

Assured Guaranty Corp.

Consolidated Financial Statements

December 31, 2018, 2017 and 2016

Assured Guaranty Corp.

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Report of Independent Auditors

To the Board of Directors of Assured Guaranty Corp.:

We have audited the accompanying consolidated financial statements of Assured Guaranty Corp. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, of comprehensive income, of shareholder's equity and of cash flows for each of the three years in the period ended December 31, 2018.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Assured Guaranty Corp. and its subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018 in accordance with accounting principles generally accepted in the United States of America.

/s/ PricewaterhouseCoopers LLP

New York, New York
March 27, 2019

Assured Guaranty Corp.
Consolidated Balance Sheets
(dollars in millions except par value and share amounts)

	As of December 31, 2018	As of December 31, 2017
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of \$2,743 and \$2,696)	\$ 2,907	\$ 2,937
Short-term investments, at fair value	126	57
Other invested assets	2	2
Equity method investments	234	227
Total investment portfolio	3,269	3,223
Cash	31	46
Premiums receivable, net of commissions payable	199	172
Ceded unearned premium reserve	221	223
Reinsurance recoverable on unpaid losses	171	205
Salvage and subrogation recoverable	214	310
Current income tax receivable	—	168
Financial guaranty variable interest entities' assets, at fair value	101	122
Other assets	252	238
Total assets	\$ 4,458	\$ 4,707
Liabilities and shareholder's equity		
Unearned premium reserve	\$ 982	\$ 891
Loss and loss adjustment expense reserve	386	473
Note payable to affiliate	300	300
Credit derivative liabilities	182	223
Financial guaranty variable interest entities' liabilities with recourse, at fair value	108	131
Financial guaranty variable interest entities' liabilities without recourse, at fair value	1	2
Other liabilities	170	169
Total liabilities	2,129	2,189
Commitments and contingencies (see Note 16)		
Preferred stock (\$1,000 par value, 200,004 shares authorized; none issued and outstanding)	—	—
Common stock (495,559 shares authorized, \$915.05 par value, 16,393 shares issued and outstanding in 2018, and 500,000 shares authorized, \$720 par value, 20,834 shares issued and outstanding in 2017)	15	15
Additional paid-in capital	842	1,042
Retained earnings	1,333	1,253
Accumulated other comprehensive income, net of tax of \$24 and \$41	139	208
Total shareholder's equity	2,329	2,518
Total liabilities and shareholder's equity	\$ 4,458	\$ 4,707

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

Assured Guaranty Corp.
Consolidated Statements of Operations
(in millions)

	Year Ended December 31,		
	2018	2017	2016
Revenues			
Net earned premiums	\$ 152	\$ 231	\$ 285
Net investment income	128	136	106
Net realized investment gains (losses)	(5)	39	7
Net change in fair value of credit derivatives	95	71	42
Fair value gains (losses) on financial guaranty variable interest entities	4	6	14
Bargain purchase gain and settlement of pre-existing relationships, net	—	58	257
Other income (loss)	7	14	16
Total revenues	381	555	727
Expenses			
Loss and loss adjustment expenses	38	54	46
Interest expense on note payable to affiliate	11	11	11
Other expenses	60	72	79
Total expenses	109	137	136
Income (loss) before income taxes and equity in net earnings of investee	272	418	591
Provision (benefit) for income taxes			
Current	99	(198)	58
Deferred	(11)	328	8
Total provision (benefit) for income taxes	88	130	66
Equity in net earnings of investee	24	32	44
Net income (loss)	\$ 208	\$ 320	\$ 569

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

Assured Guaranty Corp.

Consolidated Statements of Comprehensive Income

(in millions)

	Year Ended December 31,		
	2018	2017	2016
Net income (loss)	\$ 208	\$ 320	\$ 569
Change in net unrealized gains (losses) on:			
Investments with no other-than-temporary impairment, net of tax provision (benefit) of \$(15), \$8 and \$13	(60)	15	16
Investments with other-than-temporary impairment, net of tax provision (benefit) of \$(1), \$23, and \$12	(5)	43	23
Change in net unrealized gains (losses) on investments	(65)	58	39
Change in net unrealized gains (losses) on financial guaranty variable interest entities' liabilities with recourse, net of tax	1	—	—
Change in cumulative translation adjustment, net of tax provision (benefit) of \$-, \$3 and \$(5)	—	20	(22)
Other comprehensive income (loss)	(64)	78	17
Comprehensive income (loss)	\$ 144	\$ 398	\$ 586

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

Assured Guaranty Corp.

Consolidated Statements of Shareholder's Equity

Years Ended December 31, 2018, 2017 and 2016

(in millions)

	Assured Guaranty Corp. Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity
Balance at December 31, 2015	20,834	\$ 15	\$ 1,042	\$ 793	\$ 48	\$ 1,898
Net income	—	—	—	569	—	569
Dividends	—	—	—	(79)	—	(79)
Other comprehensive loss	—	—	—	—	17	17
Other	—	—	(1)	—	—	(1)
Balance at December 31, 2016	20,834	15	1,041	1,283	65	2,404
Net income	—	—	—	320	—	320
Net impact of sale of the European Subsidiaries to affiliate (see Note 1)	—	—	—	(203)	37	(166)
Dividends - cash	—	—	—	(107)	—	(107)
Dividends - transfer of benefit/ health/retirement plans to AG US Services (see Note 15)	—	—	—	(12)	—	(12)
Reclassification of stranded tax effects (see Note 13)	—	—	—	(28)	28	—
Other comprehensive income (see Note 18)	—	—	—	—	78	78
Other	—	—	1	—	—	1
Balance at December 31, 2017	20,834	15	1,042	1,253	208	2,518
Net income	—	—	—	208	—	208
Dividends	—	—	—	(133)	—	(133)
Common stock repurchases (see Note 12)	(4,441)	—	(200)	—	—	(200)
Other comprehensive loss	—	—	—	—	(64)	(64)
Effect of adoption of ASU 2016-01 (see Note 1)	—	—	—	5	(5)	—
Balance at December 31, 2018	16,393	\$ 15	\$ 842	\$ 1,333	\$ 139	\$ 2,329

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

Assured Guaranty Corp.
Consolidated Statements of Cash Flows
(in millions)

	Year Ended December 31,		
	2018	2017	2016
Operating Activities:			
Net Income	\$ 208	\$ 320	\$ 569
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Net amortization of premium (discount) on investments	(37)	(40)	(18)
Provision (benefit) for deferred income taxes	(11)	328	8
Net realized investment losses (gains)	5	(39)	(7)
Bargain purchase gain and settlement of pre-existing relationships, net	—	(58)	(257)
Equity in net earnings of investee	(24)	(32)	(44)
Change in premiums receivable, net of premiums payable and commissions	(21)	14	12
Change in ceded unearned premium reserve	2	88	106
Change in unearned premium reserve	91	(328)	(391)
Change in loss and loss adjustment expense reserve, net	42	(60)	(83)
Change in current income tax	169	(198)	16
Change in financial guaranty variable interest entities' assets and liabilities, net	(1)	(1)	(10)
Change in credit derivative assets and liabilities, net	(30)	(62)	(45)
Dividends received from investee (see Note 11)	11	42	114
Other	22	(6)	(10)
Net cash flows provided by (used in) operating activities	426	(32)	(40)
Investing activities			
Fixed-maturity securities:			
Purchases	(596)	(1,002)	(516)
Sales	393	561	692
Maturities	164	192	212
Short-term investments with original maturities of over three months:			
Purchases	(6)	(121)	(120)
Sales	—	42	149
Maturities	2	44	33
Net sales (purchases) of short-term investments with original maturities of less than three months	(65)	16	122
Net proceeds from paydowns on financial guaranty variable interest entities' assets	24	28	511
Acquisitions, net of cash acquired (see Note 2)	—	95	(442)
Proceeds from return of capital (see Note 11)	—	70	4
Sale of the European Subsidiaries to affiliates, net of cash sold (see Note 1)	—	127	—
Proceeds from maturity of other invested asset	—	85	—
Other	—	4	—
Net cash flows provided by (used in) investing activities	(84)	141	645
Financing activities			
Dividends paid	(133)	(107)	(79)
Net paydowns of financial guaranty variable interest entities' liabilities	(24)	(30)	(476)
Repurchases of common stock	(200)	—	—
Net cash flows provided by (used in) financing activities	(357)	(137)	(555)
Effect of foreign exchange rate changes	—	4	(2)
Increase (decrease) in cash and restricted cash	(15)	(24)	48
Cash and restricted cash at beginning of period (see Note 10)	46	70	22
Cash and restricted cash at end of period (see Note 10)	\$ 31	\$ 46	\$ 70
Supplemental cash flow information			
Cash paid (received) during the period for:			
Income taxes	\$ (70)	\$ —	\$ 38
Interest on note payable to affiliate	\$ 11	\$ 11	\$ 11

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

Assured Guaranty Corp.
Notes to Consolidated Financial Statements
December 31, 2018, 2017 and 2016

1. Business and Basis of Presentation

Business

Assured Guaranty Corp. (AGC and, together with its subsidiaries, the Company), a Maryland domiciled insurance company, is an indirect and wholly-owned operating subsidiary of Assured Guaranty Ltd. (AGL and, together with its subsidiaries, Assured Guaranty). AGL is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (U.S.) and international public finance (including infrastructure) and structured finance markets.

The Company applies its credit underwriting judgment, risk management skills and capital markets experience primarily to offer financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment (debt service), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom (U.K.), and also guarantees obligations issued in other countries and regions, including Australia and Western Europe.

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

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). In management's opinion, all material adjustments necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated variable interest entities (VIEs) are reflected in the periods presented and are of a normal recurring nature. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The December 31, 2017 balance sheet was revised to reclassify \$3 million from other invested assets to equity method investments. The presentation of cash flow amounts related to short-term investments was changed during 2018 to reflect cash flows on a gross, rather than a net, basis.

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

AGC owns 39.3% of Municipal Assurance Holdings Inc. (MAC Holdings), incorporated in Delaware. AGC's affiliate, Assured Guaranty Municipal Corp. (AGM), owns the remaining 60.7% of MAC Holdings. MAC Holdings owns 100% of MAC, domiciled in New York.

On June 26, 2017, AGC sold to its affiliate Assured Guaranty Municipal Corp. (AGM), all of the shares of AGC's direct, wholly-owned subsidiaries, Assured Guaranty (UK) plc (AGUK, formerly Assured Guaranty (UK) Ltd.), CIFG Europe S.A. (CIFGE) and Assured Guaranty (London) plc (AGLN, formerly MBIA UK Insurance Limited) (collectively the European Subsidiaries).

The total consideration of \$411 million paid by AGM to purchase AGC's European Subsidiaries consisted of: (i) \$344 million gross principal amount of the Series A-1 Floating Rate Guaranteed Notes due December 21, 2035 issued by Orkney Re II plc (the Orkney Bonds) and (ii) \$139 million of cash. The carrying value of the European Subsidiaries, as of June 26, 2017, was approximately \$651 million. In addition, AGC's approximately \$55 million deferred tax liability at June 26, 2017 on unremitted earnings of its European Subsidiaries was transferred to AGM.

AGUK (Assured Guaranty (Europe) plc (AGE), post-combination described below) guarantees the Orkney Bonds through a financial guarantee; it cedes 90% of the exposure to AGC and retains the remaining 10%. The \$344 million principal amount of Orkney Bonds had a fair value (inclusive of the AGUK (AGE, post-combination described below) financial guarantee) of \$272 million and constituted 90% of the total amount of Orkney Bonds owned by AGM.

In accordance with GAAP guidance on common control transactions, the net loss on the sale of the European Subsidiaries of approximately \$166 million was recorded as a direct reduction to shareholder's equity. This net reduction consisted of a \$203 million dividend, offset by an accumulated other comprehensive income (AOCI) increase of \$37 million (consisting of \$17 million of cumulative translation adjustment benefit and \$20 million of net unrealized gains). The Orkney Bonds were recorded excluding the value of AGUK (AGE, post-combination described below) financial guarantee, and were carried in the financial statements of the Company on the same basis as the common parent, Assured Guaranty US Holdings Inc. (AGUS), with approximately \$44 million in gains established in AOCI.

AGM combined the operations of its wholly-owned subsidiary, AGE and the European Subsidiaries in a transaction that was completed on November 7, 2018. Under the combination, the European Subsidiaries transferred their insurance portfolios to and merged with and into AGE (the Combination). See Note 2, Assumption of Insured Portfolio and Business Combinations and Note 14, Reinsurance for additional information.

Impact of Sale of the European Subsidiaries As of June 26, 2017

	(in millions)
Consideration received	\$ 411
Carrying value of European Subsidiaries	651
Deferred tax liabilities transferred	(55)
Net carrying value transferred	596
Impact before other related adjustments	(185)
Elimination of the financial guarantee on Orkney Bonds	20
Other	(1)
Net shareholder's equity impact	\$ (166)

Significant Accounting Policies

The Company revalues assets, liabilities, revenue and expenses denominated in non-U.S. currencies into U.S. dollars using applicable exchange rates. Gains and losses relating to transactions in foreign denominations in those subsidiaries where the functional currency is the U.S. dollar are reported in the consolidated statement of operations. Prior to the sale of the European Subsidiaries, two of those companies had a functional currency other than the U.S. dollar. Gains and losses relating to translating foreign functional currency financial statements for U.S. GAAP reporting are recorded in other comprehensive income (loss) (OCI).

The chief operating decision maker manages the operations of the Company at a consolidated level. Therefore, all results of operations are reported as one segment.

AGC participates in AGL's long term incentive plans. AGL follows the fair value recognition provisions for share based compensation expense. The Company is allocated its proportionate share of expenses, including compensation expense based on time studies conducted annually, in accordance with the Amended and Restated Service Agreement (Group Service Agreement). See Note 15, Related Party Transactions for additional information.

Other accounting policies are included in the following notes.

Accounting Policies

Business Combinations	Note 2
Expected loss to be paid (insurance, credit derivatives and FG VIE contracts)	Note 5
Contracts accounted for as insurance (premium revenue recognition, loss and loss adjustment expense and policy acquisition cost)	Note 6 and Note 14
Fair value measurement	Note 7
Credit derivatives (at fair value)	Note 8
Variable interest entities (at fair value)	Note 9
Investments and cash	Note 10 and Note 11
Share repurchases	Note 12
Income taxes	Note 13
Commitments and contingencies	Note 16
Note payable to affiliate and credit facilities	Note 17

Adopted Accounting Standards

Changes to the Disclosure Requirements for Fair Value Measurement

In August 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU removed, modified and added additional disclosure requirements on fair value measurements in Topic 820. The Company has adopted this ASU as of December 31, 2018 with the relevant disclosure updates included in Note 7, Fair Value Measurements.

Financial Instruments

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

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

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

On January 1, 2018, the Company adopted this ASU resulting in a cumulative-effect reclassification of a \$5 million loss, net of tax, from retained earnings to AOCI.

Income Taxes

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory*, which removed the prohibition against immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under the ASU, the selling (transferring) entity is required to recognize a current income tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. The ASU was adopted on January 1, 2018 with no material effect on the consolidated financial statements.

Future Application of Accounting Standards

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Topic 310-20) - Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. This ASU has no effect on the accounting for purchased callable debt securities held at a discount. It is to be applied using a modified retrospective approach and the ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. This ASU will have no effect on the Company's consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Subsequent to the issuance of this ASU, Topic 842 was amended by various updates that clarified the impact and implementation of ASU 2016-02. Collectively, these updates will require lessees to present right-of-use assets and lease liabilities on the balance sheet. As of December 31, 2018, the Company's leases, where the Company is the lessee, are immaterial. This ASU will not have a material effect on the Company's consolidated financial statements.

Credit Losses on Financial Instruments

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

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

Targeted Improvements to the Accounting for Long-Duration Contracts

In August 2018, the FASB issued ASU 2018-12, *Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*. This ASU does not impact the Company's financial guaranty insurance contracts, and will have no effect on the Company's consolidated financial statements.

2. Assumption of Insured Portfolio and Business Combinations

Consistent with one of its key business strategies of supplementing its book of business through acquisitions of legacy financial guaranty companies or their portfolios, the Company has acquired two financial guaranty companies and completed one reinsurance transaction, since January 1, 2016, as described below.

Reinsurance of Syncora Guarantee Inc.'s Insured Portfolio

On June 1, 2018, AGC closed a reinsurance transaction (SGI Transaction) with Syncora Guarantee Inc. (SGI) under which AGC assumed, generally on a 100% quota share basis, substantially all of SGI's insured portfolio. The SGI Transaction also included the commutation of a book of business previously ceded to SGI by AGM. As of June 1, 2018, the gross par value of exposures reinsured by AGC totaled approximately \$12 billion (including credit derivative gross par of approximately \$1.7 billion). The reinsured portfolio consists predominantly of public finance and infrastructure obligations that meet AGC's underwriting criteria and generated \$331 million of assumed written premiums. On June 1, 2018, as consideration, SGI paid \$344 million and assigned to AGC estimated financial guaranty future insurance installment premiums of \$55 million, and future credit derivative installments of approximately \$17 million. The assumed portfolio from SGI included below-investment-grade (BIG) contracts which had, as of June 1, 2018, expected losses to be paid of \$131 million (present value basis using risk free rates), which will be expensed over the expected terms of those contracts as unearned premium reserve amortizes. In connection with the SGI Transaction, the Company incurred and expensed \$4 million in fees to professional advisors.

The effect of the SGI Transaction on the insurance and credit derivative balances as of June 1, 2018 is summarized below:

Effect of SGI Transaction

	Assumed (in millions)
Cash	\$ 344
Premiums receivable, net of commissions	\$ 55
Unearned premium reserve	(331)
Credit derivative liability, net	(68)
Net assets (liabilities) acquired, excluding cash	<u>\$ (344)</u>

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

Immediately after the closing of the SGI Transaction, AGC ceded par of \$4.1 billion and unearned premium reserve of \$67 million of the SGI business to Assured Guaranty Re Ltd. (AG Re).

Business Combinations

Accounting Policies

The acquisitions were accounted for under the acquisition method of accounting which requires that the assets and liabilities acquired be recorded at fair value. The Company exercised significant judgment to determine the fair value of the assets it acquired and liabilities it assumed in each of the acquisitions. The most significant of these determinations related to the valuation of the acquired financial guaranty insurance contracts. On an aggregate basis, the acquired companies' contractual premiums for financial guaranty insurance contracts acquired were less than the premiums a market participant of similar credit quality would demand to acquire those contracts at the date of acquisition (particularly for BIG transactions), resulting in a significant amount of the purchase price being allocated to these contracts. For information on the methodology used to measure the fair value of assets acquired and liabilities assumed in the acquisitions, see Note 7, Fair Value Measurement.

The fair value of the Company's stand-ready obligation on the date of acquisition is recorded in unearned premium reserve. Thereafter, loss reserves and loss and loss adjustment expenses (LAE) are recorded in accordance with the Company's accounting policy for insurance or credit derivatives, depending on each contract's characteristics.

The excess of the fair value of net assets acquired over the consideration transferred was recorded, in each acquisition, as a bargain purchase gain in the statement of operations. In addition, the Company and each of the acquired companies had pre-existing reinsurance relationships, which were effectively settled at fair value on their respective acquisition dates. The gain or loss on settlement of these pre-existing reinsurance relationships represents the net difference between the historical assumed or ceded balances that were recorded by the Company and the fair value of ceded or assumed balances acquired and was also recorded in the statement of operations.

MBIA UK Insurance Limited

AGC completed its acquisition of MBIA UK Insurance Limited (MBIA UK) (the MBIA UK Acquisition), the U.K. operating subsidiary of MBIA Insurance Corporation (MBIA) on January 10, 2017 (the MBIA UK Acquisition Date). As consideration for the outstanding shares of MBIA UK plus \$23 million in cash, AGC exchanged all its holdings of notes issued in the Zohar II 2005-1 transaction (Zohar II Notes), which were insured by MBIA. AGC's Zohar II Notes had total outstanding principal of approximately \$347 million and fair value of \$334 million as of the MBIA UK Acquisition Date. The MBIA UK Acquisition added approximately \$12 billion of net par insured on January 10, 2017.

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

The following table shows the net effect of the MBIA UK Acquisition on January 10, 2017, including the effects of the settlement of pre-existing relationships.

	Fair Value of Net Assets Acquired, before Settlement of Pre-existing Relationships	Net effect of Settlement of Pre-existing Relationships	Net Effect of MBIA UK Acquisition
		(in millions)	
Purchase price (1)	\$ 334	\$ —	\$ 334
Identifiable assets acquired:			
Investments	459	—	459
Cash	72	—	72
Premiums receivable, net of commissions payable	274	(3)	271
Other assets	16	(6)	10
Total assets	821	(9)	812
Liabilities assumed:			
Unearned premium reserves	389	(6)	383
Current tax payable	25	—	25
Other liabilities	4	(4)	—
Total liabilities	418	(10)	408
Net assets of MBIA UK	403	1	404
Cash acquired from MBIA Holdings	23	—	23
Deferred tax liability	(36)	—	(36)
Net asset effect of MBIA UK Acquisition	390	1	391
Bargain purchase gain and settlement of pre-existing relationships resulting from MBIA UK Acquisition, after-tax	56	1	57
Deferred tax	—	1	1
Bargain purchase gain and settlement of pre-existing relationships resulting from MBIA UK Acquisition, pre-tax	\$ 56	\$ 2	\$ 58

- (1) The purchase price of \$334 million was allocated as follows: (1) \$329 million for the purchase of net assets of \$385 million, and (2) the settlement of pre-existing relationships between MBIA UK and Assured Guaranty at a fair value of \$5 million.

The Company believes the bargain purchase gain resulted from MBIA's strategy to address its insurance obligations with regards to the Zohar II Notes, the issuers of which MBIA did not expect would have sufficient funds to repay such notes in full on the scheduled maturity date of such notes in January 2017.

Revenue and net income (excluding the effects of subsequent tax reform) related to MBIA UK from the MBIA UK Acquisition Date through December 31, 2017 included in the consolidated statement of operations were approximately \$149 million and \$112 million, respectively, including the bargain purchase gain, settlement of pre-existing relationships, activity during the year and realized gain on the disposition of AGC's Zohar II Notes. For 2017, the Company recognized transaction expenses related to the MBIA UK Acquisition of \$7 million, primarily related to legal and financial advisors fees.

Unaudited Pro Forma Results of Operations

The following unaudited pro forma information presents the combined results of operations of the Company and MBIA UK as if the acquisition had been completed on January 1, 2016, as required under GAAP. The pro forma accounts include the estimated historical results of the Company and MBIA UK and pro forma adjustments related to the earning of the unearned premium reserve and expected losses that would be recognized in the statement of operations for each prior period presented, as well as the bargain purchase gain, settlement of pre-existing relationships, realized gain on the disposition of the Zohar II Notes and MBIA UK acquisition related expenses, all net of tax at the applicable statutory rate.

