

Assured Guaranty Municipal Corp.

Condensed Combined Financial Statements

(Unaudited)

March 31, 2018

ASSURED GUARANTY MUNICIPAL CORP.

INDEX TO CONDENSED COMBINED FINANCIAL STATEMENTS

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Assured Guaranty Municipal Corp.
Condensed Combined Balance Sheets (unaudited)
(dollars in millions except per share and share amounts)

	As of March 31, 2018	As of December 31, 2017
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of \$5,450 and \$5,479)	\$ 5,559	\$ 5,659
Short-term investments, at fair value	274	364
Other invested assets (includes Surplus Note from affiliate of \$300 and \$300)	373	378
Total investment portfolio	6,206	6,401
Cash	66	36
Premiums receivable	765	730
Ceded unearned premium reserve	766	757
Reinsurance recoverable on unpaid losses	191	227
Salvage and subrogation recoverable	275	297
Financial guaranty variable interest entities' assets, at fair value	534	577
Other assets	166	159
Total assets	\$ 8,969	\$ 9,184
Liabilities and shareholder's equity		
Unearned premium reserve	\$ 2,723	\$ 2,746
Loss and loss adjustment expense reserve	822	931
Reinsurance balances payable, net	202	197
Current income tax payable	110	121
Financial guaranty variable interest entities' liabilities with recourse, at fair value	473	495
Financial guaranty variable interest entities' liabilities without recourse, at fair value	108	128
Other liabilities	293	316
Total liabilities	4,731	4,934
Commitments and contingencies (See Note 14)		
Preferred stock (\$1,000 par value, 5,000.1 shares authorized; 0 shares issued and outstanding)	—	—
Common stock (\$92,025 par value, 163 shares authorized, issued and outstanding)	15	15
Additional paid-in capital	702	702
Retained earnings	3,256	3,199
Accumulated other comprehensive income, net of tax of \$7 and \$32	45	118
Total shareholder's equity attributable to Assured Guaranty Municipal Corp.	4,018	4,034
Noncontrolling interest	220	216
Total shareholder's equity	4,238	4,250
Total liabilities and shareholder's equity	\$ 8,969	\$ 9,184

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

Assured Guaranty Municipal Corp.
Condensed Combined Statements of Operations (unaudited)
(in millions)

	Three Months Ended March 31,	
	2018	2017
Revenues		
Net earned premiums	\$ 76	\$ 78
Net investment income	51	58
Net realized investment gains (losses):		
Other-than-temporary impairment losses	(10)	(1)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(2)	7
Net impairment loss	(8)	(8)
Other net realized investment gains (losses)	5	1
Net realized investment gains (losses)	(3)	(7)
Net change in fair value of credit derivatives:		
Realized gains (losses) and other settlements	0	14
Net unrealized gains (losses)	(1)	7
Net change in fair value of credit derivatives	(1)	21
Fair value gains (losses) on financial guaranty variable interest entities	2	8
Commutation gains (see Note 13)	1	73
Other income (loss)	20	11
Total revenues	146	242
Expenses		
Loss and loss adjustment expenses	(8)	16
Amortization of deferred ceding commissions	(2)	(4)
Other operating expenses	37	36
Total expenses	27	48
Income (loss) before income taxes	119	194
Provision (benefit) for income taxes		
Current	(8)	67
Deferred	17	(11)
Total provision (benefit) for income taxes	9	56
Net income (loss)	110	138
Less: Noncontrolling interest	7	8
Net income (loss) attributable to Assured Guaranty Municipal Corp.	\$ 103	\$ 130

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

Assured Guaranty Municipal Corp.
Condensed Combined Statements of Comprehensive Income (unaudited)
(in millions)

	Three Months Ended March 31,	
	2018	2017
Net income (loss)	\$ 110	\$ 138
Unrealized holding gains (losses) arising during the period on:		
Investments with no other-than-temporary impairment, net of tax provision (benefit) of \$(19) and \$16	(43)	32
Investments with other-than-temporary impairment, net of tax provision (benefit) of \$(2) and \$8	(9)	15
Unrealized holding gains (losses) arising during the period, net of tax	(52)	47
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$(1) and \$(3)	(1)	(3)
Change in net unrealized gains (losses) on investments	(51)	50
Net unrealized gains (losses) arising during the period on FG VIE liabilities with recourse attributable to changes in instrument-specific credit risk, net of tax provision (benefit) of \$(1) (see Note 1)	(3)	—
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of \$(1)	(1)	—
Change in net unrealized gains (losses) on FG VIE liabilities with recourse	(2)	—
Other, net of tax provision	4	1
Comprehensive income (loss)	61	189
Less: Comprehensive income (loss) attributable to noncontrolling interest	4	10
Comprehensive income (loss) attributable to Assured Guaranty Municipal Corp.	\$ 57	\$ 179

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

Assured Guaranty Municipal Corp.
Condensed Combined Statements of Shareholder's Equity (unaudited)

For the Three Months Ended March 31, 2018

(dollars in millions, except share data)

