the Amount of the Non- Compliance at the end of the reporting period

Not Applicable.

c. Approved Internal Capital Model

The Company does not use an internal model to calculate its ECR. For more information see *Section v.b Regulatory Capital Requirements.*

vi. SUBSEQUENT EVENTS

a. Description of Significant Events

There are no significant events either in the reporting period, or that have occurred between the end of the reporting period and the date of signing the return other than as mentioned in *Section i.h Any Other Material Information.*

b. Approximate date(s) or proposed timings of the significant event

Not applicable.

c. Confirmation of how the significant event has impacted or will impact any information provided in the most recent financial condition report filed with the Authority

Not applicable.

d. Any other material information

Not applicable.

DECLARATION

We declare, to the best of our knowledge and belief, that the financial condition report fairly presents the financial condition of the Company in all material respects.

Gary Burnet
President
Assured Guaranty Re Ltd.

Darrin Futter
Financial Controller
Assured Guaranty Re Ltd.