The unaudited pro forma combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined as of January 1, 2016, nor is it indicative of the results of operations in future periods. The Company did not include any pro forma combined financial information for 2017 as substantially all of MBIA UK's results of operations for 2017 are included in the year ended December 31, 2017 consolidated statements of operations.

Unaudited Pro Forma Results of Operations

	Year Ended December 31, 2016	
	(in millions)	
Pro forma revenues	\$	898
Pro forma net income		692

CIFG Holding Inc.

On July 1, 2016, AGC acquired all of the issued and outstanding capital stock of CIFG Holding Inc. (CIFGH, and together with its subsidiaries, CIFG) (the CIFG Acquisition), the parent of financial guaranty insurer CIFG Assurance North America, Inc. (CIFGNA), for \$450.6 million in cash. AGC merged CIFGNA with and into AGC, with AGC as the surviving company, on July 5, 2016. The CIFG Acquisition added \$4.4 billion of net par insured on July 1, 2016. The CIFG Acquisition also caused the cancellation of a retrocession from AGC to AG Re of \$1.2 billion of insured par that had been reinsured by AGC from CIFG, so the CIFG Acquisition added \$5.6 billion of net par insured to AGC on July 1, 2016.

At the time of the CIFG Acquisition, CIFGNA had a subsidiary financial guaranty company domiciled in France, CIFGE, which had been put into run-off and surrendered its licenses. CIFGNA had reinsured all of CIFGE's outstanding financial guaranty business and also had issued a "second-to-pay policy" pursuant to which CIFGNA guaranteed the full and complete payment of any shortfall in amounts due from CIFGE on its insured portfolio; AGC assumed these obligations as part of the CIFGNA merger with and into AGC. As part of the Combination completed on November 7, 2018, CIFGE transferred its insurance portfolio to and merged with and into AGE. See Note 1, Business and Basis of Presentation for additional information on the Combination.

The following table shows the net effect of the CIFG Acquisition on July 1, 2016, including the effects of the settlement of pre-existing relationships.

	Fair Value of Net Assets Acquired, before Settlement of Pre-existing Relationships	Net effect of Settlement of Pre-existing Relationships (in millions)	Net Effect of CIFG Acquisition
Cash Purchase Price (1)	\$ 450	\$ —	\$ 450
Identifiable assets acquired:			
Investments	775	—	775
Cash	8	—	8
Premiums receivable, net of commissions payable	18	—	18
Ceded unearned premium reserve	173	(173)	—
Deferred acquisition costs	1	(1)	—
Salvage and subrogation recoverable	23	—	23
Credit derivative assets	1	—	1
Deferred tax asset, net	194	34	228
Other assets	4	—	4
Total assets	1,197	(140)	1,057
Liabilities assumed:			
Unearned premium reserves	306	(10)	296
Loss and loss adjustment expense reserve	1	(66)	(65)
Credit derivative liabilities	68	—	68
Other liabilities	17	—	17
Total liabilities	392	(76)	316
Net asset effect of CIFG Acquisition	805	(64)	741
Bargain purchase gain and settlement of pre-existing relationships resulting from CIFG Acquisition, after-tax	355	(64)	291
Deferred tax	—	(34)	(34)
Bargain purchase gain and settlement of pre-existing relationships resulting from CIFG Acquisition, pre-tax	\$ 355	\$ (98)	\$ 257

(1) The cash purchase price of \$450.6 million represents the cash transferred for the acquisition which was allocated as follows: (1) \$277 million for the purchase of net assets of \$632 million and (2) the settlement of pre-existing relationships between CIFG and AGC at a fair value of \$173 million.

The bargain purchase gain reflects the fair value of CIFG's assets and liabilities, as well as tax attributes that were recorded in deferred taxes related to net operating losses (NOL) (after Internal Revenue Code change in control provisions) and other temporary book-to-tax differences for which CIFG had recorded a full valuation allowance. The Company believes the bargain purchase gain resulted from the nature of the financial guaranty business and the desire of investors in CIFG to monetize their investments in CIFG.

Revenue and net income related to CIFG from the CIFG Acquisition Date through December 31, 2016 included in the consolidated statement of operations were approximately \$295 million and \$311 million, respectively. For 2016, the Company recognized transaction expenses related to the CIFG Acquisition of \$6 million, primarily consisting of legal and financial advisors fees.

The Company has determined that the presentation of pro-forma information is impractical for the CIFG Acquisition as historical financial records are not available on a U.S. GAAP basis.

3. Ratings

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

	S&P Global Ratings, a division of Standard & Poor's Financial Services LLC	Kroll Bond Rating Agency	Moody's Investors Service, Inc.
AGC	AA(stable) (6/26/18)	AA (stable) (11/30/18)	(1)
MAC	AA(stable) (6/26/18)	AA+ (stable) (7/12/18)	—

(1) AGC requested that Moody's Investors Service, Inc. (Moody's) withdraw its financial strength ratings of AGC in January 2017, but Moody's denied that request. Moody's continues to rate AGC A3 (stable).

There can be no assurance that any of the rating agencies will not take negative action on the financial strength ratings (or similar ratings) of AGC in the future or cease to rate AGC, either voluntarily or at the request of AGC.

For a discussion of the effects of rating actions on the Company, see Note 6, Contracts Accounted for as Insurance, and Note 14, Reinsurance.

4. Outstanding Exposure

The Company primarily writes financial guaranty contracts in insurance form. Until 2009, the Company also wrote some of its financial guaranty contracts in credit derivative form, and has acquired or reinsured portfolios both before and after 2009 that include financial guaranty contracts in credit derivative form. Whether written as an insurance contract or as a credit derivative, the Company considers these financial guaranty contracts.

The Company seeks to limit its exposure to losses by underwriting obligations that it views as investment grade at inception, although on occasion it may underwrite new issuances that it views as BIG, typically as part of its loss mitigation strategy for existing troubled exposures. The Company also seeks to acquire portfolios of insurance from financial guarantors that are no longer writing new business by acquiring such companies, or providing reinsurance on a portfolio of insurance; in such instances, it evaluates the risk characteristics of the target portfolio, which may include some BIG exposures, as a whole in the context of the proposed transaction. The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, typically requires subordination or collateral to protect it from loss. Reinsurance may be used in order to reduce net exposure to certain insured transactions.

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

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 9, Variable Interest Entities. Unless otherwise specified, the outstanding par and debt service amounts presented in this note include outstanding exposures on VIEs whether or not they are consolidated.

Second-to-pay insured par outstanding represents transactions the Company has insured that are insured directly by another monoline financial guaranty insurer and where the Company's obligation to pay under its insurance of such transactions arises only if both the underlying insured obligation and the primary financial guarantor insurer default. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. The second-to-pay insured par outstanding as of December 31, 2018 and 2017 was \$3.0 billion and \$1.6 billion, respectively. The par on

second-to-pay exposure where the ratings of the primary insurer and underlying transaction are both BIG and/or not rated is \$76 million and \$104 million as of December 31, 2018 and December 31, 2017, respectively.

Significant Risk Management Activities

The Portfolio Risk Management Committee of the Company's indirect parent, AGL, which includes members of AGL's senior management and senior risk and surveillance officers, establishes AGL-wide credit policy for AGL's direct and assumed business. It implements specific underwriting procedures and limits for AGL and allocates underwriting capacity among AGL's subsidiaries, including the Company. The Portfolio Risk Management Committee is responsible for enterprise risk management for AGL and focuses on measuring and managing credit, market and liquidity risk for AGL. All transactions in new asset classes or new jurisdictions must be approved by this committee. The Company's risk management committee conducts an in-depth review of the Company's insured portfolio, focusing on varying portions of the portfolio at each meeting. It reviews and may revise internal ratings assigned to the insured transactions and review sector reports, monthly product line surveillance reports and compliance reports.

All transactions in the insured portfolio are assigned internal credit ratings by the relevant underwriting committee at inception, which credit ratings are updated by the relevant risk management committee based on changes in transaction credit quality. As part of the surveillance process, the Company monitors trends and changes in transaction credit quality, and recommends such remedial actions as may be necessary or appropriate. The Company also develops strategies to enforce its contractual rights and remedies and to mitigate its losses, engage in negotiation discussions with transaction participants and, when necessary, manage the Company's litigation proceedings.

Surveillance Categories

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

The Company monitors its insured portfolio and refreshes its internal credit ratings on individual exposures in quarterly, semi-annual or annual cycles based on the Company's view of the exposure's quality, loss potential, volatility and sector. Ratings on exposures in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter, although the Company may also review a rating in response to developments impacting the credit when a ratings review is not scheduled. For assumed exposures, the Company may use the ceding company's credit ratings of transactions where it is impractical for it to assign its own rating. The Company provides surveillance for exposures assumed from SGI, so for those exposures the Company assigns its own rating.

Exposures identified as BIG are subjected to further review to determine the probability of a loss. See Note 5, Expected Loss to be Paid, for additional information. Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a future loss is expected and whether a claim has been paid. The Company uses a tax-equivalent yield, which reflects long-term trends in interest rates, to calculate the present value of projected payments and recoveries and determine whether a future loss is expected in order to assign the appropriate BIG surveillance category to a transaction. For financial statement measurement purposes, the Company uses risk-free rates, which are determined each quarter, to calculate the expected loss.

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

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected.
- BIG Category 2: Below-investment-grade transactions for which future losses are expected but for which no claims (other than liquidity claims which are claims that the Company expects to be reimbursed within one year) have yet been paid.

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

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

Components of Outstanding Exposure

The Company purchases securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses (loss mitigation securities). The Company excludes amounts attributable to loss mitigation securities from par and debt service outstanding, which amounts are included in the investment portfolio, because it manages such securities as investments and not insurance exposure. As of December 31, 2018 and December 31, 2017, the Company excluded \$688 million and \$733 million, respectively, of net par attributable to loss mitigation securities, and other loss mitigation strategies (which are mostly BIG).

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

Financial Guaranty Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
	(in millions)			
Public finance	\$ 63,368	\$ 67,530	\$ 35,575	\$ 33,516
Structured finance	6,978	7,446	5,044	5,469
Total financial guaranty	<u>\$ 70,346</u>	<u>\$ 74,976</u>	<u>\$ 40,619</u>	<u>\$ 38,985</u>

Financial Guaranty Portfolio by Internal Rating As of December 31, 2018

Rating Category	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	\$ 19	0.1%	\$ 778	15.9%	\$ 639	15.7%	\$ 136	23.8%	\$ 1,572	5.7%
AA	3,092	17.3	187	3.8	1,438	35.5	41	7.2	4,758	17.4
A	7,883	44.1	916	18.6	726	17.9	142	24.8	9,667	35.3
BBB	5,044	28.2	2,887	58.9	519	12.8	253	44.2	8,703	31.7
BIG	1,839	10.3	137	2.8	736	18.1	—	0.0	2,712	9.9
Total net par outstanding	<u>\$ 17,877</u>	<u>100.0%</u>	<u>\$ 4,905</u>	<u>100.0%</u>	<u>\$ 4,058</u>	<u>100.0%</u>	<u>\$ 572</u>	<u>100.0%</u>	<u>\$ 27,412</u>	<u>100.0%</u>

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2017

Rating Category	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
(dollars in millions)										
AAA	\$ 38	0.2%	\$ 867	26.1%	\$ 687	15.9%	\$ 180	23.9%	\$ 1,772	6.7%
AA	2,772	15.1	1	0.0	1,362	31.7	48	6.3	4,183	15.6
A	8,872	48.3	599	18.1	1,211	28.1	139	18.4	10,821	40.4
BBB	4,646	25.3	1,714	51.6	306	7.1	388	51.3	7,054	26.4
BIG	2,043	11.1	138	4.2	743	17.2	1	0.1	2,925	10.9
Total net par outstanding	<u>\$ 18,371</u>	<u>100.0%</u>	<u>\$ 3,319</u>	<u>100.0%</u>	<u>\$ 4,309</u>	<u>100.0%</u>	<u>\$ 756</u>	<u>100.0%</u>	<u>\$ 26,755</u>	<u>100.0%</u>

**Financial Guaranty Portfolio
by Sector**

Sector	Gross Par Outstanding		Net Par Outstanding	
	As of December 31, 2018	As of December 31, 2017	As of December 31, 2018	As of December 31, 2017
(in millions)				
Public finance:				
U.S.:				
Tax backed	\$ 7,046	\$ 8,157	\$ 4,168	\$ 4,480
General obligation	11,478	16,179	3,777	4,276
Transportation	3,285	4,331	2,255	2,759
Infrastructure finance	2,429	1,335	2,051	1,072
Municipal utilities	4,662	5,540	1,928	2,107
Healthcare	1,869	2,790	1,371	2,048
Investor-owned utilities	779	265	603	246
Higher education	1,335	2,283	585	785
Housing revenue	180	99	145	96
Other public finance	1,508	1,159	994	502
Total public finance—U.S.	34,571	42,138	17,877	18,371
Non-U.S.:				
Regulated utilities	4,051	1,501	2,347	1,227
Infrastructure finance	1,791	1,053	1,509	989
Pooled infrastructure	1,373	1,561	687	780
Other public finance	391	323	362	323
Total public finance—non-U.S.	7,606	4,438	4,905	3,319
Total public finance	42,177	46,576	22,782	21,690
Structured finance:				
U.S.:				
Residential Mortgage-Backed Securities (RMBS)	1,662	1,792	1,399	1,452
Pooled corporate obligations	1,189	1,322	1,015	1,149
Consumer receivables	866	1,119	720	955
Insurance securitization	1,585	1,585	510	510
Other structured finance	548	332	414	243
Total structured finance—U.S.	5,850	6,150	4,058	4,309
Non-U.S.:				
RMBS	221	231	215	230
Commercial receivables	171	280	145	235
Pooled corporate obligations	47	78	47	78
Other structured finance	213	230	165	213
Total structured finance—non-U.S.	652	819	572	756
Total structured finance	6,502	6,969	4,630	5,065
Total par outstanding	\$ 48,679	\$ 53,545	\$ 27,412	\$ 26,755

Actual maturities of insured obligations could differ from contractual maturities because borrowers have the right to call or prepay certain obligations. The expected maturities of structured finance obligations are, in general, considerably shorter than the contractual maturities for such obligations.

**Expected Amortization of
Net Par Outstanding
As of December 31, 2018**

	Public Finance	Structured Finance (in millions)	Total
0 to 5 years	\$ 7,524	\$ 2,667	\$ 10,191
5 to 10 years	3,787	931	4,718
10 to 15 years	3,664	321	3,985
15 to 20 years	3,365	568	3,933
20 years and above	4,442	143	4,585
Total net par outstanding	<u>\$ 22,782</u>	<u>\$ 4,630</u>	<u>\$ 27,412</u>

**Components of BIG Net Par Outstanding
As of December 31, 2018**

	BIG Net Par Outstanding				Net Par Outstanding
	BIG 1	BIG 2	BIG 3	Total BIG	
	(in millions)				
Public finance:					
U.S. public finance	\$ 252	\$ 305	\$ 1,282	\$ 1,839	\$ 17,877
Non-U.S. public finance	89	48	—	137	4,905
Public finance	341	353	1,282	1,976	22,782
Structured finance:					
U.S. RMBS	83	163	478	724	1,399
Triple-X life insurance transactions	—	—	—	—	330
Trust preferred securities (TruPS)	—	—	—	—	837
Other structured finance	2	8	2	12	2,064
Structured finance	85	171	480	736	4,630
Total	<u>\$ 426</u>	<u>\$ 524</u>	<u>\$ 1,762</u>	<u>\$ 2,712</u>	<u>\$ 27,412</u>

**Components of BIG Net Par Outstanding
As of December 31, 2017**

	BIG Net Par Outstanding				Net Par Outstanding
	BIG 1	BIG 2	BIG 3	Total BIG	
	(in millions)				
Public finance:					
U.S. public finance	\$ 381	\$ 302	\$ 1,360	\$ 2,043	\$ 18,371
Non-U.S. public finance	83	55	—	138	3,319
Public finance	464	357	1,360	2,181	21,690
Structured finance:					
U.S. RMBS	143	101	353	597	1,452
Triple-X life insurance transactions	—	—	—	—	330
TruPS	122	—	—	122	1,177
Other structured finance	14	8	3	25	2,106
Structured finance	279	109	356	744	5,065
Total	\$ 743	\$ 466	\$ 1,716	\$ 2,925	\$ 26,755

**BIG Net Par Outstanding
and Number of Risks
As of December 31, 2018**

Description	Net Par Outstanding			Number of Risks (2)		
	Financial Guaranty Insurance (1)	Credit Derivative	Total	Financial Guaranty Insurance (1)	Credit Derivative	Total
(dollars in millions)						
BIG:						
Category 1	\$ 360	\$ 66	\$ 426	78	6	84
Category 2	520	4	524	33	1	34
Category 3	1,699	63	1,762	115	8	123
Total BIG	\$ 2,579	\$ 133	\$ 2,712	226	15	241

**BIG Net Par Outstanding
and Number of Risks
As of December 31, 2017**

Description	Net Par Outstanding			Number of Risks (2)		
	Financial Guaranty Insurance (1)	Credit Derivative	Total	Financial Guaranty Insurance (1)	Credit Derivative	Total
(dollars in millions)						
BIG:						
Category 1	\$ 565	\$ 178	\$ 743	96	7	103
Category 2	451	15	466	35	3	38
Category 3	1,637	79	1,716	112	9	121
Total BIG	\$ 2,653	\$ 272	\$ 2,925	243	19	262

(1) Includes net par outstanding for VIEs.

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

The Company seeks to maintain a diversified portfolio of insured obligations designed to spread its risk across a number of geographic areas.

**Geographic Distribution of
Net Par Outstanding
As of December 31, 2018**

	Number of Risks	Net Par Outstanding (dollars in millions)	Percent of Total Net Par Outstanding
U.S.:			
U.S. Public finance:			
California	335	\$ 3,477	12.7%
Puerto Rico	17	1,586	5.8%
Texas	353	1,582	5.8%
New Jersey	80	1,332	4.9%
New York	218	1,329	4.8%
Florida	100	863	3.1%
Illinois	187	739	2.7%
District of Columbia	6	631	2.3%
Pennsylvania	93	587	2.1%
Massachusetts	67	484	1.8%
Other	974	5,267	19.2%
Total U.S. public finance	2,430	17,877	65.2%
U.S. Structured finance (multiple states)	399	4,058	14.8%
Total U.S.	2,829	21,935	80.0%
Non-U.S.:			
United Kingdom	83	3,318	12.1%
Australia	8	565	2.1%
Chile	4	237	0.9%
New Zealand	2	232	0.8%
Mexico	2	198	0.7%
Other	48	927	3.4%
Total non-U.S.	147	5,477	20.0%
Total	2,976	\$ 27,412	100.0%

Exposure to Puerto Rico

The Company had insured exposure to general obligation bonds of the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations aggregating \$1.6 billion net par as of December 31, 2018, all of which was rated BIG. Puerto Rico has experienced significant general fund budget deficits and a challenging economic environment since at least the financial crisis. Beginning on January 1, 2016, a number of Puerto Rico exposures have defaulted on bond payments, and the Company has now paid claims on all of its Puerto Rico exposures except for Puerto Rico Aqueduct and Sewer Authority (PRASA), Municipal Finance Agency (MFA) and University of Puerto Rico (U of PR).

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

On June 30, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law by the President of the United States. PROMESA established a seven-member financial oversight board (Oversight Board) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. On February 15, 2019, the United States Court of Appeals for the First Circuit (First Circuit) held that members of the Oversight Board were not appointed in compliance with the appointments clause of the U.S. Constitution, but declined to dismiss the Title III petitions previously filed by the Oversight Board and delayed the effectiveness of its ruling for 90 days so as to allow the President of the United States and the U.S. Senate to validate the currently defective appointments or reconstitute the Oversight Board in accordance with the appointments clause. See "Puerto Rico Recovery Litigation" below.

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.

Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under chapter 9 of the United States Bankruptcy Code (Bankruptcy Code).

Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over any legal proceedings under PROMESA.

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

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

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

The Company also participates in mediation and negotiations relating to its Puerto Rico exposure.

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

The Company groups its Puerto Rico exposure into three categories:

- *Constitutionally Guaranteed.* The Company includes in this category public debt benefiting from Article VI of the Constitution of the Commonwealth, which expressly provides that interest and principal payments on the public debt are to be paid before other disbursements are made.
- *Public Corporations – Certain Revenues Potentially Subject to Clawback.* The Company includes in this category the debt of public corporations for which applicable law permits the Commonwealth to claw back, subject to certain conditions and for the payment of public debt, at least a portion of the revenues supporting the bonds the Company insures. As a constitutional condition to clawback, available Commonwealth revenues for any fiscal year must be insufficient to pay Commonwealth debt service before the payment of any appropriations for that year. The Company believes that this condition has not been satisfied to date, and accordingly that the Commonwealth has not to date been entitled to claw back revenues supporting debt insured by the Company.
- *Other Public Corporations.* The Company includes in this category the debt of public corporations that are supported by revenues it does not believe are subject to clawback.

Constitutionally Guaranteed

General Obligation. As of December 31, 2018, the Company had \$301 million insured net par outstanding of the general obligations of Puerto Rico, which are supported by the good faith, credit and taxing power of the Commonwealth. Despite the requirements of Article VI of its Constitution, the Commonwealth defaulted on the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since that date. The Oversight Board has filed a petition under Title III of PROMESA with respect to the Commonwealth.

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

Puerto Rico Public Buildings Authority (PBA). As of December 31, 2018, the Company had \$142 million insured net par outstanding of PBA bonds, which are supported by a pledge of the rents due under leases of government facilities to departments, agencies, instrumentalities and municipalities of the Commonwealth, and that benefit from a Commonwealth guaranty supported by a pledge of the Commonwealth's good faith, credit and taxing power. Despite the requirements of Article VI of its Constitution, the PBA defaulted on most of the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since then.

Public Corporations - Certain Revenues Potentially Subject to Clawback

PRHTA. As of December 31, 2018, the Company had \$495 million insured net par outstanding of PRHTA (transportation revenue) bonds and \$84 million insured net par outstanding of PRHTA (highways revenue) bonds. The transportation revenue bonds are secured by a subordinate gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to \$120 million annually of taxes on crude oil, unfinished oil and derivative products. The highways revenue bonds are secured by a gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The non-toll revenues consisting of excise taxes and fees collected by the Commonwealth on behalf of PRHTA and its bondholders that are statutorily allocated to PRHTA and its bondholders are potentially subject to clawback. Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments on these bonds since that date. The Oversight Board has filed a petition under Title III of PROMESA with respect to PRHTA.

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

PRCCDA. As of December 31, 2018, the Company had \$152 million insured net par outstanding of PRCCDA bonds, which are secured by certain hotel tax revenues. These revenues are sensitive to the level of economic activity in the area and are potentially subject to clawback. There were sufficient funds in the PRCCDA bond accounts to make only partial payments on the July 1, 2017 PRCCDA bond payments guaranteed by the Company, and the Company has been making claim payments on these bonds since that date.

PRIFA. As of December 31, 2018, the Company had \$15 million insured net par outstanding of PRIFA bonds, which are secured primarily by the return to Puerto Rico of federal excise taxes paid on rum. These revenues are potentially subject to the clawback. The Company has been making claim payments on the PRIFA bonds since January 2016.

Other Public Corporations

PREPA. As of December 31, 2018, the Company had \$72 million insured net par outstanding of PREPA obligations, which are secured by a lien on the revenues of the electric system. The Company has been making claim payments on these bonds since July 1, 2017.

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

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

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

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

PRASA. As of December 31, 2018, the Company had \$284 million of insured net par outstanding of PRASA bonds, which are secured by a lien on the gross revenues of the water and sewer system. On September 15, 2015, PRASA entered into a settlement with the U.S. Department of Justice and the U.S. Environmental Protection Agency that requires it to spend \$1.6 billion to upgrade and improve its sewer system island-wide. The PRASA bond accounts contained sufficient funds to make the PRASA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

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

MFA. As of December 31, 2018, the Company had \$40 million net par outstanding of bonds issued by MFA secured by a lien on local property tax revenues. The MFA bond accounts contained sufficient funds to make the MFA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

U of PR. As of December 31, 2018, the Company had \$1 million insured net par outstanding of U of PR bonds, which are general obligations of the university and are secured by a subordinate lien on the proceeds, profits and other income of the university, subject to a senior pledge and lien for the benefit of outstanding university system revenue bonds. As of the date of this filing, all debt service payments on U of PR bonds insured by the Company have been made.

Puerto Rico Recovery Litigation

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

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

On June 3, 2017, AGC and AGM filed an adversary complaint in the Federal District Court for Puerto Rico seeking (i) a judgment declaring that the application of pledged special revenues to the payment of the PRHTA bonds is not subject to the PROMESA Title III automatic stay and that the Commonwealth has violated the special revenue protections provided to the PRHTA bonds under the Bankruptcy Code; (ii) an injunction enjoining the Commonwealth from taking or causing to be taken any action that would further violate the special revenue protections provided to the PRHTA bonds under the Bankruptcy Code; and (iii) an injunction ordering the Commonwealth to remit the pledged special revenues securing the PRHTA bonds in accordance with the terms of the special revenue provisions set forth in the Bankruptcy Code. On January 30, 2018, the court rendered an opinion dismissing the complaint and holding, among other things, that (x) even though the special revenue provisions of the Bankruptcy Code protect a lien on pledged special revenues, those provisions do not mandate the turnover of pledged special revenues to the payment of bonds and (y) actions to enforce liens on pledged special revenues remain stayed. AGC and AGM appealed the district court's decision to the First Circuit. On March 26, 2019, the First Circuit issued its opinion affirming the trial court's decision and held that Sections 928(a) and 922(d) of the Bankruptcy Code permit, but do not

require, continued payments during the pendency of the Title III proceedings. The First Circuit agreed with the trial court that (i) Section 928(a) of the Bankruptcy Code does not mandate the turnover of special revenues or require continuity of payments to the PRHTA Bonds during the pendency of the Title III proceedings, and (ii) Section 922(d) of the Bankruptcy Code is not an exception to the automatic stay that would compel PRHTA, or third parties holding special revenues, to apply special revenues to outstanding obligations.

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

On July 18, 2017, AGM and AGC filed in the Federal District Court for Puerto Rico a motion for relief from the automatic stay in the PREPA Title III bankruptcy proceeding and a form of complaint seeking the appointment of a receiver for PREPA. The court denied the motion on September 14, 2017, but on August 8, 2018, the First Circuit vacated and remanded the court’s decision. On October 3, 2018, AGM and AGC, together with other bond insurers, filed a motion with the court to lift the automatic stay to commence an action against PREPA for the appointment of a receiver.

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

On July 23, 2018, AGC and AGM filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment (i) declaring the members of the Oversight Board are officers of the U.S. whose appointments were unlawful under the Appointments Clause of the U.S. Constitution; (ii) declaring void *ab initio* the unlawful actions taken by the Oversight Board to date, including (x) development of the Commonwealth’s Fiscal Plan, (y) development of PRHTA’s Fiscal Plan, and (z) filing of the Title III cases on behalf of the Commonwealth and PRHTA; and (iii) enjoining the Oversight Board from taking any further action until the Oversight Board members have been lawfully appointed in conformity with the Appointments Clause of the U.S. Constitution. The Title III court dismissed a similar lawsuit filed by another party in the Commonwealth’s Title III case in July 2018. On August 3, 2018, a stipulated judgment was entered against AGM and AGC at their request based upon the court’s July decision in the other Appointments Clause lawsuit and, on the same date, AGM and AGC appealed the stipulated judgment to the First Circuit. On August 15, 2018, the court consolidated, for purposes of briefing and oral argument, AGM and AGC’s appeal with the other Appointments Clause lawsuit. The First Circuit consolidated AGM’s and AGC’s appeal with a third Appointments Clause lawsuit on September 7, 2018 and held a hearing on December 3, 2018. On February 15, 2019, the First Circuit issued its ruling on the appeal and held that members of the Oversight Board were not appointed in compliance with the Appointments Clause of the U.S. Constitution but declined to dismiss the Title III petitions citing the (i) de facto officer doctrine and (ii) negative consequences to the many innocent third parties who relied on the Oversight Board’s actions to date, as well as the further delay which would result from a dismissal of the Title III petitions. The case was remanded back to the Federal District Court for Puerto Rico for the appellants’ requested declaratory relief that the appointment of the board members of the Oversight Board is unconstitutional. The First Circuit delayed the effectiveness of its ruling for 90 days so as to allow the President and the Senate to validate the currently defective appointments or reconstitute the Oversight Board in accordance with the Appointments Clause. On February 28, 2019, the Oversight Board announced that it will ask the U.S. Supreme Court to review the First Circuit’s February 15, 2019 decision and will also request a stay of the First Circuit’s ruling, pending the U.S. Supreme Court’s consideration of the Oversight Board’s petition for a *writ of certiorari*.

On December 21, 2018, the Oversight Board and the Official Committee of Unsecured Creditors of all Title III Debtors (other than COFINA) filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment declaring that (i) the leases to public occupants (“Leases”) entered into by the PBA are not “true leases” for purposes of Section 365(d)(3) of the Bankruptcy Code and therefore the Commonwealth has no obligation to make payments to the PBA under the Leases or Section 365(d)(3) of the Bankruptcy Code, (ii) the PBA is not entitled to a priority administrative expense claim

under the Leases pursuant to Sections 503(b)(1) and 507(a)(2) of the Bankruptcy Code, and (iii) any such claims filed or asserted against the Commonwealth are disallowed. On January 28, 2019, the PBA filed an answer to the complaint. On March 12, 2019, the Federal District Court for Puerto Rico granted, with certain limitations, AGM's and AGC's motion to intervene. On March 21, 2019, AGM and AGC, together with certain other intervenors, filed a motion for judgment on the pleadings.

Puerto Rico Par and Debt Service Schedules

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

Puerto Rico Gross Par and Gross Debt Service Outstanding

	Gross Par Outstanding		Gross Debt Service Outstanding	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
	(in millions)			
Exposure to Puerto Rico	\$ 1,939	\$ 2,041	\$ 3,295	\$ 3,501

Puerto Rico Net Par Outstanding

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Commonwealth Constitutionally Guaranteed		
Commonwealth of Puerto Rico - General Obligation Bonds (1)	\$ 301	\$ 343
PBA	142	141
Public Corporations - Certain Revenues Potentially Subject to Clawback		
PRHTA (Transportation revenue) (1)	495	511
PRHTA (Highways revenue) (1)	84	93
PRCCDA	152	152
PRIFA	15	17
Other Public Corporations		
PREPA (1)	72	73
PRASA	284	284
MFA	40	54
U of PR	1	1
Total net exposure to Puerto Rico	\$ 1,586	\$ 1,669

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

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

**Amortization Schedule of Puerto Rico Net Par Outstanding
and Net Debt Service Outstanding
As of December 31, 2018**

	Scheduled Net Par Amortization	Scheduled Net Debt Service Amortization
	(in millions)	
2019 (January 1 - March 31)	\$ —	\$ 40
2019 (April 1 - June 30)	—	—
2019 (July 1 - September 30)	68	107
2019 (October 1 - December 31)	—	—
Subtotal 2019	68	147
2020	118	196
2021	54	125
2022	35	104
2023	40	107
2024-2028	348	644
2029-2033	250	463
2034-2038	381	498
2039-2043	93	155
2044-2047	199	229
Total	<u>\$ 1,586</u>	<u>\$ 2,668</u>

Exposure to the U.S. Virgin Islands

As of December 31, 2018, the Company had \$11 million insured net par outstanding to the U.S. Virgin Islands and its related authorities (USVI), of which it rated \$9 million BIG. The \$2 million USVI net par the Company rated investment grade was primarily consisted of bonds secured by a lien on matching fund revenues related to excise taxes on products produced in the USVI and exported to the U.S., primarily rum. The \$9 million BIG USVI net par consisted of bonds of the Virgin Islands Water and Power Authority secured by a net revenue pledge of the electric system.

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

5. Expected Loss to be Paid

In order to effectively evaluate and monitor the economics and liquidity of the entire insured portfolio, management compiles loss information, monitors and assigns ratings and calculates expected losses in the same manner for all its exposures regardless of form or differing accounting models. This note provides information regarding expected claim payments to be made under all contracts in the insured portfolio.

Expected loss to be paid is important from a liquidity perspective in that it represents the present value of amounts that the Company expects to pay or recover in future periods for all contracts. The expected loss to be paid is equal to the present value of expected future cash outflows for claim and LAE payments, net of inflows for expected salvage and subrogation (e.g., future payments by obligors pursuant to restructuring agreements, settlements or litigation judgments, excess spread on underlying collateral, and other estimated recoveries, including those from restructuring bonds and for breaches of representations and warranties (R&W)), using current risk-free rates. Expected cash outflows and inflows are probability weighted cash flows that reflect management's assumptions about the likelihood of all possible outcomes based on all information available to it. Those assumptions consider the relevant facts and circumstances and are consistent with the information tracked and monitored through the Company's risk-management activities. The Company updates the discount rates each quarter and reflects the effect of such changes in economic loss development. Net expected loss to be paid is defined as expected loss to be paid, net of amounts ceded to reinsurers.

In circumstances where the Company has purchased its own insured obligations that have expected losses, and in certain cases, issuers of insured obligations elected, or the Company and an issuer mutually agreed as part of a negotiation, to deliver the underlying collateral or insured obligation to the Company, expected loss to be paid is reduced by the proportionate share of the insured obligation that is held in the investment portfolio. The difference between the purchase price of the obligation and the fair value excluding the value of the Company's insurance is treated as a paid loss. Assets that are purchased by the Company are recorded in the investment portfolio, at fair value excluding the value of the Company's insurance. See Note 10, Investments and Cash and Note 7, Fair Value Measurement.

Economic loss development represents the change in net expected loss to be paid attributable to the effects of changes in assumptions based on observed market trends, changes in discount rates, accretion of discount and the economic effects of loss mitigation efforts.

The insured portfolio includes policies accounted for under three separate accounting models depending on the characteristics of the contract and the Company's control rights. The three models are: (1) insurance as described in "Financial Guaranty Insurance Losses" in Note 6, Contracts Accounted for as Insurance, (2) derivative as described in Note 7, Fair Value Measurement and Note 8, Contracts Accounted for as Credit Derivatives, and (3) VIE consolidation as described in Note 9, Variable Interest Entities. The Company has paid and expects to pay future losses (net of recoveries) on policies which fall under each of the three accounting models.

Loss Estimation Process

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

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

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

Changes over a reporting period in the Company's loss estimates for municipal obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, generally will be influenced by factors impacting their revenue levels, such as changes in demand; changing demographics; and other economic factors, especially if the obligations do not benefit from financial support from other tax revenues or governmental authorities. Changes over a reporting period in the Company's loss estimates for its tax-supported public finance transactions generally will be influenced by factors impacting the public issuer's ability and willingness to pay, such as changes in the economy and population of the relevant area; changes in the issuer's ability or willingness to raise taxes, decrease spending or receive federal assistance; new legislation; rating agency actions that affect the issuer's ability to refinance maturing obligations or issue new debt at a reasonable cost; changes in the priority or amount of pensions and other obligations owed to workers; developments in restructuring or settlement negotiations; and other political and economic factors. Changes in loss estimates may also be affected by the Company's loss mitigation efforts.

Changes in the Company's loss estimates for structured finance transactions generally will be influenced by factors impacting the performance of the assets supporting those transactions. For example, changes over a reporting period in the

Company's loss estimates for its RMBS transactions may be influenced by factors such as the level and timing of loan defaults experienced; changes in housing prices; results from the Company's loss mitigation activities; and other variables.

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

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

The following tables present a roll forward of net expected loss to be paid for all contracts. The Company used risk-free rates for U.S. dollar denominated obligations, that ranged from 0.00% to 3.06% with a weighted average of 2.75% as of December 31, 2018 and from 0.00% to 2.78% with a weighted average of 2.35% as of December 31, 2017. Expected losses to be paid for transactions denominated in currencies other than the U.S. dollar represented approximately 1.1% and 2.4% of the total as of December 31, 2018 and December 31, 2017, respectively.

**Net Expected Loss to be Paid
Roll Forward**

	Year Ended December 31,	
	2018	2017
	(in millions)	
Net expected loss to be paid, beginning of period	\$ 224	\$ 337
Net expected loss to be paid on the SGI portfolio as of June 1, 2018 (see Note 2)	131	—
Net expected loss to be paid on the MBIA UK portfolio as of January 10, 2017	—	21
Economic loss development (benefit) due to:		
Accretion of discount	9	10
Changes in discount rates	4	6
Changes in timing and assumptions	4	42
Total economic loss development (benefit)	17	58
Net (paid) recovered losses	(18)	(117)
Net effect of sale of the European Subsidiaries on June 26, 2017	—	(75)
Net expected loss to be paid, end of period	<u>\$ 354</u>	<u>\$ 224</u>

**Net Expected Loss to be Paid
Roll Forward by Sector
Year Ended December 31, 2018**

	Net Expected Loss to be Paid (Recovered) as of December 31, 2017(2)	Net Expected Loss to be Paid on SGI portfolio as of June 1, 2018	Economic Loss Development/ (Benefit)	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid (Recovered) as of December 31, 2018(2)
	(in millions)				
Public finance:					
U.S. public finance	\$ 444	\$ —	\$ 20	\$ (150)	\$ 314
Non-U.S. public finance	5	1	(2)	—	4
Public finance	449	1	18	(150)	318
Structured finance:					
U.S. RMBS	(111)	130	(24)	128	123
Other structured finance	(114)	—	23	4	(87)
Structured finance	(225)	130	(1)	132	36
Total	\$ 224	\$ 131	\$ 17	\$ (18)	\$ 354

**Net Expected Loss to be Paid
Roll Forward by Sector
Year Ended December 31, 2017**

	<u>Net Expected Loss to be Paid (Recovered) as of December 31, 2016</u>	<u>Net Expected Loss to be Paid (Recovered) on MBIA UK as of January 10, 2017</u>	<u>Economic Loss Development/ (Benefit)</u>	<u>(Paid) Recovered Losses (1)</u>	<u>Net Effect of Sale of the European Subsidiaries on June 26, 2017</u>	<u>Net Expected Loss to be Paid (Recovered) as of December 31, 2017(2)</u>
	(in millions)					
Public finance:						
U.S. public finance	\$ 374	\$ —	\$ 189	\$ (119)	\$ —	\$ 444
Non-U.S. public finance	6	13	(2)	—	(12)	5
Public finance	380	13	187	(119)	(12)	449
Structured finance:						
U.S. RMBS	29	—	(146)	6	—	(111)
Other structured finance	(72)	8	17	(4)	(63)	(114)
Structured finance	(43)	8	(129)	2	(63)	(225)
Total	\$ 337	\$ 21	\$ 58	\$ (117)	\$ (75)	\$ 224

- (1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets. The Company paid \$11 million and \$10 million in LAE for the years ended December 31, 2018 and 2017, respectively.
- (2) Includes expected LAE to be paid of \$13 million as of December 31, 2018 and \$7 million as of December 31, 2017.

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

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

	Net Expected Loss to be Paid (Recovered)		Net Economic Loss Development (Benefit)	
	As of December 31, 2018	As of December 31, 2017	Year Ended December 31, 2018	Year Ended December 31, 2017
	(in millions)			
Financial guaranty insurance	\$ 348	\$ 222	\$ 9	\$ 80
FG VIEs (1) and other	8	13	(6)	(1)
Credit derivatives (2)	(2)	(11)	14	(21)
Total	<u>\$ 354</u>	<u>\$ 224</u>	<u>\$ 17</u>	<u>\$ 58</u>

(1) See Note 9, Variable Interest Entities.

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

Selected U.S. Public Finance Transactions

The Company insured general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$1.6 billion net par as of December 31, 2018, all of which was BIG. For additional information regarding the Company's Puerto Rico exposure, see "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

The Company had approximately \$18 million of net par exposure as of December 31, 2018, to bonds issued by Parkway East Public Improvement District (District), which is located in Madison County, Mississippi (the County). The bonds, which are rated BIG, are payable from special assessments on properties within the District, as well as amounts paid under a contribution agreement with the County in which the County covenants that it will provide funds in the event special assessments are not sufficient to make a debt service payment. The special assessments have not been sufficient to pay debt service in full. In earlier years, the County provided funding to cover the balance of the debt service requirement, but subsequently claimed the District's failure to reimburse it within the two years stipulated in the contribution agreement means that the County is not required to provide funding until it is reimbursed. See "Recovery Litigation" at the end of this note for the settlement agreement reached between the County, the District and AGC with respect to the County's obligations.

The Company projects that its total net expected loss across its troubled U.S. public finance exposures as of December 31, 2018, including those mentioned above, would be \$314 million, compared with a net expected loss of \$444 million as of December 31, 2017. The total net expected loss for troubled U.S. public finance exposures is net of a credit for estimated future recoveries of claims already paid. At December 31, 2018, that credit was \$224 million, compared with \$147 million at December 31, 2017. The economic loss development in 2018 was \$20 million, which was primarily attributable to Puerto Rico exposures.

U.S. RMBS Loss Projections

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

The further behind a mortgage borrower falls in making payments, the more likely it is that he or she will default. The rate at which borrowers from a particular delinquency category (number of monthly payments behind) eventually default is referred to as the "liquidation rate." The Company derives its liquidation rate assumptions from observed roll rates, which are the rates at which loans progress from one delinquency category to the next and eventually to default and liquidation. The

Company applies liquidation rates to the mortgage loan collateral in each delinquency category and makes certain timing assumptions to project near-term mortgage collateral defaults from loans that are currently delinquent.

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay through the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default, by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates (CDR), then projecting how the CDR will develop over time. Loans that are defaulted pursuant to the CDR after the near-term liquidation of currently delinquent loans represent defaults of currently performing loans and projected re-performing loans. A CDR is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or "collateral pool balance"). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector and vintage based on its experience to date. The Company continues to update its evaluation of these loss severities as new information becomes available.

The Company had been enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates R&W recoveries and payables to include in its cash flow projections based on its agreements with R&W providers. As of December 31, 2018, the Company had a net R&W receivable of \$25 million from R&W counterparties, compared to a net R&W receivable of \$140 million as of December 31, 2017. The decrease was primarily due to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017.

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

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will continue improving. Each period the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the period of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as to whether those changes are normal fluctuations or part of a trend. The assumptions that the Company uses to project RMBS losses are shown in the sections below.

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

Net Economic Loss Development (Benefit)
U.S. RMBS

	Year Ended December 31,	
	2018	2017
	(in millions)	
First lien U.S. RMBS	\$ (2)	\$ (27)
Second lien U.S. RMBS	(22)	(119)

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

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

First Lien Liquidation Rates

	As of December 31,		
	2018	2017	2016
Delinquent/Modified in the Previous 12 Months			
Alt-A and Prime	20%	20%	25%
Option ARM	20	20	25
Subprime	20	20	25
30 – 59 Days Delinquent			
Alt-A and Prime	30	30	35
Option ARM	35	35	35
Subprime	40	40	40
60 – 89 Days Delinquent			
Alt-A and Prime	40	40	45
Option ARM	45	50	50
Subprime	45	50	50
90+ Days Delinquent			
Alt-A and Prime	50	55	55
Option ARM	55	60	55
Subprime	50	55	55
Bankruptcy			
Alt-A and Prime	45	45	45
Option ARM	50	50	50
Subprime	40	40	40
Foreclosure			
Alt-A and Prime	60	65	65
Option ARM	65	70	65
Subprime	60	65	65
Real Estate Owned			
All	100	100	100

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

In the most heavily weighted scenario (the base case), after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 4.5 years after the initial 36-month CDR plateau period. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified or delinquent in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period represent defaults attributable to borrowers that are currently performing or are projected to reperform.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions had reached historically high levels, and the Company is assuming in the base case that the still elevated levels generally will continue for another 18 months. The Company determines its initial loss severity based on actual recent experience. Each quarter the Company reviews available data and (if necessary) adjusts its severities based on its observations. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period, declining to 40% in the base case over 2.5 years.

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

**Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS**

	As of December 31, 2018		As of December 31, 2017		As of December 31, 2016	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Alt-A First Lien						
Plateau CDR	1.2% - 10.3%	3.9%	1.3% - 9.7%	4.9%	1.0% - 13.5%	5.5%
Final CDR	0.1% - 0.5%	0.2%	0.1% - 0.5%	0.2%	0.0% - 0.7%	0.3%
Initial loss severity:						
2005 and prior	60%		60%		60%	
2006	70%		80%		80%	
2007+	70%		70%		70%	
Option ARM						
Plateau CDR	1.8% - 6.8%	5.2%	2.5% - 6.9%	5.8%	3.4% - 6.6%	5.5%
Final CDR	0.1% - 0.3%	0.3%	0.1% - 0.3%	0.3%	0.2% - 0.3%	0.3%
Initial loss severity:						
2005 and prior	60%		60%		60%	
2006	60%		70%		70%	
2007+	70%		75%		75%	
Subprime						
Plateau CDR	3.2% - 11.5%	6.3%	3.5% - 13.1%	7.9%	2.8% - 14.1%	7.9%
Final CDR	0.2% - 0.6%	0.3%	0.2% - 0.7%	0.4%	0.1% - 0.7%	0.4%
Initial loss severity:						
2005 and prior	80%		80%		80%	
2006	75%		90%		90%	
2007+	95%		95%		90%	

The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the CDR, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntary conditional prepayment rate (CPR) follows a similar pattern to that of the CDR. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. These CPR assumptions are the same as those the Company used for December 31, 2017.

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

Total expected loss to be paid on all first lien U.S. RMBS was \$119 million and \$2 million as of December 31, 2018 and December 31, 2017, respectively. The reinsurance of the SGI portfolio added \$113 million of net expected loss to first lien U.S. RMBS on June 1, 2018. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of December 31, 2018 as it used as of December 31, 2017, increasing and decreasing the periods of stress from those used in the base case.

In the Company's most stressful scenario where loss severities were assumed to rise and then recover over nine years and the initial ramp-down of the CDR was assumed to occur over 15 months, expected loss to be paid would increase from current projections by approximately \$13 million for all first lien U.S. RMBS transactions.

In the Company's least stressful scenario where the CDR plateau was six months shorter (30 months, effectively assuming that liquidation rates would improve) and the CDR recovery was more pronounced (including an initial ramp-down of the CDR over nine months), expected loss to be paid would decrease from current projections by approximately \$4 million for all first lien U.S. RMBS transactions.

U.S. Second Lien RMBS Loss Projections

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

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

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

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

The HELOC loans underlying the Company's insured HELOC transactions are now past their original interest-only reset date, although a significant number of HELOC loans were modified to extend the original interest-only period for another five years. As a result, in 2017, the Company eliminated the CDR increase that was applied when such loans reached their principal amortization period. In addition, based on the average performance history, starting in the third quarter of 2017, the Company applied a CDR floor of 2.5% for the future steady state CDR on all its HELOC transactions.

When a second lien loan defaults, there is generally a very low recovery. The Company assumed as of December 31, 2018 that it will generally recover only 2% of future defaulting collateral at the time of charge-off, with additional amounts of post charge-off recoveries assumed to come in over time. This is the same assumption used as of December 31, 2017. A second lien on the borrower's home may be retained in the Company's second lien transactions after the loan is charged off and the loss applied to the transaction, particularly in cases where the holder of the first lien has not foreclosed. If the second lien is retained and the value of the home increases, the servicer may be able to use the second lien to increase recoveries, either by arranging for the borrower to resume payments or by realizing value upon the sale of the underlying real estate. In instances where the Company is able to obtain information on the lien status of charged-off loans, it assumes future recoveries of 10% of the balance of the charged off loans where the second lien is still intact. The Company assumes the recoveries are received evenly over the next five years, although actual recoveries will vary. The Company evaluates its assumptions periodically based on actual recoveries of charged off loans.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected as well as the amount of excess spread. In the base case, an average CPR (based on experience of the past year) is assumed to continue

until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. The final CPR is assumed to be 15% for second lien transactions (in the base case), which is lower than the historical average but reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. This pattern is generally consistent with how the Company modeled the CPR as of December 31, 2017. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

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

The Company continues to evaluate the assumptions affecting its modeling results. The Company believes the most important driver of its projected second lien RMBS losses is the performance of its HELOC transactions. Total expected loss to be paid on all second lien U.S. RMBS was \$4 million as of December 31, 2018 and total expected recovery on all second lien U.S. RMBS was \$113 million as of December 31, 2017, respectively. This change was primarily due to cash received in 2018 from a favorable settlement of R&W litigation reached in late December 2017 and the addition of \$17 million of net expected loss on second lien U.S. RMBS from reinsurance of the SGI portfolio on June 1, 2018 and partially offset by improvement in the performance of primarily HELOC transactions.

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

**Key Assumptions in Base Case Expected Loss Estimates
HELOCs**

	As of December 31, 2018		As of December 31, 2017		As of December 31, 2016	
	Range	Weighted Average	Range	Weighted Average	Range	Weighted Average
Plateau CDR	7.2% - 26.8%	12.8%	8.5% - 13.3%	11.4%	5.3% - 24.8%	13.6%
Final CDR trended down to	2.5%		2.5%		0.5% - 2.5%	1.5%
Liquidation rates:						
Delinquent/Modified in the Previous 12 Months	20%		20%		25%	
30 – 59 Days Delinquent	35		45		50	
60 – 89 Days Delinquent	50		60		65	
90+ Days Delinquent	70		75		80	
Bankruptcy	55		55		55	
Foreclosure	65		70		75	
Real Estate Owned	100		100		100	
Loss severity	98%		98%		98%	

The Company's base case assumed a six month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults. In the Company's most stressful scenario, increasing the CDR plateau to eight months and increasing the ramp-down by three months to 31 months (for a total stress period of 39 months) would increase the expected loss by approximately \$3 million for HELOC transactions. On the other hand, in the Company's least stressful scenario, reducing the CDR plateau to four months and decreasing the length of the CDR ramp-down to 25 months (for a total stress period of 29 months), and lowering the ultimate prepayment rate to 10% would decrease the expected loss by approximately \$3 million for HELOC transactions.

Other Structured Finance

Other structured finance has an expected recovery of \$87 million, which is primarily attributable to insured financial guaranty triple-X life insurance transactions, for which the Company has mitigated its exposure with the purchase of loss mitigation bonds. The BIG net par in this sector of \$12 million primarily consists of consumer receivables and other structured finance transactions. The economic loss development during 2018 of \$23 million was related to triple-X life insurance transactions and LAE.

Recovery Litigation

In the ordinary course of its business, the Company asserts claims in legal proceedings against third parties to recover losses paid in prior periods or prevent losses in the future.

Public Finance Transactions

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

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

RMBS Transactions

On November 26, 2012, CIFGNA filed a complaint in the Supreme Court of the State of New York against JP Morgan Securities LLC (JP Morgan) for material misrepresentation in the inducement of insurance and common law fraud, alleging that JP Morgan fraudulently induced CIFGNA to insure \$400 million of securities issued by ACA ABS CDO 2006-2 Ltd. and \$325 million of securities issued by Libertas Preferred Funding II, Ltd. On June 26, 2015, the court dismissed with prejudice CIFGNA's material misrepresentation in the inducement of insurance claim and dismissed without prejudice CIFGNA's common law fraud claim. On September 24, 2015, the court denied CIFGNA's motion to amend but allowed CIFGNA to re-plead a cause of action for common law fraud. On November 20, 2015, CIFGNA filed a motion for leave to amend its complaint to re-plead common law fraud. On April 29, 2016, CIFGNA filed an appeal to reverse the court's decision dismissing CIFGNA's material misrepresentation in the inducement of insurance claim. On November 29, 2016, the Appellate Division of the Supreme Court of the State of New York ruled that the court's decision dismissing with prejudice CIFGNA's material misrepresentation in the inducement of insurance claim should be modified to grant CIFGNA leave to re-plead such claim. On February 27, 2017, AGC (as successor to CIFGNA) filed an amended complaint which includes a claim for material misrepresentation in the inducement of insurance.

6. Contracts Accounted for as Insurance

Premiums

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

Accounting Policies

Accounting for financial guaranty contracts that meet the scope exception under derivative accounting guidance are subject to industry specific guidance for financial guaranty insurance. The accounting for contracts that fall under the financial guaranty insurance definition are consistent whether contracts are written on a direct basis, assumed from another financial guarantor under a reinsurance treaty, ceded to another insurer under a reinsurance treaty, or acquired in a business combination.

Premiums receivable represent the present value of contractual or expected future premium collections discounted using risk free rates. Unearned premium reserve represents deferred premium revenue, less claim payments made and recoveries received that have not yet been recognized in the statement of operations (contra-paid). The following discussion relates to the deferred premium revenue component of the unearned premium reserve, while the contra-paid is discussed below under "Financial Guaranty Insurance Losses."

The amount of deferred premium revenue at contract inception is determined as follows:

- For premiums received upfront on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is equal to the amount of cash received. Upfront premiums typically relate to public finance transactions.
- For premiums received in installments on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is the present value (discounted at risk free rates) of either (1) contractual premiums due or (2) in cases where the underlying collateral consists of homogeneous pools of assets, the expected premiums to be collected over the life of the contract. To be considered a homogeneous pool of assets, prepayments must be contractually allowable, the amount of prepayments must be probable, and the timing and amount of prepayments must be reasonably estimable. Installment premiums typically relate to structured finance transactions, where the insurance premium rate is determined at the inception of the contract but the insured par is subject to prepayment throughout the life of the transaction.
- For financial guaranty insurance contracts acquired in a business combination, deferred premium revenue is equal to the fair value of the Company's stand-ready obligation portion of the insurance contract at the date of acquisition based on what a hypothetical similarly rated financial guaranty insurer would have charged for the contract at that date and not the actual cash flows under the insurance contract. The amount of deferred premium revenue may differ significantly from cash collections primarily due to fair value adjustments recorded in connection with a business combination.

When the Company adjusts prepayment assumptions or expected premium collections, an adjustment is recorded to the deferred premium revenue, with a corresponding adjustment to the premium receivable. Premiums receivable are 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.

The Company recognizes deferred premium revenue as earned premium over the contractual period or expected period of the contract in proportion to the amount of insurance protection provided. As premium revenue is recognized, a corresponding decrease to the deferred premium revenue is recorded. The amount of insurance protection provided is a function of the insured principal amount outstanding. Accordingly, the proportionate share of premium revenue recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amounts outstanding in the reporting period compared with the sum of each of the insured principal amounts outstanding for all periods. When an insured financial obligation is retired before its maturity, the financial guaranty insurance contract is extinguished. Any nonrefundable deferred premium revenue related to that contract is accelerated and recognized as premium revenue. When a premium receivable balance is deemed uncollectible, it is written off to bad debt expense.

For assumed reinsurance contracts, net earned premiums reported in the consolidated statements of operations are calculated based upon data received from ceding companies; however, some ceding companies report premium data between 30 and 90 days after the end of the reporting period. The Company estimates net earned premiums for the lag period. Differences between such estimates and actual amounts are recorded in the period in which the actual amounts are determined. When installment premiums are related to assumed reinsurance contracts, the Company assesses the credit quality and liquidity of the ceding companies and the impact of any potential regulatory constraints to determine the collectability of such amounts.

Ceded unearned premium reserve is recorded as an asset. Direct, assumed and ceded earned premiums are presented together as net earned premiums in the statement of operations. See Note 14, Reinsurance, for a breakout of direct, assumed and ceded premiums. The components of net earned premiums are shown in the table below:

Net Earned Premiums

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Scheduled net earned premiums	\$ 99	\$ 122	\$ 117
Accelerations from refundings and terminations	50	104	165
Accretion of discount on net premiums receivable	3	5	3
Net earned premiums (1)	<u>\$ 152</u>	<u>\$ 231</u>	<u>\$ 285</u>

- (1) Excludes \$1 million, \$1 million and \$1 million for the years ended December 31, 2018, 2017 and 2016, respectively, related to consolidated FG VIEs.

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

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Beginning of year	\$ 172	\$ 213	\$ 222
Premiums receivable from acquisitions (see Note 2)	—	271	18
Gross written premiums on new business, net of commissions on assumed business (1)	338	2	4
Gross premiums received, net of commissions (2)	(309)	(39)	(31)
Adjustments:			
Changes in the expected term	(3)	(7)	(2)
Accretion of discount, net of commissions on assumed business	4	4	5
Foreign exchange translation and remeasurement	(2)	16	(3)
Cancellation of assumed reinsurance	(1)	—	—
Premiums receivable of the European Subsidiaries sold (see Note 1)	—	(288)	—
December 31, (3)	<u>\$ 199</u>	<u>\$ 172</u>	<u>\$ 213</u>

- (1) 2018 includes \$331 million of assumed written premiums from SGI on June 1, 2018. See Note 2, Assumption of Insured Portfolio and Business Combinations.
- (2) The year ended December 31, 2018 includes \$277 million of cash received from SGI on June 1, 2018.
- (3) Excludes \$5 million, \$6 million and \$6 million as of December 31, 2018, 2017 and 2016, respectively, related to consolidated FG VIEs.

Approximately 22% and 9% of installment premiums at December 31, 2018 and December 31, 2017, respectively, are denominated in currencies other than the U.S. dollar, primarily the euro and pound sterling.

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

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

	As of December 31, 2018
	(in millions)
2019 (January 1 – March 31)	\$ 19
2019 (April 1 – June 30)	9
2019 (July 1 – September 30)	5
2019 (October 1 – December 31)	6
2020	24
2021	22
2022	17
2023	15
2024-2028	56
2029-2033	33
2034-2038	17
After 2038	9
Total (1)	<u>\$ 232</u>

(1) Excludes expected cash collections on consolidated FG VIEs of \$7 million.

The timing and cumulative amount of actual net earned premiums may differ from expected net earned premiums in the table below due to factors such as accelerations, commutations, changes in expected lives and new business.

Scheduled Financial Guaranty Insurance Net Earned Premiums

	As of December 31, 2018 (in millions)
2019 (January 1 – March 31)	\$ 24
2019 (April 1 – June 30)	24
2019 (July 1 – September 30)	22
2019 (October 1 – December 31)	22
Subtotal 2019	92
2020	82
2021	72
2022	63
2023	57
2024-2028	216
2029-2033	136
2034-2038	63
After 2038	29
Net deferred premium revenue (1)	810
Future accretion	24
Total future net earned premiums	\$ 834

(1) Excludes net earned premiums on consolidated FG VIEs of \$6 million.

Selected Information for Financial Guaranty Insurance Policies Paid in Installments

	As of December 31, 2018	As of December 31, 2017
	(dollars in millions)	
Premiums receivable, net of commission payable	\$ 199	\$ 172
Gross deferred premium revenue	375	214
Weighted-average risk-free rate used to discount premiums	2.6%	2.7%
Weighted-average period of premiums receivable (in years)	7.2	7.5

Financial Guaranty Insurance Acquisition Costs

Accounting Policy

Policy acquisition costs that are directly related and essential to successful insurance contract acquisition, as well as ceding commission income and expense on ceded and assumed reinsurance contracts, are deferred and reported net.

Capitalized policy acquisition costs include the cost of underwriting personnel attributable to successful underwriting efforts. Management uses its judgment in determining the type and amount of costs to be deferred. The Company conducts an annual study to determine deferral rates.

Ceding commission expense on assumed reinsurance contracts and ceding commission income on ceded reinsurance contracts that are associated with premiums received in installments are calculated at their contractually defined commission

rates, discounted consistent with premiums receivable for all future periods, and included in deferred acquisition costs (DAC), with a corresponding offset to net premiums receivable or reinsurance balances payable.

DAC is amortized in proportion to net earned premiums. Amortization of deferred policy acquisition costs includes the accretion of discount on ceding commission receivable and payable. When an insured obligation is retired early, the remaining related DAC is recognized at that time. Costs incurred for soliciting potential customers, market research, training, administration, unsuccessful acquisition efforts, and product development as well as all overhead type costs are charged to expense as incurred.

Expected losses and LAE, investment income, and the remaining costs of servicing the insured or reinsured business, are considered in determining the recoverability of DAC.

**Rollforward of
Deferred Ceding Commissions,
Net of DAC**

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Beginning of year	\$ 3	\$ (8)	\$ (14)
DAC adjustments from acquisitions and sales (see Notes 1 and 2)	—	9	—
Deferrals	(15)	1	3
Amortization	4	1	3
End of year (1)	<u>\$ (8)</u>	<u>\$ 3</u>	<u>\$ (8)</u>

- (1) The positive December 31 balance is included in other assets on the consolidated balance sheets. The negative December 31 balances are included in other liabilities on the consolidated balance sheets.

Financial Guaranty Insurance Losses

Accounting Policies

Loss and LAE Reserve

Loss and LAE reserve reported on the balance sheet relates only to direct and assumed reinsurance contracts that are accounted for as insurance, substantially all of which are financial guaranty insurance contracts. The corresponding reserve ceded to reinsurers is reported as reinsurance recoverable on unpaid losses and reported in other assets. As discussed in Note 7, Fair Value Measurement, contracts that meet the definition of a derivative, as well as consolidated FG VIEs' assets and liabilities, are recorded separately at fair value. Any expected losses related to consolidated FG VIEs are eliminated upon consolidation.

Under financial guaranty insurance accounting, the sum of unearned premium reserve and loss and LAE reserve represents the Company's stand-ready obligation. Unearned premium reserve is deferred premium revenue, less claim payments and recoveries received that have not yet been recognized in the statement of operations (contra-paid). At contract inception, the entire stand-ready obligation is represented by unearned premium reserve. A loss and LAE reserve for an insurance contract is recorded only to the extent, and for the amount, that expected loss to be paid plus contra-paid ("total losses") exceed the deferred premium revenue, on a contract by contract basis. As a result, the Company has expected loss to be paid that has not yet been expensed. Such amounts will be recognized in future periods as deferred premium revenue amortizes into income.

When a claim or LAE payment is made on a contract, it first reduces any recorded loss and LAE reserve. To the extent there is no loss and LAE reserve on a contract, then such claim payment is recorded as "contra-paid," which reduces the unearned premium reserve. The contra-paid is recognized in the line item "loss and LAE" in the consolidated statement of operations when and for the amount that total losses exceed the remaining deferred premium revenue on the insurance contract. Loss and LAE in the consolidated statement of operations is presented net of cessions to reinsurers.

Salvage and Subrogation Recoverable

When the Company becomes entitled to the cash flow from the underlying collateral of an insured exposure under salvage and subrogation rights as a result of a claim payment or estimated future claim payment, it reduces the expected loss to be paid on the contract. Such reduction in expected loss to be paid can result in one of the following:

- a reduction in the corresponding loss and LAE reserve with a benefit to the income statement,
- no entry recorded, if “total loss” is not in excess of deferred premium revenue, or
- the recording of a salvage asset with a benefit to the income statement if the transaction is in a net recovery position at the reporting date.

The ceded component of salvage and subrogation recoverable is recorded in the line item other liabilities.

Expected Loss to be Expensed

Expected loss to be expensed represents past or expected future net claim payments that have not yet been expensed. Such amounts will be expensed in future periods as deferred premium revenue amortizes into income on financial guaranty insurance policies. Expected loss to be expensed is the Company's projection of incurred losses that will be recognized in future periods, excluding accretion of discount.

Insurance Contracts' Loss Information

The following table provides information on net reserve (salvage), which includes loss and LAE reserves and salvage and subrogation recoverable, both net of reinsurance. To discount loss reserves, the Company used risk-free rates for U.S. dollar denominated financial guaranty insurance obligations that ranged from 0.00% to 3.06% with a weighted average of 2.76% as of December 31, 2018 and from 0.00% to 2.78% with a weighted average of 2.35% as of December 31, 2017.

Net Reserve (Salvage)

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Public finance:		
U.S. public finance	\$ 121	\$ 204
Non-U.S. public finance	—	1
Public finance	121	205
Structured finance:		
U.S. RMBS (1)	(17)	(135)
Other structured finance	(79)	(91)
Structured finance	(96)	(226)
Subtotal	25	(21)
Other payable (recoverable)	(3)	(4)
Total	<u>\$ 22</u>	<u>\$ (25)</u>

(1) Excludes net reserves of \$3 million and \$8 million as of December 31, 2018 and December 31, 2017, respectively, related to consolidated FG VIEs.

Components of Net Reserves (Salvage)

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Loss and LAE reserve	\$ 386	\$ 473
Reinsurance recoverable on unpaid losses (1)	(171)	(205)
Loss and LAE reserve, net	215	268
Salvage and subrogation recoverable	(214)	(310)
Salvage and subrogation payable (2)	24	21
Other payable (recoverable) (1)	(3)	(4)
Salvage and subrogation recoverable, net and other recoverable	(193)	(293)
Net reserves (salvage)	<u>\$ 22</u>	<u>\$ (25)</u>

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

(2) Represents ceded reinsurance amounts recorded as a component of other liabilities in consolidated balance sheets.

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

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

	As of December 31, 2018
	(in millions)
Net expected loss to be paid - financial guaranty insurance (1)	\$ 348
Contra-paid, net	48
Salvage and subrogation recoverable, net and other recoverable	193
Loss and LAE reserve - financial guaranty insurance contracts, net of reinsurance	(214)
Net expected loss to be expensed (present value) (2)	<u>\$ 375</u>

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

(2) Excludes \$4 million as of December 31, 2018, related to consolidated FG VIEs.

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

**Net Expected Loss to be Expensed
Financial Guaranty Insurance Contracts**

	As of December 31, 2018 (in millions)
2019 (January 1 – March 31)	\$ 5
2019 (April 1 – June 30)	7
2019 (July 1 – September 30)	6
2019 (October 1 – December 31)	6
Subtotal 2019	24
2020	25
2021	27
2022	28
2023	29
2024-2028	121
2029-2033	80
2034-2038	35
After 2038	6
Net expected loss to be expensed	375
Future accretion	45
Total expected future loss and LAE	\$ 420

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

**Loss and LAE
Reported on the
Consolidated Statements of Operations**

	Loss (Benefit)		
	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Public finance:			
U.S. public finance	\$ 39	\$ 152	\$ 52
Non-U.S. public finance	(1)	(1)	—
Public finance	38	151	52
Structured finance:			
U.S. RMBS (1)	(7)	(114)	16
Other structured finance	7	17	(22)
Structured finance	—	(97)	(6)
Loss and LAE	\$ 38	\$ 54	\$ 46

- (1) Excludes a benefit of \$5 million, \$1 million and \$1 million for the years ended December 31, 2018, 2017 and 2016, respectively, related to consolidated FG VIEs.

The following tables provide information on financial guaranty insurance contracts categorized as BIG.

**Financial Guaranty Insurance
BIG Transaction Loss Summary
As of December 31, 2018**

	BIG Categories								Total
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks (1)	78	(18)	33	(9)	115	(29)	226	—	226
Remaining weighted- average contract period (in years)	7.2	6.7	16.7	19.9	10.4	11.5	11.0	—	11.0
Outstanding exposure:									
Principal	\$ 501	\$ (141)	\$ 619	\$ (99)	\$ 2,046	\$ (347)	\$ 2,579	—	\$ 2,579
Interest	203	(58)	474	(99)	1,001	(185)	1,336	—	1,336
Total (2)	<u>\$ 704</u>	<u>\$ (199)</u>	<u>\$ 1,093</u>	<u>\$ (198)</u>	<u>\$ 3,047</u>	<u>\$ (532)</u>	<u>\$ 3,915</u>	<u>\$ —</u>	<u>\$ 3,915</u>
Expected cash outflows (inflows)	\$ 15	\$ (2)	\$ 199	\$ (21)	\$ 1,674	\$ (317)	\$ 1,548	\$ (42)	\$ 1,506
Potential recoveries (3)	(220)	26	(52)	7	(993)	87	(1,145)	32	(1,113)
Subtotal	(205)	24	147	(14)	681	(230)	403	(10)	393
Discount	46	(6)	(44)	4	(109)	61	(48)	3	(45)
Present value of expected cash flows	<u>\$ (159)</u>	<u>\$ 18</u>	<u>\$ 103</u>	<u>\$ (10)</u>	<u>\$ 572</u>	<u>\$ (169)</u>	<u>\$ 355</u>	<u>\$ (7)</u>	<u>\$ 348</u>
Deferred premium revenue	\$ 28	\$ (1)	\$ 96	\$ (4)	\$ 377	\$ (12)	\$ 484	\$ (4)	\$ 480
Reserves (salvage)	\$ (171)	\$ 20	\$ 30	\$ (6)	\$ 312	\$ (161)	\$ 24	\$ (3)	\$ 21

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

	BIG Categories								Total
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating FG VIEs	
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks (1)	96	(25)	35	(8)	112	(30)	243	—	243
Remaining weighted-average contract period (in years)	6.7	5.1	17.0	20.2	10.5	11.4	10.6	—	10.6
Outstanding exposure:									
Principal	\$ 709	\$ (144)	\$ 553	\$ (102)	\$ 2,016	\$ (379)	\$ 2,653	\$ —	\$ 2,653
Interest	232	(36)	475	(104)	1,053	(200)	1,420	—	1,420
Total (2)	<u>\$ 941</u>	<u>\$ (180)</u>	<u>\$ 1,028</u>	<u>\$ (206)</u>	<u>\$ 3,069</u>	<u>\$ (579)</u>	<u>\$ 4,073</u>	<u>\$ —</u>	<u>\$ 4,073</u>
Expected cash outflows (inflows)	\$ 52	\$ (8)	\$ 150	\$ (26)	\$ 1,390	\$ (390)	\$ 1,168	\$ (49)	\$ 1,119
Potential recoveries (3)	(352)	29	(80)	12	(678)	95	(974)	33	(941)
Subtotal	(300)	21	70	(14)	712	(295)	194	(16)	178
Discount	38	(5)	(13)	3	(71)	88	40	4	44
Present value of expected cash flows	<u>\$ (262)</u>	<u>\$ 16</u>	<u>\$ 57</u>	<u>\$ (11)</u>	<u>\$ 641</u>	<u>\$ (207)</u>	<u>\$ 234</u>	<u>\$ (12)</u>	<u>\$ 222</u>
Deferred premium revenue	\$ 49	\$ (1)	\$ 44	\$ (6)	\$ 333	\$ (13)	\$ 406	\$ (4)	\$ 402
Reserves (salvage)	\$ (276)	\$ 17	\$ 33	\$ (7)	\$ 409	\$ (194)	\$ (18)	\$ (8)	\$ (26)

- (1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making debt service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.
- (2) Includes BIG amounts related to FG VIEs.
- (3) Represents expected inflows for future payments by obligors pursuant to restructuring agreements, settlement or litigation judgments, excess spread on any underlying collateral and other estimated recoveries.

Ratings Impact on Financial Guaranty Business

A downgrade of AGC may result in increased claims under financial guaranties issued by AGC if counterparties exercise contractual rights triggered by the downgrade against insured obligors, and the insured obligors are unable to pay.

For example, with respect to variable rate demand obligations (VRDOs) for which a bank has agreed to provide a liquidity facility, a downgrade of AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGC under its financial guaranty policy. As of December 31, 2018, AGC had insured approximately \$0.6 billion net par of VRDOs, of which approximately \$6 million of net par constituted VRDOs issued by municipal obligors rated BBB– or lower pursuant to the Company’s internal rating. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

7. Fair Value Measurement

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

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 2018, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's 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.

During the periods presented, there were no transfers into or from Level 3 except for one transfer from Level 2 into Level 3 during 2017 because starting in the second quarter of 2017 the price of the security includes a significant unobservable assumption.

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-Term Investments

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

pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news.

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

As of December 31, 2018, the Company used models to price 51 securities, primarily securities that were purchased or obtained for loss mitigation or other risk management purposes, with a fair value of \$726 million. Most Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price appreciation/depreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the security including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could have materially changed the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

Other invested assets include equity securities that were carried at \$2 million as of December 31, 2018 and December 31, 2017. These equity investments were classified as Level 3.

Other Assets

Committed Capital Securities

The fair value of committed capital securities (CCS), which is recorded in other assets on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under the AGC CCS agreement, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 16, Note Payable to Affiliate and Credit Facilities). The AGC CCS are carried at fair value with changes in fair value recorded in other income in the consolidated statement of operations. The estimated current cost of the Company's CCS is based on several factors, including AGC CDS spreads, London Interbank Offered Rate (LIBOR) curve projections, Assured Guaranty's publicly traded debt and the term the securities are estimated to remain outstanding.

Contracts Accounted for as Credit Derivatives

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

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

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

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay at the reporting date for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at December 31, 2018 were such that market prices of the Company's CDS contracts were not available.

Assumptions and Inputs

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

With respect to CDS transactions for which there is an expected claim payment within the next twelve months, the allocation of gross spread reflects a higher allocation to the cost of credit rather than the bank profit component. In the current market, it is assumed that a bank would be willing to accept a lower profit on distressed transactions in order to remove these transactions from its financial statements.

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

- Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available).
- Transactions priced or closed during a specific quarter within a specific asset class and specific rating. No transactions closed during the periods presented.
- Credit spreads interpolated based upon market indices adjusted to reflect the non-standard terms of the Company's CDS contracts.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Information by Credit Spread Type (1)

	As of December 31, 2018	As of December 31, 2017
Based on actual collateral specific spreads	30%	20%
Based on market indices	30%	52%
Provided by the CDS counterparty	40%	28%
Total	100%	100%

(1) Based on par.

The rates used to discount future expected premium cash flows ranged from 2.47% to 2.89% at December 31, 2018 and 1.72% to 2.55% at December 31, 2017.

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

In the Company’s valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company’s own credit spreads, approximately 13% and 12%, based on fair value, of the Company’s CDS contracts were fair valued using this minimum premium as of December 31, 2018 and December 31, 2017, respectively. The percentage of transactions that price using the minimum premiums fluctuates due to changes in AGC’s credit spreads. In general when AGC’s credit spreads narrow, the cost to hedge AGC’s name declines and more transactions price above previously established floor levels. Meanwhile, when AGC’s credit spreads widen, the cost to hedge AGC’s name increases causing more transactions to price at previously established floor levels. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGC hedged by its counterparties, with independent third parties each reporting period. The current level of AGC’s own credit spread has resulted in the bank or transaction originator hedging a portion of its exposure to AGC. This reduces the amount of contractual cash flows AGC can capture as premium for selling its protection.

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

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

Strengths and Weaknesses of Model

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

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

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

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

- There is no exit market or any actual exit transactions, therefore, the Company's exit market is a hypothetical one based on the Company's entry market.
- There is a very limited market in which to validate the reasonableness of the fair values developed by the Company's model.
- The markets for the inputs to the model are highly illiquid, which impacts their reliability.
- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs' assets and liabilities and classifies them as Level 3 in the fair value hierarchy. The prices are generally determined with the assistance of an independent third-party, based on a discounted cash flow approach. The FG VIEs issued securities collateralized by first lien and second lien RMBS as well as loans and receivables.

The fair value of the Company's FG VIEs' assets is generally sensitive to changes in estimated prepayment speeds; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); yields implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. Significant changes to some of these inputs could have materially changed the market value of the FG VIEs' assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIEs' assets is most sensitive to changes in the projected collateral losses, where an increase in collateral losses typically could lead to a decrease in the fair value of FG VIEs' assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIEs' assets. The third-party utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithms designed to aggregate market color, received by the independent third-party, on comparable bonds.

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

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

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

**Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2018**

		Fair Value Hierarchy		
	Fair Value	Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale (1):				
Fixed-maturity securities				
Obligations of state and political subdivisions	\$ 1,710	\$ —	\$ 1,649	\$ 61
U.S. government and agencies	52	—	52	—
Corporate securities	288	—	288	—
Mortgage-backed securities:				
RMBS	105	—	88	17
Commercial mortgage-backed securities (CMBS)	42	—	42	—
Asset-backed securities	710	—	62	648
Total fixed-maturity securities	2,907	—	2,181	726
Short-term investments	126	106	20	—
Other invested assets	2	—	—	2
FG VIEs' assets, at fair value (2)	101	—	—	101
Other assets (2) (3)	64	—	—	64
Total assets carried at fair value	\$ 3,200	\$ 106	\$ 2,201	\$ 893
Liabilities:				
Credit derivative liabilities (2)	\$ 182	\$ —	\$ —	\$ 182
FG VIEs' liabilities with recourse, at fair value (4)	108	—	—	108
FG VIEs' liabilities without recourse, at fair value (2)	1	—	—	1
Total liabilities carried at fair value	\$ 291	\$ —	\$ —	\$ 291

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

	Fair Value	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale (1):				
Fixed-maturity securities				
Obligations of state and political subdivisions	\$ 1,826	\$ —	\$ 1,771	\$ 55
U.S. government and agencies	58	—	58	—
Corporate securities	227	—	227	—
Mortgage-backed securities:				
RMBS	72	—	44	28
CMBS	63	—	63	—
Asset-backed securities	691	—	77	614
Total fixed-maturity securities	2,937	—	2,240	697
Short-term investments	57	56	—	1
Other invested assets	2	—	—	2
FG VIEs' assets, at fair value (2)	122	—	—	122
Other assets (2) (3)	68	—	—	68
Total assets carried at fair value	\$ 3,186	\$ 56	\$ 2,240	\$ 890
Liabilities:				
Credit derivative liabilities (2)	\$ 223	\$ —	\$ —	\$ 223
FG VIEs' liabilities with recourse, at fair value (2)	131	—	—	131
FG VIEs' liabilities without recourse, at fair value (2)	2	—	—	2
Total liabilities carried at fair value	\$ 356	\$ —	\$ —	\$ 356

- (1) Change in fair value is included in OCI.
- (2) Change in fair value is included in the consolidated statements of operations.
- (3) Includes credit derivative assets.
- (4) Change in fair value attributable to ISCR is recorded in OCI with the remainder of the change in fair value recorded in the consolidated statements of operations.

Changes in Level 3 Fair Value Measurements

The tables below present a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during the years ended December 31, 2018 and 2017.

Fair Value Level 3 Rollforward Recurring Basis Year Ended December 31, 2018

	Fixed-Maturity Securities			FG VIEs' Assets at Fair Value	Other (7)	Credit Derivative Asset (Liability), net (5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities					
	(in millions)							
Fair value as of December 31, 2017	\$ 55	\$ 28	\$ 614	\$ 122	\$ 34	\$ (186)	\$ (131)	\$ (2)
Total pretax realized and unrealized gains/(losses) recorded in:								
(1)								
Net income (loss)	2 (2)	— (2)	51 (2)	3 (3)	7 (4)	95 (6)	(2) (3)	1 (3)
Other comprehensive income (loss)	1	—	(33)	—	—	—	1	—
Purchases	4	—	35	—	—	3 (8)	—	—
Issuances	—	—	—	—	—	(68) (8)	—	—
Settlements	(1)	(11)	(19)	(24)	(1)	—	24	—
Fair value as of December 31, 2018	<u>\$ 61</u>	<u>\$ 17</u>	<u>\$ 648</u>	<u>\$ 101</u>	<u>\$ 40</u>	<u>\$ (156)</u>	<u>\$ (108)</u>	<u>\$ (1)</u>
Change in unrealized gains/(losses) included in earnings related to financial instruments held as of December 31, 2018				<u>\$ 5 (3)</u>	<u>\$ 7 (4)</u>	<u>\$ 90 (6)</u>	<u>\$ (2) (3)</u>	<u>\$ 1 (3)</u>
Change in unrealized gains/(losses) included in OCI related to financial instruments held as of December 31, 2018	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ (31)</u>		<u>\$ —</u>		<u>\$ 1</u>	

**Fair Value Level 3 Rollforward
Recurring Basis
Year Ended December 31, 2017**

	Fixed-Maturity Securities							
	Obligations of State and Political Subdivisions	RMBS	Asset- Backed Securities	FG VIEs' Assets at Fair Value	Other (7)	Credit Derivative Asset (Liability), net (5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)							
Fair value as of December 31, 2016	\$ 2	\$ 33	\$ 563	\$ 232	\$ 34	\$ (248)	\$ (205)	\$ (41)
MBIA UK Acquisition	—	—	7	—	—	—	—	—
Total pretax realized and unrealized gains/ (losses) recorded in: (1)								
Net income (loss)	— (2)	(2) (2)	102 (2)	5 (3)	(1) (4)	71 (6)	(4) (3)	— (3)
Other comprehensive income(loss)	(1)	4	8	—	—	—	—	—
Purchases	—	—	317	—	1	—	—	—
Settlements	—	(7)	(383)	(28)	—	(9)	27	3
FG VIE consolidations	—	—	—	(87)	—	—	51	36
Transfers into Level 3	54	—	—	—	—	—	—	—
Fair value as of December 31, 2017	<u>\$ 55</u>	<u>\$ 28</u>	<u>\$ 614</u>	<u>\$ 122</u>	<u>\$ 34</u>	<u>\$ (186)</u>	<u>\$ (131)</u>	<u>\$ (2)</u>
Change in unrealized gains/(losses) related to financial instruments held as of December 31, 2017	<u>\$ (1)</u>	<u>\$ 4</u>	<u>\$ 111</u>	<u>\$ 7 (3)</u>	<u>\$ (1) (4)</u>	<u>\$ 48 (6)</u>	<u>\$ (4) (3)</u>	<u>\$ — (3)</u>

- (1) Realized and unrealized gains (losses) from changes in values of Level 3 financial instruments represent gains (losses) from changes in values of those financial instruments only for the periods in which the instruments were classified as Level 3.
- (2) Included in net realized investment gains (losses) and net investment income.
- (3) Included in fair value gains (losses) on FG VIEs.
- (4) Recorded in net investment income and other income.
- (5) Represents the net position of credit derivatives. Credit derivative assets (recorded in other assets) and credit derivative liabilities (presented as a separate line item) are shown gross in the consolidated balance sheet based on net exposure by counterparty.
- (6) Reported in net change in fair value of credit derivatives.
- (7) Includes short-term investments, CCS and other invested assets.
- (8) Relates to SGI Transaction. See Note 2, Assumption of Insured Portfolio and Business Combinations.

Level 3 Fair Value Disclosures

**Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2018**

				Weighted Average as a Percentage of Current Par Outstanding
Financial Instrument Description (1)	Fair Value at December 31, 2018 (in millions)	Significant Unobservable Inputs	Range	
Assets (2):				
Fixed-maturity securities:				
Obligations of state and political subdivisions	\$ 61	Yield	6.2% - 32.7%	8.9%
RMBS	17	CPR	3.8% - 19.4%	11.2%
		CDR	1.5% - 6.9%	4.7%
		Loss severity	40.0% - 125.0%	84.2%
		Yield	5.8% - 8.1%	7.5%
Asset-backed securities:				
Triple-X life insurance transactions	561	Yield	6.5% - 7.1%	6.8%
Collateralized loan obligations (CLOs)/TruPS	34	Yield	3.8% - 4.7%	4.1%
Others	53	Yield	11.5%	
FG VIEs’ assets, at fair value	101	CPR	2.5% - 16.8%	11.7%
		CDR	2.2% - 7.7%	5.1%
		Loss severity	75.0% - 100.0%	92.4%
		Yield	6.0% - 8.4%	7.1%
Other assets	38	Implied Yield	7.2%	
		Term (years)	10 years	
Liabilities:				
Credit derivative liabilities, net	(156)	Year 1 loss estimates	0.0% - 66.0%	2.8%
		Hedge cost (in bps)	5.5 - 82.5	24.5
		Bank profit (in bps)	7.2 - 509.9	86.5
		Internal floor (in bps)	8.8 - 30.0	17.8
		Internal credit rating	AAA - CCC	AA-
FG VIEs’ liabilities, at fair value	(109)	CPR	2.5% - 16.8%	11.7%
		CDR	2.2% - 7.7%	5.1%
		Loss severity	75.0% - 100.0%	92.4%
		Yield	5.2% - 7.6%	5.3%

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

(2) Excludes an investment recorded in other invested assets with fair value of \$2 million.

Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2017

Financial Instrument Description (1)	Fair Value at December 31, 2017 (in millions)	Significant Unobservable Inputs	Range	Weighted Average as a Percentage of Current Par Outstanding
Assets (2):				
Fixed-maturity securities:				
Obligations of state and political subdivisions	\$ 55	Yield	6.6% - 40.8%	8.9%
RMBS	28	CPR	3.0% - 17.4%	10.0%
		CDR	1.5% - 7.0%	5.3%
		Loss severity	40.0% - 125.0%	79.7%
		Yield	4.0% - 7.4%	6.5%
Asset-backed securities:				
Triple-X life insurance transactions	555	Yield	6.2% - 6.4%	6.3%
CLO/TruPS	1	Yield	4.5% - 4.6%	4.5%
Others	58	Yield	10.7%	
FG VIEs' assets, at fair value	122	CPR	4.7% - 11.4%	10.0%
		CDR	2.0% - 8.1%	4.8%
		Loss severity	75.0% - 100.0%	92.3%
		Yield	4.9% - 7.3%	6.1%
Other assets	31	Implied Yield	5.8%	
		Term (years)	10 years	
Liabilities:				
Credit derivative liabilities, net	(186)	Year 1 loss estimates	0.0% - 42.0%	4.4%
		Hedge cost (in bps)	17.6 - 122.6	52.4
		Bank profit (in bps)	6.0 - 852.5	120.6
		Internal floor (in bps)	8.0 - 30.0	23.0
		Internal credit rating	AAA - CCC	AA-
FG VIEs' liabilities, at fair value	(133)	CPR	4.7% - 11.4%	10.0%
		CDR	2.0% - 8.1%	4.8%
		Loss severity	75.0% - 100.0%	92.3%
		Yield	4.2% - 6.9%	4.9%

- (1) Discounted cash flow is used as the primary valuation technique for all financial instruments listed in this table.
- (2) Excludes short-term investments with fair value of \$1 million and an investment recorded in other invested assets with fair value of \$2 million.

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

For financial guaranty insurance contracts that are acquired in a business combination, the Company measures each contract at fair value on the date of acquisition, and then follows insurance accounting guidance on a recurring basis thereafter. In addition, the Company discloses the fair value of its outstanding financial guaranty insurance contracts. In both cases, fair value is based on management's estimate of what a similarly rated financial guaranty insurance company would demand to acquire the Company's in-force book of financial guaranty insurance business. It is based on a variety of factors that may include pricing assumptions management has observed for portfolio transfers, commutations, and acquisitions that have occurred in the financial guaranty market, as well as prices observed in the credit derivative market with an adjustment for illiquidity so that the terms would be similar to a financial guaranty insurance contract, and also includes adjustments to the carrying value of unearned premium reserve for stressed losses, ceding commissions and return on capital. The Company classified this fair value measurement as Level 3.

Note Payable to Affiliate

The fair value of the Company's note payable to AGM is determined by calculating the present value of the expected cash flows. The Company determines discounted future cash flows using the effect of changes in the U.S. Treasury yield at the end of each reporting period as well as the change in its own credit spread. The significant inputs were not readily observable. The Company accordingly classified this fair value measurement as Level 3.

The carrying amount and estimated fair value of the Company's financial instruments not carried at fair value are presented in the following table.

Fair Value of Financial Instruments Not Carried at Fair Value

	As of December 31, 2018		As of December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(in millions)				
Assets:				
Other invested assets	\$ —	\$ —	\$ 1	\$ 1
Other assets (2)	24	24	23	23
Liabilities:				
Financial guaranty insurance contracts (1)	649	1,340	842	1,576
Note payable to affiliate	300	289	300	304
Other liabilities (2)	2	2	30	30

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

(2) The Company's other assets and other liabilities consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, for which the carrying value approximates fair value.

8. Contracts Accounted for as Credit Derivatives

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

Credit derivative transactions are governed by ISDA documentation and have certain characteristics that differ from financial guaranty insurance contracts. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, there are more circumstances under which the Company may be obligated to make payments. Similar to a financial guaranty insurance contract, the Company would be obligated to pay if the obligor failed to make a scheduled payment of principal or interest in full. However, the Company may also be required to pay if the obligor becomes bankrupt or if the reference

obligation were restructured if, after negotiation, those credit events are specified in the documentation for the credit derivative transactions. Furthermore, the Company may be required to make a payment due to an event that is unrelated to the performance of the obligation referenced in the credit derivative. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. In that case, the Company may be required to make a termination payment to its swap counterparty upon such termination. Absent such an event of default or termination event, the Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Accounting Policy

Credit derivatives are recorded at fair value. Changes in fair value are recorded in “net change in fair value of credit derivatives” on the consolidated statement of operations. Realized gains (losses) and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, premiums paid and payable for credit protection the Company has purchased, claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commission expense or income and any realized gains or losses on termination. The fair value of credit derivatives is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 7, Fair Value Measurement, for a discussion on the fair value methodology for credit derivatives.

Credit Derivative Net Par Outstanding by Sector

The components of the Company's credit derivative net par outstanding are presented in the table below. The increase in credit derivative net par outstanding from year-end 2017 was a result of the June 1, 2018 SGI Transaction discussed in Note 2, Assumption of Insured Portfolio and Business Combinations. As part of that transaction, the Company reinsured SGI's insurance of credit derivatives within its portfolio, primarily infrastructure finance and regulated utility transactions, with a gross par of \$1.7 billion and a credit derivative liability of \$68 million (prior to subsequent partial cession to AG Re). The credit derivatives assumed from SGI have no expected losses. The estimated remaining weighted average life of credit derivatives was 11.8 years at December 31, 2018 and December 31, 2017.

Credit Derivatives (1)

Asset Type	As of December 31, 2018		As of December 31, 2017	
	Net Par Outstanding	Net Fair Value	Net Par Outstanding	Net Fair Value
	(in millions)			
Infrastructure finance	\$ 1,267	\$ (63)	\$ 529	\$ (36)
Regulated utilities	741	(5)	294	—
Pooled infrastructure	687	(17)	780	(21)
Pooled corporate obligations (TruPS collateralized debt obligations (CDOs))	595	(27)	803	(69)
U.S. RMBS	520	(27)	742	(45)
Other (2)	376	(17)	508	(15)
Total	<u>\$ 4,186</u>	<u>\$ (156)</u>	<u>\$ 3,656</u>	<u>\$ (186)</u>

(1) Expected recoveries were \$2 million as of December 31, 2018 and \$11 million as of December 31, 2017.

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

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of December 31, 2018		As of December 31, 2017	
	Net Par Outstanding	% of Total	Net Par Outstanding	% of Total
	(dollars in millions)			
AAA	\$ 1,041	24.9%	\$ 1,240	33.9%
AA	1,628	38.9%	891	24.4
A	608	14.5%	768	21.0
BBB	776	18.5%	485	13.3
BIG (1)	133	3.2%	272	7.4
Credit derivative net par outstanding	\$ 4,186	100.0%	\$ 3,656	100.0%

(1) BIG relates to U.S. RMBS exposures as of December 31, 2018 and both U.S. RMBS and TruPS CDOs as of December 31, 2017.

Fair Value of Credit Derivatives

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

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Realized gains on credit derivatives	\$ 5	\$ 7	\$ 32
Net credit derivative losses (paid and payable) recovered and recoverable and other settlements	(4)	(1)	3
Realized gains (losses) and other settlements	1	6	35
Net unrealized gains (losses)	94	65	7
Net change in fair value of credit derivatives	\$ 95	\$ 71	\$ 42

During 2018, unrealized fair value gains were primarily generated by CDS terminations, run-off of CDS par and price improvements on the underlying collateral of the Company's CDS. In addition, unrealized fair value gains were generated by the increase in credit given to the primary insurer on one of the Company's second-to-pay CDS policies during the period. The unrealized fair value gains were partially offset by unrealized fair value losses resulting from wider implied net spreads driven by the decreased cost to buy protection in AGC's name, as the market cost of AGC's credit protection decreased during the period. For those CDS transactions that were pricing at or above their floor levels, when the cost of purchasing CDS protection on AGC decreased, the implied spreads that the Company would expect to receive on these transactions increased.

During 2017 and 2016, unrealized fair value gains were primarily generated by CDS terminations, run-off of net par outstanding, and price improvements on the underlying collateral of the Company's CDS. The majority of the CDS transactions that were terminated were as a result of settlement agreements with several CDS counterparties. In 2016, the unrealized fair value gains were partially offset by unrealized losses resulting from wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name, as the market cost of AGC's credit protection decreased significantly during the period. During 2017, the cost to buy protection in AGC's name, specifically the five-year CDS spread, did not change materially during the period, and therefore did not have a material impact on the Company's unrealized fair value gains and losses on CDS.

The following table summarizes the effects of terminations and settlements of credit derivative contracts.

**Terminations and Settlements
of Direct Credit Derivative Contracts**

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Net par of terminated credit derivative contracts	\$ 117	\$ 228	\$ 2,934
Realized gains (losses) and other settlements	—	(2)	14
Net unrealized gains (losses) on credit derivatives	3	17	81

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

**CDS Spread on AGC
Quoted price of CDS contract (in basis points)**

	As of December 31,		
	2018	2017	2016
Five-year CDS spread	110	163	158
One-year CDS spread	22	70	35

**Fair Value of Credit Derivatives Assets (Liabilities)
and Effect of AGC
Credit Spreads**

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Fair value of credit derivatives before effect of AGC credit spread	\$ (319)	\$ (415)
Plus: Effect of AGC credit spread	163	229
Net fair value of credit derivatives	<u>\$ (156)</u>	<u>\$ (186)</u>

The fair value of CDS contracts at December 31, 2018, before considering the implications of AGC's credit spread, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. Offsetting the benefit attributable to AGC's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the TruPS CDO, and pooled infrastructure markets as well as continuing market concerns over the 2005-2007 vintages of RMBS.

Collateral Posting for Certain Credit Derivative Contracts

The transaction documentation with one counterparty for \$250 million of CDS par insured by AGC requires AGC to post collateral, subject to a \$250 million cap, to secure its obligation to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount. The table below summarizes AGC's CDS collateral posting requirements as of December 31, 2018 and December 31, 2017.

AGC Insured CDS Collateral Posting Requirements

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Gross par of CDS with collateral posting requirement	\$ 250	\$ 497
Maximum posting requirement	250	464
Collateral posted	1	18

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

9. Variable Interest Entities

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

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

Accounting Policy

The Company evaluates whether it is the primary beneficiary of its VIEs. If the Company concludes that it is the primary beneficiary, it is required to consolidate the entire VIE in the Company's financial statements and eliminate the effects of the financial guaranty insurance contracts issued by AGC on the consolidated FG VIEs' debt obligations.

The primary beneficiary of a VIE is the enterprise that has both 1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and 2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

As part of the terms of its financial guaranty contracts, the Company, under its insurance contract, obtains certain protective rights with respect to the VIE that give the Company additional controls over a VIE. These protective rights are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company is deemed to be the control party for

certain VIEs under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the protective rights that could make the Company the control party have not been triggered, then the VIE is not consolidated. If the Company is deemed no longer to have those protective rights, the VIE is deconsolidated.

The FG VIEs' liabilities that are insured by the Company are considered to be with recourse, because the Company guarantees the payment of principal and interest regardless of the performance of the related FG VIEs' assets. FG VIEs' liabilities that are not insured by the Company are considered to be without recourse, because the payment of principal and interest of these liabilities is wholly dependent on the performance of the FG VIEs' assets.

The Company has limited contractual rights to obtain the financial records of its consolidated FG VIEs. The FG VIEs do not prepare separate GAAP financial statements; therefore, the Company compiles GAAP financial information for them based on trustee reports prepared by and received from third parties. Such trustee reports are not available to the Company until approximately 30 days after the end of any given period. The time required to perform adequate reconciliations and analyses of the information in these trustee reports results in a one quarter lag in reporting the FG VIEs' activities. The Company records the fair value of FG VIEs' assets and liabilities based on modeled prices. The Company updates the model assumptions each reporting period for the most recent available information, which incorporates the impact of material events that may have occurred since the quarter lag date. The net change in the fair value of consolidated FG VIEs' assets and liabilities is recorded in "fair value gains (losses) on FG VIEs" in the consolidated statements of operations, except for change in fair value of FG VIEs' liabilities with recourse caused by changes in ISCR which is now separately presented in OCI, effective January 1, 2018 as described below. Interest income and interest expense are derived from the trustee reports and also included in "fair value gains (losses) on FG VIEs." The Company has elected the fair value option for assets and liabilities classified as FG VIEs' assets and liabilities because the carrying amount transition method was not practical.

The cash flows generated by the FG VIEs' assets are classified as cash flows from investing activities. Paydowns of FG VIEs' liabilities are supported by the cash flows generated by FG VIEs' assets, and for liabilities with recourse, possibly claim payments made by AGC under its financial guaranty insurance contracts. Paydowns of FG VIEs' liabilities both with and without recourse are classified as cash flows used in financing activities. Interest income, interest expense and other expenses of the FG VIEs' assets and liabilities are classified as operating cash flows. Claim payments made by AGC under the financial guaranty contracts issued to the FG VIEs are eliminated upon consolidation and therefore such claim payments are treated as paydowns of FG VIEs' liabilities as a financing activity as opposed to an operating activity of AGC.

Adoption of ASU 2016-01

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

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

On adoption of ASU 2016-01, the Company reclassified a loss of approximately \$5 million, net of tax, from retained earnings to AOCI. This amount represents the portion of the fair value of the FG VIEs' liabilities with recourse that related to the change in the Company's own credit risk from the date of consolidation through January 1, 2018. The accounting and disclosure of the FG VIEs' liabilities without recourse are unchanged.

Consolidated FG VIEs

Number of FG VIEs Consolidated

	Year Ended December 31,		
	2018	2017	2016
Beginning of year	8	9	10
Consolidated	—	—	1
Deconsolidated	—	(1)	(1)
Matured	—	—	(1)
December 31	8	8	9

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately \$12 million at December 31, 2018 and \$15 million at December 31, 2017. The aggregate unpaid principal of the FG VIEs' assets was approximately \$43 million greater than the aggregate fair value at December 31, 2018. The aggregate unpaid principal of the FG VIEs' assets was approximately \$48 million greater than the aggregate fair value at December 31, 2017.

The change in the ISCR of the FG VIEs' assets held as of December 31, 2018 that was recorded in the consolidated statements of operations for 2018 was a gain of \$3 million. The change in the ISCR of the FG VIEs' assets was a gain of \$6 million for 2017 and a gain of \$10 million for 2016. To calculate ISCR, the change in the fair value of the FG VIEs' assets is allocated between changes that are due to ISCR and changes due to other factors, including interest rates. The ISCR amount is determined by using expected cash flows at the date of consolidation less current expected cash flows discounted at original contractual rate. The net present value is calculated by discounting the expected cash flows of the underlying security, at the relevant effective interest rate.

The unpaid principal for FG VIEs' liabilities with recourse, which represent obligations insured by AGC, was \$115 million and \$139 million as of December 31, 2018 and December 31, 2017, respectively. FG VIEs' liabilities with recourse will mature at various dates ranging from 2023 to 2038. The aggregate unpaid principal balance of the FG VIEs' liabilities with recourse was approximately \$8 million greater than the aggregate fair value of the FG VIEs' liabilities with recourse as of both December 31, 2018 and December 31, 2017. The aggregate unpaid principal balance of the FG VIEs' liabilities without recourse was approximately \$1 million greater than the aggregate fair value of the FG VIEs' liabilities without recourse as of both December 31, 2018 and December 31, 2017. See Consolidated Statements of Comprehensive Income and Note 18, Other Comprehensive Income, for information on changes in fair value of the FG VIEs' liabilities with recourse that is attributable to changes in the Company's own credit risk.

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

Consolidated FG VIEs By Type of Collateral

	As of December 31, 2018		As of December 31, 2017	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
With recourse:				
U.S. RMBS first lien	\$ 20	\$ 18	\$ 24	\$ 22
U.S. RMBS second lien	28	36	32	44
Manufactured housing	52	54	64	65
Total with recourse	100	108	120	131
Without recourse	1	1	2	2
Total	\$ 101	\$ 109	\$ 122	\$ 133

The effects consolidating of FG VIEs includes (i) changes in fair value gains (losses) on FG VIEs' assets and liabilities, (ii) the elimination of premiums and losses related to the AGC FG VIEs' liabilities with recourse and (iii) the elimination of investment balances related to the Company's purchase of AGC insured FG VIEs' debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

Effect of Consolidating FG VIEs

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Net earned premiums	\$ (1)	\$ (1)	\$ (1)
Net investment income	(1)	(1)	(4)
Fair value gains (losses) on FG VIEs	4	6	14
Loss and LAE	(5)	(1)	(1)
Effect on income before tax	(3)	3	8
Less: tax provision (benefit)	(1)	2	3
Effect on net income (loss)	\$ (2)	\$ 1	\$ 5
Effect on OCI	\$ 1	\$ —	\$ 1
Effect on cash flows from operating activities	\$ 2	\$ 3	\$ (5)

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Effect on shareholder's equity (decrease) increase	\$ (8)	\$ (7)

For all periods presented, the primary driver of the gain in fair value of FG VIEs' assets and FG VIEs' liabilities was an increase in the value of the FG VIEs' assets resulting from improvement in the underlying collateral.

Other Consolidated VIEs

In certain instances where the Company consolidates a VIE that was established as part of a loss mitigation negotiated settlement that results in the termination of the original insured financial guaranty insurance or credit derivative contract the Company classifies the assets and liabilities of those VIEs in the line items that most accurately reflect the nature of the items, as opposed to within the FG VIEs' assets and FG VIEs' liabilities. The largest of these VIEs had assets of \$87 million and liabilities of \$21 million as of December 31, 2018 and assets of \$86 million and liabilities of \$41 million as of December 31, 2017.

Non-Consolidated VIEs

As described in Note 4, Outstanding Exposure, the Company monitors all policies in the insured portfolio. Of the approximately 4 thousand policies monitored as of December 31, 2018, approximately 2 thousand policies are not within the scope of FASB Accounting Standards Codification (ASC) 810 because these financial guaranties relate to the debt obligations of governmental organizations or financing entities established by a governmental organization. The majority of the remaining policies involve transactions where the Company is not deemed to currently have control over the FG VIEs' most significant activities. As of December 31, 2018 and 2017, the Company identified 99 and 93 policies, respectively, that contain provisions and experienced events that may trigger consolidation. Based on management's assessment of these potential triggers or events, the Company consolidated 8 FG VIEs as of both December 31, 2018 and December 31, 2017. The Company's exposure provided through its financial guaranties with respect to debt obligations of FG VIEs is included within net par outstanding in Note 4, Outstanding Exposure.

10. Investments and Cash

Accounting Policy

The vast majority of the Company's investment portfolio consists of fixed-maturity and short-term investments, classified as available-for-sale at the time of purchase (approximately 93% based on fair value as of December 31, 2018), and therefore carried at fair value. Changes in fair value for other-than-temporarily-impaired securities are bifurcated between credit losses and non-credit changes in fair value. The credit loss on other-than-temporarily-impaired securities is recorded in the statement of operations and the non-credit component of the change in fair value of securities is recorded in OCI. For securities in an unrealized loss position where the Company has the intent to sell or it is more-likely-than-not that it will be required to sell the security before recovery, the entire impairment loss (i.e., the difference between the security's fair value and its amortized cost) is recorded in the consolidated statements of operations. Credit losses reduce the amortized cost of impaired securities. The amortized cost basis is adjusted for accretion and amortization (using the effective interest method) with a corresponding entry recorded in net investment income.

Realized gains and losses on sales of investments are determined using the specific identification method. Realized loss includes amounts recorded for other-than-temporary impairments (OTTI) on debt securities and the declines in fair value of securities for which the Company has the intent to sell the security or inability to hold until recovery of amortized cost.

For mortgage-backed securities, and any other holdings for which there is prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any necessary adjustments due to changes in effective yields and maturities are recognized in net investment income using the retrospective method.

Loss mitigation securities are generally purchased at a discount and are accounted for based on their underlying investment type, excluding the effects of the Company's insurance. Interest income on loss mitigation securities is recognized on a level yield basis over the remaining life of the security.

Short-term investments, which are those investments with a maturity of less than one year at time of purchase, are carried at fair value and include amounts deposited in money market funds.

Equity method investments include primarily a 39.3% investment in MAC Holdings (see Note 11, Investment in MAC Holdings).

Cash consists of cash on hand and demand deposits. As a result of the lag in reporting FG VIEs, cash and short-term investments do not reflect cash outflow to the holders of the debt issued by the FG VIEs for claim payments made by the Company to the consolidated FG VIEs until the subsequent reporting period. The Company has a de minimis amount of restricted cash at December 31, 2018 and 2017.

Assessment for Other-Than Temporary Impairments

The Company has a formal review process to determine OTTI for securities in its investment portfolio where there is no intent to sell and it is not more-likely-than-not that it will be required to sell the security before recovery. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;
- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- the impact of foreign exchange rates; and
- whether scheduled interest payments are past due.

The Company assesses the ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. If the security is in an unrealized loss position and its net present value is less than the amortized cost of the investment, an OTTI is recorded. The net present value is calculated by discounting the Company's estimate of projected future cash flows at the effective interest rate implicit in the debt security at the time of purchase. The Company's estimates of projected future cash flows are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company develops these estimates using information based on historical experience, credit analysis and market observable data, such as industry analyst reports and forecasts, sector credit ratings and other relevant data. For mortgage-backed and asset backed securities, cash flow estimates also include prepayment and other assumptions regarding the underlying collateral such as default rates, recoveries and changes in value. The assumptions used in these projections requires the use of significant management judgment.

In addition to the factors noted above, the Company also seeks advice from its outside investment managers. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

Adoption of ASU 2016-01

Up until December 31, 2017, the change in fair value of certain equity investments was recorded in OCI. Effective January 1, 2018, in accordance with ASU 2016-01, the change in fair value of these investments is recorded in other income in the consolidated statements of operations. Upon adoption of this section of ASU 2016-01, the Company reclassified a loss of approximately \$23 thousand, net of tax, from AOCI to retained earnings. See also Note 9, Variable Interest Entities, for the effect of this ASU on FG VIEs.

Net Investment Income and Realized Gains (Losses)

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Accrued investment income, which is recorded in Other Assets, was \$24 million and \$23 million as of December 31, 2018 and December 31, 2017, respectively.

Net Investment Income

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Income from fixed-maturity securities managed by third parties	\$ 66	\$ 68	\$ 65
Income from internally managed securities (1)	64	70	43
Gross investment income	130	138	108
Investment expenses	(2)	(2)	(2)
Net investment income	\$ 128	\$ 136	\$ 106

(1) Year ended December 31, 2017 included accretion on Zohar II Notes used as consideration for the MBIA UK Acquisition. See Note 2, Assumption of Insured Portfolio and Business Combinations.

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

Net Realized Investment Gains (Losses)

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Gross realized gains on available-for-sale securities (1)	\$ 1	\$ 50	\$ 14
Gross realized losses on available-for-sale securities	(3)	(5)	(2)
OTTI			
Total OTTI	(5)	(4)	(9)
Less: portion of OTTI recognized in OCI	(2)	2	(4)
Net OTTI recognized in net income (loss) (2)	(3)	(6)	(5)
Net realized investment gains (losses)	\$ (5)	\$ 39	\$ 7

- (1) Year ended December 31, 2017 included a gain on Zohar II Notes used as consideration for the MBIA UK Acquisition. See Note 2, Assumption of Insured Portfolio and Business Combinations.
- (2) Net OTTI recognized in net income (loss) was primarily a result of a decline in expected cash flows on loss mitigation securities.

The proceeds from sales of fixed-maturity securities available-for-sale were \$393 million, \$561 million and \$692 million for the years ended December 31, 2018, 2017 and 2016, respectively.

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

Roll Forward of Credit Losses in the Investment Portfolio

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Balance, beginning of period	\$ 11	\$ 8	\$ 8
Reductions for securities sold and other settlements	—	(1)	—
Additions for credit losses on securities for which an OTTI was previously recognized	2	4	—
Balance, end of period	\$ 13	\$ 11	\$ 8

Investment Portfolio

As of December 31, 2018, the majority of the investment portfolio is managed by five outside managers. The Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. The Company's investment guidelines generally do not permit its outside managers to purchase securities rated lower than A- by S&P Global Ratings, a division of Standard & Poor's Financial Services LLC (S&P) or A3 by Moody's, excluding an allocation not to exceed 5% of the aggregate externally managed portfolio, to corporate securities not rated lower than BBB by S&P or Baa2 by Moody's.

The investment portfolio tables shown below include assets managed both externally and internally. The internally managed portfolio primarily consists of the Company's investments in securities for (i) loss mitigation purposes, (ii) other risk management purposes and (iii) may also include other alternative investments that the Company believes present an attractive investment opportunity.

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

**Investment Portfolio
Carrying Value**

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Fixed-maturity securities (1):		
Externally managed	\$ 2,182	\$ 2,170
Internally managed	725	767
Short-term investments	126	57
Other invested assets:		
Internally managed		
Equity method investments	234	227
Other	2	2
Total	\$ 3,269	\$ 3,223

(1) 22.0% and 21.8% of fixed-maturity securities are rated BIG as of December 31, 2018 and December 31, 2017, respectively.

**Fixed-Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2018**

Investment Category	Percent of Total (1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI (2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Rating (3)
			(dollars in millions)				
Fixed-maturity securities:							
Obligations of state and political subdivisions	58%	\$ 1,659	\$ 61	\$ (10)	\$ 1,710	\$ 27	AA-
U.S. government and agencies	2	51	2	(1)	52	—	AA+
Corporate securities	10	292	1	(5)	288	—	A
Mortgage-backed securities (4):							
RMBS	4	105	2	(2)	105	(1)	A+
CMBS	1	43	—	(1)	42	—	AAA
Asset-backed securities	21	593	119	(2)	710	74	CCC+
Total fixed-maturity securities	96	2,743	185	(21)	2,907	100	A-
Short-term investments	4	126	—	—	126	—	AAA
Total investment portfolio	100%	\$ 2,869	\$ 185	\$ (21)	\$ 3,033	\$ 100	A-

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

Investment Category	Percent of Total (1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI (2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Rating (3)
(dollars in millions)							
Fixed-maturity securities:							
Obligations of state and political subdivisions	63%	\$ 1,738	\$ 90	\$ (2)	\$ 1,826	\$ 26	AA-
U.S. government and agencies	2	56	3	(1)	58	—	AA+
Corporate securities	8	226	2	(1)	227	—	A
Mortgage-backed securities (4):							
RMBS	3	72	2	(2)	72	(1)	A
CMBS	2	63	1	(1)	63	—	AAA
Asset-backed securities	20	541	150	—	691	81	CCC+
Total fixed-maturity securities	98	2,696	248	(7)	2,937	106	A-
Short-term investments	2	57	—	—	57	—	AAA
Total investment portfolio	100%	\$ 2,753	\$ 248	\$ (7)	\$ 2,994	\$ 106	A-

(1) Based on amortized cost.

(2) See Note 18, Other Comprehensive Income.

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

(4) U.S. government-agency obligations were approximately 59% of mortgage backed securities as of December 31, 2018 and 34% as of December 31, 2017 based on fair value.

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

The following tables present the fair value of the Company's available-for-sale portfolio of obligations of state and political subdivisions as of December 31, 2018 and December 31, 2017 by state.

**Fair Value of Available-for-Sale Portfolio of
Obligations of State and Political Subdivisions
As of December 31, 2018 (1)**

State	State General Obligation	Local General Obligation	Revenue Bonds	Fair Value	Amortized Cost	Average Credit Rating
(in millions)						
California	\$ 42	\$ 17	\$ 187	\$ 246	\$ 219	BBB+
New York	—	11	192	203	200	AA
Texas	9	63	105	177	173	AA
Washington	50	41	53	144	143	AA
Massachusetts	29	—	40	69	68	AA
Arizona	—	5	54	59	57	AA
Florida	—	2	55	57	57	A
Colorado	—	23	29	52	51	AA
District of Columbia	24	—	19	43	43	AA
Illinois	9	6	24	39	39	A
All others	42	72	361	475	467	AA-
Total	<u>\$ 205</u>	<u>\$ 240</u>	<u>\$ 1,119</u>	<u>\$ 1,564</u>	<u>\$ 1,517</u>	<u>AA-</u>

**Fair Value of Available-for-Sale Portfolio of
Obligations of State and Political Subdivisions
As of December 31, 2017 (1)**

State	State General Obligation	Local General Obligation	Revenue Bonds	Fair Value	Amortized Cost	Average Credit Rating
(in millions)						
California	\$ 42	\$ 19	\$ 185	\$ 246	\$ 214	BBB+
New York	—	9	202	211	202	AA
Texas	9	68	92	169	162	AA
Washington	60	45	60	165	159	AA
Massachusetts	28	—	43	71	68	AA
Arizona	—	11	57	68	66	AA
Florida	—	2	54	56	54	AA-
Colorado	—	24	26	50	49	AA
District of Columbia	25	—	19	44	42	AA
Illinois	10	6	26	42	41	A-
All others	44	87	370	501	485	AA-
Total	<u>\$ 218</u>	<u>\$ 271</u>	<u>\$ 1,134</u>	<u>\$ 1,623</u>	<u>\$ 1,542</u>	<u>AA-</u>

- (1) Excludes \$146 million and \$203 million as of December 31, 2018 and 2017, respectively, of pre-refunded bonds, at fair value. The credit ratings are based on the underlying ratings and do not include any benefit from bond insurance.

The revenue bond portfolio primarily consists of essential service revenue bonds issued by transportation authorities and other utilities, water and sewer authorities and universities.

**Revenue Bonds
Sources of Funds**

Type	As of December 31, 2018		As of December 31, 2017	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
(in millions)				
Transportation	\$ 364	\$ 335	\$ 330	\$ 295
Water and sewer	186	183	215	208
Tax backed	176	174	208	199
Higher education	167	164	144	138
Healthcare	91	89	96	93
Municipal utilities	66	63	68	66
All others	69	67	73	69
Total	<u>\$ 1,119</u>	<u>\$ 1,075</u>	<u>\$ 1,134</u>	<u>\$ 1,068</u>

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

**Fixed-Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2018**

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(dollars in millions)						
Obligations of state and political subdivisions	\$ 99	\$ (3)	\$ 333	\$ (7)	\$ 432	\$ (10)
U.S. government and agencies	—	—	17	(1)	17	(1)
Corporate securities	124	(2)	96	(3)	220	(5)
Mortgage-backed securities:						
RMBS	18	—	32	(2)	50	(2)
CMBS	15	—	19	(1)	34	(1)
Asset-backed securities	76	(2)	16	—	92	(2)
Total	<u>\$ 332</u>	<u>\$ (7)</u>	<u>\$ 513</u>	<u>\$ (14)</u>	<u>\$ 845</u>	<u>\$ (21)</u>
Number of securities (1)		<u>123</u>		<u>208</u>		<u>328</u>
Number of securities with OTTI		<u>13</u>		<u>4</u>		<u>17</u>

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

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

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(dollars in millions)					
Obligations of state and political subdivisions	\$ 67	\$ (1)	\$ 93	\$ (1)	\$ 160	\$ (2)
U.S. government and agencies	—	—	17	(1)	17	(1)
Corporate securities	68	(1)	21	—	89	(1)
Mortgage-backed securities:						
RMBS	4	—	38	(2)	42	(2)
CMBS	8	—	24	(1)	32	(1)
Asset-backed securities	31	—	3	—	34	—
Total	<u>\$ 178</u>	<u>\$ (2)</u>	<u>\$ 196</u>	<u>\$ (5)</u>	<u>\$ 374</u>	<u>\$ (7)</u>
Number of securities		<u>79</u>		<u>75</u>		<u>154</u>
Number of securities with OTTI		<u>8</u>		<u>4</u>		<u>12</u>

Of the securities in an unrealized loss position for 12 months or more as of December 31, 2018, three securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of December 31, 2018 was \$1 million. As of December 31, 2017, of the securities in an unrealized loss position for 12 months or more, four securities had unrealized losses greater than 10% of book value with an unrealized loss of \$1 million. The Company considered the credit quality, cash flows, interest rate movements, ability to hold a security to recovery and intent to sell a security in determining whether a security had a credit loss. The Company has determined that the unrealized losses recorded as of December 31, 2018 and December 31, 2017 were yield related and not the result of OTTI.

The amortized cost and estimated fair value of available-for-sale fixed-maturity securities by contractual maturity as of December 31, 2018 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of December 31, 2018

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	\$ 10	\$ 10
Due after one year through five years	235	236
Due after five years through 10 years	642	647
Due after 10 years	1,708	1,867
Mortgage-backed securities:		
RMBS	105	105
CMBS	43	42
Total	<u>\$ 2,743</u>	<u>\$ 2,907</u>

Based on fair value, investments and restricted cash that are either held in trust for the benefit of third party ceding insurers in accordance with statutory requirements, placed on deposit to fulfill state licensing requirements, or otherwise pledged or restricted totaled \$93 million and \$110 million, as of December 31, 2018 and December 31, 2017, respectively. The investment portfolio also contains securities that are held in trust for the benefit of affiliates, in accordance with statutory and regulatory requirements in the amount of \$572 million and \$540 million based on fair value as of December 31, 2018 and December 31, 2017, respectively.

No material investments of the Company were non-income producing for years ended December 31, 2018 and 2017, respectively.

11. Investment in MAC Holdings

Accounting Policy

The Company accounts for its investment in MAC Holdings using the equity method. The Company classifies distributions received from equity method investees using the cumulative earnings approach. Distributions received are considered returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess should be considered a return of investment and classified as cash inflows from investing activities.

Summarized Financial Information of MAC Holdings Consolidated

The table below presents summarized financial information for MAC Holdings as of and for the periods ended December 31, 2018, 2017 and 2016. AGC owns approximately 39% of the outstanding MAC Holdings common stock.

Balance Sheet Data

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
Total assets	\$ 765	\$ 839
Total liabilities	190	289

Statement of Operations Data

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Total revenues	\$ 84	\$ 121	\$ 173
Net income	61	82	111

The table below presents summarized distributions for MAC and MAC Holdings.

Distributions

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Dividends paid by MAC Holdings to AGC	\$ 11	\$ 42	\$ 114
Return of capital from MAC Holdings to AGC	—	70	4

12. Insurance Company Regulatory Requirements

The following table summarizes the equity and income amounts reported to the Maryland Insurance Administration (MIA) for AGC. The discussion that follows describes the basis of accounting and differences to U.S. GAAP.

Insurance Regulatory Amounts Reported

	Policyholders' Surplus		Net Income (Loss)		
	As of December 31,		Year Ended December 31,		
	2018	2017	2018	2017	2016
			(in millions)		
AGC (1) (2)	\$ 1,793	\$ 2,073	\$ (5)	\$ 219	\$ 108

- (1) As indicated in Note 2, Assumption of Insured Portfolio and Business Combinations, AGC completed the acquisition of MBIA UK (AGLN) on January 10, 2017 and CIFGH (the parent company of CIFGNA) on July 1, 2016. As mentioned in Note 1, Business and Basis of Presentation, AGC sold AGLN to AGM on June 26, 2017. CIFGNA was merged with and into AGC, with AGC as the surviving company of the merger. The impact to AGC's policyholders' surplus was a decrease of approximately \$36 million from the MBIA UK Acquisition, on a statutory basis, as of January 10, 2017.
- (2) As of December 31, 2018 and 2017, policyholders' surplus is net of contingency reserves of \$550 million and \$554 million, respectively.

Basis of Regulatory Financial Reporting

The Company's ability to pay dividends depends, among other things, upon its financial condition, results of operations, cash requirements, compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of its state of domicile and other states. Financial statements prepared in accordance with accounting practices prescribed or permitted by local insurance regulatory authorities differ in certain respects from GAAP.

AGC is a Maryland domiciled insurance company. AGC prepares statutory financial statements in accordance with accounting practices prescribed or permitted by the National Association of Insurance Commissioners and the MIA. Prescribed statutory accounting practices are set forth in the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The Company has no permitted accounting practices on a statutory basis, except for those related to CIFGNA which was merged into AGC in 2016 and therefore subject to statutory merger accounting requiring the restatement of prior year balances of AGC to include CIFGNA. On the CIFG Acquisition Date, accounting policies were conformed with AGC's accounting policies which do not include any permitted practices.

GAAP differs in certain significant respects from U.S. insurance companies' statutory accounting practices prescribed or permitted by insurance regulatory authorities. The principal differences result from the statutory accounting practices listed below.

- Upfront premiums are earned upon expiration of risk rather than earned over the expected period of coverage. Premiums earnings are accelerated when transactions are economically defeased, rather than legally defeased.
- Acquisition costs are charged to expense as incurred rather than over the period that related premiums are earned.
- A contingency reserve is computed based on statutory requirements, whereas no such reserve is required under GAAP.
- Certain assets designated as "non-admitted assets" are charged directly to statutory surplus, rather than reflected as assets under GAAP.
- Investments in subsidiaries are carried on the balance sheet on the equity basis, to the extent admissible, rather than consolidated with the parent.

- The amount of deferred tax assets that may be admitted is subject to an adjusted surplus threshold and is generally limited to the lesser of those assets the Company expects to realize within three years of the balance sheet date or fifteen percent of the Company's adjusted surplus. This realization period and surplus percentage is subject to change based on the amount of adjusted surplus. Under GAAP there is no non-admitted asset determination, rather a valuation allowance is recorded to reduce the deferred tax asset to an amount that is more likely than not to be realized.
- Insured credit derivatives are accounted for as insurance contracts rather than as derivative contracts measured at fair value.
- Bonds are generally carried at amortized cost rather than fair value.
- Insured obligations of VIEs and refinancing vehicles debt, where the Company is deemed the primary beneficiary, are accounted for as insurance contracts. Under GAAP, such VIEs and refinancing vehicles are consolidated and any transactions with the Company are eliminated.
- Surplus notes are recognized as surplus and each payment of principal and interest is recorded only upon approval of the insurance regulator rather than as liabilities with periodic accrual of interest.
- Acquisitions are accounted for as either statutory purchases or statutory mergers, rather than under the purchase method under GAAP.
- Losses are discounted at tax equivalent yields, and recorded when the loss is deemed probable and without consideration of the deferred premium revenue. Under GAAP, expected losses are discounted at the risk free rate at the end of each reporting period and are recorded only to the extent they exceed deferred premium revenue.
- The present value of installment premiums and commissions are not recorded on the balance sheet as they are under GAAP.
- Mergers of acquired companies are treated as statutory mergers at historical balances and financial statements are retroactively revised assuming the merger occurred at the beginning of the prior year, rather than prospectively beginning with the date of acquisition at fair value under GAAP.

Dividend Restrictions and Capital Requirements

Under Maryland's insurance law, AGC may, with prior notice to the Maryland Insurance Commissioner, pay an ordinary dividend that, together with all dividends paid in the prior 12 months, does not exceed the lesser of 10% of its policyholders' surplus (as of the prior December 31) or 100% of its adjusted net investment income during that period. The maximum amount available during 2019 for AGC to distribute as ordinary dividends is approximately \$123 million. Of such \$123 million, approximately \$42 million was available and distributed in the first quarter of 2019.

Accounting Policy

The Company records share repurchases as a reduction to common stock and additional paid-in capital. Once additional paid-in capital has been exhausted, share repurchases are recorded as a reduction to common stock and retained earnings.

Dividend Restrictions and Capital Requirements

Dividends and Return of Capital

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Dividends paid by AGC to AGUS	\$ 133	\$ 107	\$ 79
Repurchase of common stock by AGC from AGUS (1)	200	—	—

- (1) Represents repurchase of 4,441 of AGC's shares in the first quarter of 2018. Pursuant to an amendment to AGC's Charter, the par value of AGC's remaining shares of common stock issued and outstanding was increased in order to maintain AGC's total common stock at or above \$15 million as is required under the laws of the various jurisdictions for the Company to be licensed as a financial guaranty insurer.

See Note 11, Investment in MAC Holdings, for information on MAC's dividends.

13. Income Taxes

Accounting Policy

The provision for income taxes consists of an amount for taxes currently payable and an amount for deferred taxes. Deferred income taxes are provided for temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities, using enacted rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded to reduce the deferred tax asset to an amount that is more likely than not to be realized.

The Company recognizes tax benefits only if a tax position is “more likely than not” to prevail.

Overview

The Company files its U.S. federal tax return as a part of the consolidated group for AGUS, its direct parent holding company. Each member of the AGUS consolidated tax group is part of a tax sharing agreement and pays or receives its proportionate share of the consolidated regular federal tax liability for the group as if each company filed on a separate return basis.

Effect of the 2017 Tax Cuts and Jobs Act

On December 22, 2017, the 2017 Tax Cuts and Jobs Act (Tax Act) was signed into law. The Tax Act changed many items of U.S. corporate income taxation, including a reduction of the corporate income tax rate from 35% to 21%, implementation of a territorial tax system and imposition of a tax on deemed repatriated earnings of non-U.S. subsidiaries. At December 31, 2017, the Company had not completed accounting for the tax effects of the Tax Act; however, the Company made a reasonable estimate of the effects on the existing deferred tax balances and the one-time transition tax. The Company recognized a provisional income tax expense of \$42 million, which was included as a component of income tax expense from continuing operations in 2017. During 2018, the Company recorded an adjustment to the provisional amount with a \$39 million tax expense as a component of income tax expense from continuing operations resulting from adjustments made to the write-down of existing deferred tax balances. As of December 31, 2018, the accounting for the income tax effects of the Tax Act have been completed and the total net impact resulting from the Tax Act is an expense of \$81 million.

Deferred Tax Assets and Liabilities

The Company remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, excluding foreign tax credits (FTCs), which is generally 21%. The provisional amount recorded due to the remeasurement of the deferred tax balance was an income tax expense of \$48 million. As a result of adjustments identified from filing the 2017 tax return, the total remeasurement of the deferred tax balance resulting from the Tax Act is an income tax expense of \$87 million.

Foreign Tax Effects

The one-time transition tax is based on total post-1986 earnings and profits for previously deferred U.S. income taxes. The Company recorded a provisional amount for realizable FTCs due to the one-time transition tax liability, resulting in a decrease in income tax expense of \$6 million. No adjustments were identified from filing the 2017 tax return and as such, the total impact to the transition tax resulting from the Tax Act is an income tax benefit of \$6 million.

The table below summarizes the impact of the Tax Act on the consolidated statements of operations.

Summary of the Tax Act Effect

	Year Ended December 31,	
	2018	2017
	(in millions)	
Foreign tax credit realized	\$ —	\$ (6)
Net impact of repatriation	—	(6)
Write down of deferred tax asset due to tax rate change	39	48
Net impact of Tax Act	\$ 39	\$ 42

Reclassification of Stranded Tax Effects

In February 2018, the FASB issued ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Comprehensive Income*, which allows entities to elect to reclassify, from AOCI to retained earnings, stranded tax effects resulting from the Tax Act.

Under existing U.S. GAAP, deferred tax assets and liabilities are required to be adjusted for the effect of a change in tax laws or rates, with the effect included in income from continuing operations in the reporting period that includes the enactment date, even in situations in which the related income tax effects of items in AOCI were originally recognized in other comprehensive income (rather than in net income). This results in the tax rate for items within AOCI continuing to be recorded at the previous tax rate (stranded tax effects).

The Company adopted this ASU in its 2017 financial statements and elected to reclassify approximately \$28 million from AOCI to retained earnings, which is primarily attributable to the reduction in the corporate tax rate.

Provision for Income Taxes

The effective tax rates reflect the proportion of income recognized by AGC and each of its operating subsidiaries, with AGC taxed at the U.S. marginal corporate income tax rate of 21% in 2018 and 35% in 2017 and 2016. AGUK was taxed at the U.K. blended marginal corporate tax rate of 19.25% in 2017. On January 10, 2017, AGC purchased MBIA UK, a U.K. based insurance company and on June 26, 2017, AGC sold its foreign subsidiaries to AGM. MBIA UK changed its name to AGLN and will continue to file its tax returns in the U.K. as a separate entity for the period prior to its merger with AGE on November 7, 2018. For additional information, see Note 1, Business and Basis of Presentation, and Note 2, Assumption of Insured Portfolio and Business Combinations. For periods subsequent to April 1, 2017, the U.K. tax rate has been reduced to 19%. For the periods between April 1, 2015 and March 1, 2017 the U.K. corporation tax rate was 20%.

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

Effective Tax Rate Reconciliation

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Expected tax provision (benefit) at statutory rates in taxable jurisdictions	\$ 57	\$ 146	\$ 207
Tax-exempt interest	(7)	(14)	(12)
Bargain purchase gain	—	(20)	(124)
Change in liability for uncertain tax positions	(2)	(22)	5
Effect of provision to tax return filing adjustments	—	(1)	(9)
Effect of adjustments to the provisional amount as a result of the Tax Act	39	42	—
Other	1	(1)	(1)
Total provision (benefit) for income taxes	<u>\$ 88</u>	<u>\$ 130</u>	<u>\$ 66</u>
Effective tax rate	32.4%	31.2%	11.1%

The change in liability for uncertain tax positions for 2018 is driven by the closure of the 2013 - 2014 tax years, see "Audits" below for further discussion.

The expected tax provision at statutory rates in taxable jurisdictions is calculated as the sum of pretax income in each jurisdiction multiplied by the statutory tax rate of the jurisdiction by which it will be taxed.

Tax Assets (Liabilities)

Deferred and Current Tax Assets (Liabilities)

	As of December 31,	
	2018	2017
	(in millions)	
Deferred tax assets (liabilities) (1)	\$ 96	\$ 69
Current tax assets (liabilities) (2)	(3)	168

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

(2) The 2018 amount is included in other liabilities on the consolidated balance sheets.

Components of Net Deferred Tax Assets

	As of December 31,	
	2018	2017
	(in millions)	
Deferred tax assets:		
Net operating loss	\$ 103	\$ 38
Unearned premium reserves, net	71	86
Foreign tax credit	13	13
Investment basis difference	9	9
Unrealized losses on credit derivative financial instruments, net	2	22
Other	6	6
Total deferred income tax assets	204	174
Deferred tax liabilities:		
Loss and LAE reserve	33	33
Unrealized appreciation on investments	25	41
Market discount	17	7
Other	20	11
Total deferred income tax liabilities	95	92
Less: Valuation allowance	13	13
Net deferred income tax asset	96	69

As part of the CIFG Acquisition, the Company acquired \$189 million of NOL which will begin to expire in 2033. The NOL has been limited under Internal Revenue Code Section 382 due to a change in control as a result of the acquisition. As of December 31, 2018, the Company had \$162 million of NOL's available to offset its future U.S. taxable income.

Valuation Allowance

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

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

Audits

As of December 31, 2018, AGUS had open tax years with the U.S. Internal Revenue Service (IRS) for 2015 to present. In December 2016, the IRS issued a Revenue Agent Report, for the 2009 - 2012 audit period, which did not identify any material adjustments that were not already accounted for in prior periods. In April 2017, the Company received a final letter from the IRS to close the audit with no additional findings or changes, and as a result the Company released previously recorded uncertain tax position reserves and accrued interest of approximately \$25 million in second quarter 2017. The 2013 and 2014 tax years closed in 2018. CIFGNA, which was acquired by AGC during 2016, is not currently under examination and has open tax years of 2015 to the date of acquisition.

Uncertain Tax Positions

The following table provides a reconciliation of the beginning and ending balances of the total liability for unrecognized tax positions.

	2018	2017	2016
		(in millions)	
Beginning of year	\$ 6	\$ 25	\$ 21
Effect of provision to tax return filing adjustments	—	2	2
Increase in unrecognized tax positions as a result of position taken during the current period	—	1	2
Decrease in unrecognized tax positions as a result of settlement of positions taken during the prior period	—	(22)	—
Reductions to unrecognized tax benefits as a result of the applicable statute of limitations	(2)	—	—
Balance as of December 31,	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 25</u>

The Company's policy is to recognize interest related to uncertain tax positions in income tax expense and has accrued \$0.3 million for the full year 2018, \$0.5 million for the full year 2017 and \$0.9 million for the full year 2016. As of December 31, 2018 and December 31, 2017, the Company has accrued \$0.5 million and \$0.6 million of interest, respectively.

The total amount of reserves for unrecognized tax positions, including accrued interest, as of December 31, 2018 and December 31, 2017 that would affect the effective tax rate, if recognized, was \$4.7 million and \$7.1 million, respectively. The Company released \$3 million of previously recorded uncertain tax position reserves and accrued interest in 2018, due to the closing of the 2013 and 2014 tax years.

14. Reinsurance

AGC assumes exposure (Assumed Business) and may cede portions of exposure it has insured (Ceded Business) in exchange for premiums, net of any ceding commissions. AGC has historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks.

Accounting Policy

For business assumed and ceded, the accounting model of the underlying direct financial guaranty contract dictates the accounting model used for the reinsurance contract (except for those eliminated as FG VIEs). For any assumed or ceded financial guaranty insurance premiums and losses, the accounting models described in Note 6 are followed. For any assumed or ceded credit derivative contracts, the accounting model in Note 8 is followed.

Assumed and Ceded Business

The Company assumes business from affiliated and non-affiliated companies, including other monoline financial guaranty companies that currently are in runoff and no longer actively writing new business (Legacy Monoline Insurers). The Company, if required, secures its reinsurance obligations to these Legacy Monoline Insurers, typically by depositing in trust assets with a market value equal to its assumed liabilities calculated on a U.S. statutory basis. The Company currently secures its reinsurance obligations to AGE by depositing assets in trust with a market value determined by a methodology agreed with the ceding company and accepted by the Prudential Regulation Authority.

As of December 31, 2018, the majority of the Company's Assumed Business from Legacy Monoline Insurers consists of business that AGC assumed in the SGI Transaction effective as of June 1, 2018, pursuant to which AGC (among other things) assumed, generally on a 100% quota share basis, substantially all of SGI's insured portfolio. The par value on that date of the exposures reinsured totaled approximately \$12 billion. The reinsured portfolio consists predominantly of public finance and infrastructure obligations that meet Assured Guaranty's new business underwriting criteria. Immediately after the closing of the SGI Transaction, AGC ceded \$4.1 billion par to AG Re. See Note 2, Assumption of Insured Portfolio and Business Combinations for additional information on the SGI Transaction. The balance of the Company's Assumed Business mainly consists of business that the Company assumed prior to the 2008-2009 financial crisis from affiliates and Legacy Monoline Insurers.

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

- if the Company fails to meet certain financial and regulatory criteria;
- if the Company fails to maintain a specified minimum financial strength rating, or
- upon certain changes of control of the Company.

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

As of December 31, 2018, if each third party company ceding business to AGC had a right to recapture such business, and chose to exercise such right, the aggregate amount that AGC could be required to pay to all such companies would be approximately \$326 million.

The Company has Ceded Business to affiliated and non-affiliated companies to limit its exposure to risk. The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. The Company's ceded contracts generally allow the Company to recapture Ceded Business after certain triggering events, such as reinsurer downgrades.

The following table presents the components of premiums and losses reported in the consolidated statements of operations and the contribution of the Company's Assumed and Ceded Businesses.

Effect of Reinsurance on Statement of Operations

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Premiums Written:			
Direct	\$ 6	\$ (4)	\$ 3
Assumed (1)	330	(2)	(2)
Ceded (2)	(67)	4	8
Net	<u>\$ 269</u>	<u>\$ (2)</u>	<u>\$ 9</u>
Premiums Earned:			
Direct	\$ 156	\$ 285	\$ 344
Assumed	66	30	46
Ceded (2)	(70)	(84)	(105)
Net	<u>\$ 152</u>	<u>\$ 231</u>	<u>\$ 285</u>
Loss and LAE:			
Direct	\$ 16	\$ (21)	\$ 49
Assumed	16	5	24
Ceded (2)	6	70	(27)
Net	<u>\$ 38</u>	<u>\$ 54</u>	<u>\$ 46</u>

- (1) Negative assumed premiums written were due to changes in expected debt service schedules. Includes business assumed from SGI pursuant to the SGI Transaction.
- (2) Ceded amounts consist mainly of cessions to affiliates. Positive ceded premiums written were due to commutations and changes in expected debt service schedules

In addition to the items presented in the table above, the Company records in the consolidated statements of operations, the effect of assumed and ceded credit derivative exposures. These amounts were losses of \$6 million in 2018, \$17 million in 2017 and \$3 million in 2016.

Exposure to Reinsurers and Other Monolines (1)

	As of December 31, 2018		As of December 31, 2017	
	Affiliated Reinsurers	Non-Affiliated Reinsurers	Affiliated Reinsurers	Non-Affiliated Reinsurers
	(in millions)			
Due (To) From:				
Assumed premium, net of commissions	\$ 29	\$ 46	\$ 27	\$ 3
Ceded premium, net of commissions	(62)	—	(56)	—
Assumed expected loss to be paid	(28)	161	(42)	(1)
Assumed unearned premium reserve	(121)	(302)	(154)	(16)
Ceded expected loss to be paid	4	—	199	—
Ceded unearned premium reserve	218	3	222	1
Outstanding Exposure:				
Assumed par outstanding	3,216	12,576	4,486	2,108
Ceded par outstanding (2)	21,168	99	26,715	75

- (1) There was no collateral posted by third party reinsurers as of December 31, 2018 and December 31, 2017. The total collateral posted by affiliated reinsurers was \$310 million and \$288 million as of December 31, 2018 and December 31, 2017, respectively.
- (2) Of the total par ceded to unrated or BIG rated reinsurers, none is rated BIG as of either December 31, 2018 nor December 31, 2017. Of the total ceded par to affiliates, \$610 million and \$691 million is rated BIG as of December 31, 2018 and December 31, 2017, respectively.

In accordance with U.S. statutory accounting requirements and U.S. insurance laws and regulations, in order for the Company to receive credit for liabilities ceded to reinsurers domiciled outside of the U.S., such reinsurers must secure their liabilities to the Company. These reinsurers are required to post collateral for the benefit of the Company in an amount at least equal to the sum of their ceded unearned premium reserve, loss reserves and contingency reserves all calculated on a statutory basis of accounting. In addition, certain authorized reinsurers post collateral on terms negotiated with the Company.

Commutations

In 2017, the Company entered into commutation agreements where it reassumed \$456 million in par previously ceded to one affiliated and one unaffiliated reinsurers. The Company recorded a gain of \$4 million in 2017 on these commutations. In 2016, an assumed U.S. structured finance transaction for \$12 million in par was canceled. In addition, the Company canceled a retrocession to AG Re of \$1.2 billion of insured par as part of the CIFG Acquisition, see Note 2, Assumption of Insured Portfolio and Business Combinations. The Company recorded a loss of \$10 million in 2016 on these cancellations.

Excess of Loss Reinsurance Facility

Effective January 1, 2018, AGC, AGM and MAC entered into a \$400 million aggregate excess of loss reinsurance facility of which \$180 million was placed with an unaffiliated reinsurer. This facility replaces a similar \$400 million aggregate excess of loss reinsurance facility, of which \$360 million was placed with unaffiliated reinsurers, that AGC, AGM and MAC had entered into effective January 1, 2016 and which terminated on December 31, 2017. The new facility covers losses occurring either from January 1, 2018 through December 31, 2024, or January 1, 2019 through December 31, 2025, at the option of AGC, AGM and MAC. It terminates on January 1, 2020, unless AGC, AGM and MAC choose to extend it. The new facility covers certain U.S. public finance exposures insured or reinsured by AGC, AGM and MAC as of September 30, 2017, excluding exposures that were rated below investment grade as of December 31, 2017 by Moody's or S&P or internally by AGC, AGM or MAC and is subject to certain per credit limits. Among the exposures excluded are those associated with the Commonwealth of Puerto Rico and its related authorities and public corporations. The new facility attaches when AGC's,

AGM's and MAC's net losses (net of AGC's and AGM's reinsurance (including from affiliates) and net of recoveries) exceed \$0.8 billion in the aggregate. The new facility covers a portion of the next \$400 million of losses, with the reinsurer assuming \$180 million of the \$400 million of losses and AGC, AGM and MAC jointly retaining the remaining \$220 million. The reinsurer is required to be rated at least AA- or to post collateral sufficient to provide AGM, AGC and MAC with the same reinsurance credit as reinsurers rated AA-. AGM, AGC and MAC are obligated to pay the reinsurer its share of recoveries relating to losses during the coverage period in the covered portfolio. AGC, AGM and MAC paid approximately \$3.2 million of premiums (of which AGC paid approximately \$0.3 million) in 2018 for the term January 1, 2018 through December 31, 2018 and deposited approximately \$3.2 million in cash into a trust account (of which AGC deposited approximately \$0.3 million) for the benefit of the reinsurer to be used to pay the premiums for 2019. The main differences between the new facility and the prior facility that terminated on December 31, 2017 are the reinsurance attachment point (\$0.8 billion versus \$1.25 billion), the total reinsurance coverage (\$180 million part of \$400 million versus \$360 million part of \$400 million) and the annual premium (\$3.2 million versus \$9 million).

15. Related Party Transactions

Guaranties or Contingencies for Related Parties

AGC had issued financial guaranty policies guaranteeing the obligations of its affiliate, AG Financial Products Inc. (AGFP), to various third-party beneficiaries under credit default swap agreements. Pursuant to its financial guaranty policy, AGC is obligated to pay the beneficiary named in the policy, upon receipt of a claim as contemplated thereby, amounts that become due for payment by AGFP in the event of a payment default by AGFP under the applicable credit default swap agreement. AGC may have a payment obligation to the beneficiary so long as there are outstanding transactions between AGFP and the beneficiary under the ISDA master agreement entered into by the parties. Pursuant to its financial guaranty policy, AGC is fully subrogated to the rights of the beneficiary to the extent of payment by AGC under such policy. The financial guaranty policies are non-cancelable for any reason, including by reason of non-payment of premium.

In consideration of the issuance of the financial guaranty policy, AGFP agrees to pay AGC premium pursuant to a premium agreement. Pursuant to the premium agreement, AGFP also agrees to pay the fees and expenses of AGC in connection with the issuance of the financial guaranty insurance policy and the performance of its obligations under such policy. Under such premium agreement, AGC is fully subrogated to AGFP's rights (including its right to receive payments) under the underlying agreement to the extent that AGC makes payments pursuant to the financial guaranty policy.

Reinsurance and Support Agreements

AGC's Support Agreements in Respect of AGUK

Prior to the Combination, which became effective as of November 7, 2018, AGC provided support to AGUK through a Further Amended and Restated quota share reinsurance agreement (the AGC Quota Share Agreement), a Further Amended and Restated excess of loss reinsurance agreement (the AGC XOL Agreement), and a Further Amended and Restated net worth maintenance agreement (the AGUK Net Worth Agreement). The latter two agreements were terminated effective upon the Combination because AGUK's legacy policies became part of AGE's portfolio upon the Combination and, therefore, are now covered by the excess of loss portion of the new reinsurance agreement that was put in place upon the Combination between AGE and its parent, AGM (the new AGM Reinsurance Agreement) and a net worth maintenance agreement that was similarly put in place between AGE and AGM upon the Combination (the new AGE Net Worth Maintenance Agreement). The AGC Quota Share Agreement, pursuant to which AGC provided 90% quota share reinsurance of AGUK's legacy policies, was also terminated upon the Combination, but it was replaced with a new quota share reinsurance agreement between AGE and AGC (the New AGC Reinsurance Agreement). This new agreement preserves AGC's 90% quota share reinsurance of the legacy AGUK policies that are now part of AGE's portfolio, but it has no application to new business written by AGE following the Combination. The new AGC Reinsurance Agreement also imposes a new collateral requirement on AGC pursuant to which AGC's required collateral is 102% of the sum of AGC's assumed share of the following for AGE policies for which AGC provides proportionate reinsurance (and has not otherwise mitigated through bond purchases): (a) AGE's unearned premium reserve (net of AGE's reinsurance premium payable to AGM); (b) AGE's provisions for unpaid losses and allocated LAE (net of any salvage recoverable), and (c) any unexpired risk provisions of AGE, in each case (a) - (c) as calculated by AGE in accordance with U.K. GAAP. AGC continues also to post as collateral its share of two AGE-guaranteed (formerly, pre-Combination, AGUK-guaranteed) triple-X insurance bonds that have been purchased by AGC for loss mitigation (as AGC had similarly done under the prior AGC Quota Share Agreement). This new collateral measure did not materially change AGC's required collateral from its amount prior to the Combination, which was based, in part, on the assumed losses expected to borne by AGC at the 99.5% confidence interval under AGE's internal capital requirement model.

The MIA approved the termination of the prior AGC XOL Agreement, AGUK Net Worth Agreement and the AGC Quota Share Agreement and the replacement of the latter with the new AGC Reinsurance Agreement.

AGC's Letter of Support in Respect of CIFGE

AGC was a party to a letter of support dated December 6, 2001 issued to CIFGE. Pursuant to such letter of support, AGC agreed to maintain CIFGE's statutory capital and surplus to policyholders under French law and regulation in an amount not less than €20 million for so long as CIFGE carried on business. No capital contributions were made to CIFGE by AGC pursuant to this letter of support from the time AGC succeeded CIFG Assurance North America, Inc. as the parent of CIFGE in July 2016 up to the Combination on November 7, 2018. The letter of support was terminated, with the MIA's approval, effective upon the Combination since the legacy CIFGE policies are now part of AGE and, therefore, are covered by the excess of loss portion of the new AGM Reinsurance Agreement and the new AGE Net Worth Agreement.

Management, Service Contracts or Cost Sharing Arrangements

Until December 31, 2016, the Company and various of its affiliates were parties to the Amended and Restated Service Agreement, effective as April 1, 2015 (the Group Service Agreement). Under the Group Service Agreement, the Company was the payroll company for, and employer of, the U.S. employees of the Assured Guaranty group. The Company's employees made available to its Bermuda, US and UK affiliates, as applicable, equipment, insurance, reinsurance and such other services, including actuarial, marketing, underwriting, claims handling, surveillance, legal, corporate secretarial, information technology, human resources, accounting, tax, financial reporting and investment planning services. In addition, under the Group Service Agreement the Company enjoyed the use of certain equipment and office space leased by its New York affiliate, AGM. Expenses under the Group Service Agreement were allocated directly where appropriate and, where not appropriate, based upon an allocation of employee time and corresponding office overhead. The agreement provided for quarterly settlements and an express right of offset with regard to amounts owing between parties under the Group Service Agreement and other agreements between such parties.

In the first quarter of 2017, the Company's parent, AGUS, formed and capitalized AG US Group Services Inc. (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 Assured Guaranty 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, (i) the Company transferred the employees and the employee benefit, retirement and health plans relating to such employees to AG Services; and (ii) the Group Service Agreement was amended and restated to replace the Company with AG Services as the payroll company and service provider under the agreement. Such amended and restated agreement is substantially identical to the Group Service Agreement except for a few changes primarily related to operational matters, including pre-funding by affiliates who are the largest consumers of group services and inter-company allocation of expenses.

Until December 31, 2016, the Company also provided services to two of its Bermuda affiliates, AGL and AGRe, 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) (the Bermuda Service Agreements). Under the Bermuda Service Agreements, the Company provided certain services to AGL and AGRe, as applicable and as needed and requested by such companies, including, but 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 addition, under the agreement with AGL, AGL made available to the Company employee benefits, including stock options and restricted stock, as may have been granted from time to time at the discretion of AGL's Board of Directors. In connection with the transfer of the Company's employees (and the related employee benefit, retirement and health plans) to AG Services, as described above, 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 with AGL and AG Re, which agreement is substantially identical to the Bermuda Service Agreements.

The transfer from AGC to AG Services of \$12 million in net assets related to benefit, retirement and health plans was recorded as a deemed dividend in the 2017 financial statements.

The following table summarizes the allocated expenses from (to) affiliated companies under the expense sharing agreements.

Expenses Allocated From (To) Affiliated Companies

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Affiliated companies:			
AG Services	\$ 43	\$ 44	\$ —
AGL	2	2	(8)
AGM	—	—	(61)
MAC	—	—	(16)
AG Re	—	—	(9)
Other	—	2	(4)
Total	\$ 45	\$ 48	\$ (98)

The following table summarizes the amounts due (to) from affiliated companies under the expense sharing agreements.

Amounts Due (To) From Affiliated Companies

	As of December 31,	
	2018	2017
	(in millions)	
Affiliated companies:		
AG Services	\$ (19)	\$ (15)
AGM	3	7
AGL	(1)	(1)
AG Re	—	1
Other	—	6
Total	\$ (17)	\$ (2)

Note Payable to Affiliate

See Note 17, Note Payable to Affiliate and Credit Facilities.

Reinsurance Agreements

The Company cedes business to affiliated entities under certain reinsurance agreements. See below for material balance sheet and statement of operations items related to insurance transactions.

The following table summarizes the affiliated components of each balance sheet item, where applicable.

	As of December 31,					
	2018			2017		
	AGM and AGE	AGRe	MAC	AGM and AGE	AGRe	MAC
	(in millions)					
Assets:						
Premiums receivable, net of commissions payable	\$ 29	\$ —	\$ —	\$ 27	\$ —	\$ —
Ceded unearned premium reserve	—	165	53	—	140	82
Reinsurance recoverable on unpaid losses	—	171	—	—	204	1
Salvage and subrogation recoverable	35	—	—	35	—	—
Assumed funds held (1)	15	—	—	12	—	—
Net credit derivative assets (1)	—	26	—	—	36	—
Liabilities:						
Unearned premium reserve	121	—	—	154	—	—
Loss and loss adjustment expense reserve	27	—	—	23	—	—
Reinsurance balances payable, net	—	86	—	1	76	1
Ceded funds held (2)	—	15	—	—	15	—
Deferred ceding commissions (2)(3)	(15)	48	—	(14)	40	—
Other information:						
Assumed par outstanding	3,216	—	—	4,486	—	—
Ceded par outstanding	—	12,815	8,353	—	12,721	13,994

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

(2) Included in other liabilities on the consolidated balance sheets.

(3) December 31, 2017 amounts are included in other assets on the consolidated balance sheets.

The following table summarizes the affiliated components of each statement of operations item, where applicable.

	Year Ended December 31,		
	2018	2017	2016
	(in millions)		
Revenues:			
Net earned premiums			
AG Re	\$ (41)	\$ (43)	\$ (52)
MAC	(28)	(39)	(51)
AGM and AGE	28	27	41
Net change in fair value of credit derivatives			
AG Re	11	(12)	(15)
AGFP	3	3	24
Expenses:			
Loss and LAE (recoveries)			
AG Re	4	71	(27)
AGM and AGE	13	9	8
MAC	1	(1)	—
Other expenses			
AG Re	(12)	(12)	(14)
AGM and AGE	1	1	1

16. Commitments and Contingencies

Leases

The Company occupies office space that is leased by AGM and is allocated a portion of such rent expense. The Company's proportionate share of rent expense recognized in 2018, 2017 and 2016 was \$1.8 million, \$0.2 million and \$3.7 million, respectively.

AGM leases and occupies approximately 103,500 square feet in New York City through 2032. Subject to certain conditions, AGM has an option to renew the lease for five years at a fair market rent.

Legal Proceedings

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

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

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

Accounting Policy

The Company establishes accruals for litigation and regulatory matters to the extent it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. For litigation and regulatory matters where a loss may be reasonably possible, but not probable, or is probable but not reasonably estimable, no accrual is established, but if the matter is material, it is disclosed, including matters discussed below. The Company reviews relevant information with respect to its litigation and regulatory matters on a quarterly basis and updates its accruals, disclosures and estimates of reasonably possible loss based on such reviews.

Litigation

On November 28, 2011, Lehman Brothers International (Europe) (in administration) (LBIE) sued AGFP, an affiliate of AGC which in the past had provided credit protection to counterparties under CDS. AGC acts as the credit support provider of AGFP under these CDS. LBIE's complaint, which was filed in the Supreme Court of the State of New York, asserted a claim for breach of the implied covenant of good faith and fair dealing based on AGFP's termination of nine credit derivative transactions between LBIE and AGFP and asserted claims for breach of contract and breach of the implied covenant of good faith and fair dealing based on AGFP's termination of 28 other credit derivative transactions between LBIE and AGFP and AGFP's calculation of the termination payment in connection with those 28 other credit derivative transactions. Following defaults by LBIE, AGFP properly terminated the transactions in question in compliance with the agreement between AGFP and LBIE, and calculated the termination payment properly. AGFP calculated that LBIE owes AGFP approximately \$29 million in connection with the termination of the credit derivative transactions, whereas LBIE asserted in the complaint that AGFP owes LBIE a termination payment of approximately \$1.4 billion. AGFP filed a motion to dismiss the claims for breach of the implied covenant of good faith in LBIE's complaint, and on March 15, 2013, the court granted AGFP's motion to dismiss in respect of the count relating to the nine credit derivative transactions and narrowed LBIE's claim with respect to the 28 other credit derivative transactions. LBIE's administrators disclosed in an April 10, 2015 report to LBIE's unsecured creditors that LBIE's valuation expert has calculated LBIE's claim for damages in aggregate for the 28 transactions to range between a minimum of approximately \$200 million and a maximum of approximately \$500 million, depending on what adjustment, if any, is made for AGFP's credit risk and excluding any applicable interest. AGFP filed a motion for summary judgment on the remaining causes of action asserted by LBIE and on AGFP's counterclaims and on July 2, 2018, the court granted in part and denied in part AGFP's motion. The court dismissed, in its entirety, LBIE's remaining claim for breach of the implied covenant of good faith and fair dealing and also dismissed LBIE's claim for breach of contract solely to the extent that it is based upon AGFP's conduct in connection with the auction. With respect to LBIE's claim for breach of contract, the court held that there are triable issues of fact regarding whether AGFP calculated its loss reasonably and in good faith. On October 1, 2018, AGFP filed an appeal with the Appellate Division of the Supreme Court of the State of New York, First Judicial Department, seeking reversal of the portions of the lower court's ruling denying AGFP's motion for summary judgment with respect to LBIE's sole remaining claim for breach of contract. On January 17, 2019, the Appellate Division affirmed the Supreme Court's decision, holding that the lower court correctly determined that there are triable issues of fact regarding whether AGFP calculated its loss reasonably and in good faith.

17. Note Payable to Affiliate and Credit Facilities

Accounting Policy

The note payable to affiliate was recorded at its principal amount. There was no discount or premium at the time of issuance of the note.

Note Payable to Affiliate

On December 18, 2009, AGC issued a surplus note with a principal amount of \$300 million to AGM. This Note Payable to Affiliate carries a simple interest rate of 3.5% per annum and matures on December 31, 2029. Principal is payable at the option of AGC prior to the final maturity of the note in 2029 and interest is payable on the note annually in arrears as of December 31st of each year, commencing December 31, 2010. Payments of principal and interest are subject to AGC having policyholders' surplus in excess of statutory minimum requirements after such payment and to prior written approval by the MIA. AGC has paid all scheduled due and accrued interest on the surplus note since issuance.

Committed Capital Securities

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

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

Prior to 2008, the amounts paid on the CCS were established through an auction process. All of those auctions failed in 2008, and the rates paid on the CCS increased to their maximum. The annualized rate on the AGC CCS is one-month LIBOR plus 250 bps.

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

18. Other Comprehensive Income

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

Changes in Accumulated Other Comprehensive Income by Component
Year Ended December 31, 2018

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Net Unrealized Gains (Losses) on FG VIEs' Liabilities with Recourse due to ISCR	Total AOCI
	(in millions)			
Balance, December 31, 2017	\$ 124	\$ 84	\$ —	\$ 208
Effect of adoption of ASU 2016-01	—	—	(5)	(5)
Other comprehensive income (loss) before reclassifications	(61)	(8)	—	(69)
Less: Amounts reclassified from AOCI to:				
Net realized investment gains (losses)	(1)	(4)	—	(5)
Fair value gains (losses) on FG VIEs	—	—	(2)	(2)
Tax (provision) benefit	—	1	1	2
Total amount reclassified from AOCI, net of tax	(1)	(3)	(1)	(5)
Net current period other comprehensive income (loss)	(60)	(5)	1	(64)
Balance, December 31, 2018	\$ 64	\$ 79	\$ (4)	\$ 139

Changes in Accumulated Other Comprehensive Income by Component
Year Ended December 31, 2017

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Cumulative Translation Adjustment	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, December 31, 2016	\$ 76	\$ 26	\$ (37)	\$ 65
Reclassification of stranded tax effects (see Note 13)	13	15	—	28
Other comprehensive income (loss) before reclassifications	61	39	11	111
Less: Amounts reclassified from AOCI to:				
Net realized investment gains (losses)	45	(6)	—	39
Net investment income	26	—	—	26
Other income (loss)	—	—	(14)	(14)
Tax (provision) benefit	(25)	2	5	(18)
Total amount reclassified from AOCI, net of tax	46	(4)	(9)	33
Net current period other comprehensive income (loss)	15	43	20	78
Sale of the European Subsidiaries to affiliate (see Note 1)	20	—	17	37
Balance, December 31, 2017	<u>\$ 124</u>	<u>\$ 84</u>	<u>\$ —</u>	<u>\$ 208</u>

Changes in Accumulated Other Comprehensive Income by Component
Year Ended December 31, 2016

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Cumulative Translation Adjustment	Total Accumulated Other Comprehensive Income
	(in millions)			
Balance, December 31, 2015	\$ 60	\$ 3	\$ (15)	\$ 48
Other comprehensive income (loss) before reclassifications	24	20	(22)	22
Less: Amounts reclassified from AOCI to:				
Net realized investment gains (losses)	12	(5)	—	7
Tax (provision) benefit	(4)	2	—	(2)
Total amount reclassified from AOCI, net of tax	8	(3)	—	5
Net current period other comprehensive income (loss)	16	23	(22)	17
Balance, December 31, 2016	<u>\$ 76</u>	<u>\$ 26</u>	<u>\$ (37)</u>	<u>\$ 65</u>

19. Subsequent Events

Subsequent events have been considered through March 27, 2019, the date on which these financial statements were issued.