	Assured Guaranty Municipal Corp. Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity Attributable to Assured Guaranty Municipal Corp.	Noncontrolling Interest	Total Shareholder's Equity
Balance at December 31, 2017	163	\$ 15	\$ 702	\$ 3,199	\$ 118	\$ 4,034	\$ 216	\$ 4,250
Net income	—	—	—	103	—	103	7	110
Dividends	—	—	—	(73)	—	(73)	—	(73)
Other comprehensive loss	—	—	—	—	(46)	(46)	(3)	(49)
Effect of adoption of ASU 2016-01 (see Note 1)	—	—	—	27	(27)	—	—	—
Balance at March 31, 2018	163	\$ 15	\$ 702	\$ 3,256	\$ 45	\$ 4,018	\$ 220	\$ 4,238

For the Three Months Ended March 31, 2017

(dollars in millions, except share data)

	Assured Guaranty Municipal Corp. Common Shares Outstanding	Common Stock Par Value	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity Attributable to Assured Guaranty Municipal Corp.	Noncontrolling Interest	Total Shareholder's Equity
Balance at December 31, 2016	205	\$ 77	\$ 778	\$ 3,019	\$ 12	\$ 3,886	\$ 295	\$ 4,181
Net income	—	—	—	130	—	130	8	138
Dividends	—	—	—	(79)	—	(79)	(5)	(84)
Other comprehensive income	—	—	—	—	49	49	2	51
Effect of common control acquisitions (see Note 2)	—	84	282	—	—	366	—	366
Balance at March 31, 2017	205	\$ 161	\$ 1,060	\$ 3,070	\$ 61	\$ 4,352	\$ 300	\$ 4,652

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

Assured Guaranty Municipal Corp.
Condensed Combined Statements of Cash Flows (unaudited)
(in millions)

	Three Months Ended March 31,	
	2018	2017
Net cash flows provided by (used in) operating activities	\$ (49)	\$ 134
Investing activities		
Fixed-maturity securities:		
Purchases	(219)	(251)
Sales	108	120
Maturities	169	168
Net sales (purchases) of short-term investments	97	(103)
Net proceeds from paydowns on financial guaranty variable interest entities' assets	26	33
Effect of common control combination for acquisitions (see Note 2)	—	72
Other	(1)	(14)
Net cash flows provided by (used in) investing activities	180	25
Financing activities		
Dividends paid to Assured Guaranty Municipal Holdings Inc.	(73)	(79)
Dividends paid to AGC (see Note 11)	—	(5)
Repayment of notes payable	0	(1)
Net paydowns of financial guaranty variable interest entities' liabilities	(26)	(35)
Net cash flows provided by (used in) financing activities	(99)	(120)
Effect of foreign exchange rate changes	1	0
Increase (decrease) in cash and restricted cash	33	39
Cash and restricted cash at beginning of period (see Note 10)	36	40
Cash and restricted cash at end of period (see Note 10)	\$ 69	\$ 79
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	\$ 10	\$ —
Interest	\$ 0	\$ 0

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

Assured Guaranty Municipal Corp.
Notes to the Condensed Combined Financial Statements (unaudited)
March 31, 2018

1. Business and Basis of Presentation

Business

Assured Guaranty Municipal Corp. (AGM, or together with its subsidiaries, the Company), a New York domiciled insurance company, is a wholly owned subsidiary of Assured Guaranty Municipal Holdings Inc. (AGMH). AGMH is an indirect, wholly owned 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. AGM was formerly known as Financial Security Assurance Inc.

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. Obligations insured by the Company include bonds issued by U.S. state or municipal governmental authorities and notes issued to finance international infrastructure projects. AGM had previously offered insurance and reinsurance in the global structured finance market, but has not done so since mid-2008. AGM and its indirect subsidiary Municipal Assurance Corp. (MAC) each markets its financial guaranty insurance directly to issuers and underwriters of, and investors in, public finance securities. In addition, AGM's direct subsidiary, Assured Guaranty (Europe) plc (AGE, formerly Assured Guaranty (Europe) Ltd.), provides financial guaranties for the international public finance (including infrastructure) market and, with the approval of the U.K. Prudential Regulation Authority (PRA), the asset-backed and other structured finance market. AGM provides reinsurance and second-to-pay financial guaranties on financial guaranties provided by AGE for the international public finance (including infrastructure) market. 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 2008. Regulatory guidelines were issued in 2009 that limited the terms under which such protection could be sold. The capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act also contributed to the Company not entering into such new CDS in the U.S. since 2009. The Company actively pursues opportunities to terminate existing CDS, which terminations have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

On June 26, 2017, AGM purchased from its affiliate, Assured Guaranty Corp. (AGC), 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 Ltd.) (collectively, the European Subsidiaries), and then immediately contributed the European Subsidiaries to AGM's wholly owned subsidiary, AGE. See Note 2, Common Control Acquisition.

Basis of Presentation

The unaudited interim condensed combined financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all material adjustments that are of a normal recurring nature, 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) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from

those estimates. These unaudited interim condensed combined financial statements are as of March 31, 2018 and cover the three-month period ended March 31, 2018 (First Quarter 2018) and the three-month period ended March 31, 2017 (First Quarter 2017). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from the AGM combined audited financial statements.

The unaudited interim condensed combined financial statements include the accounts of AGM, its direct and indirect subsidiaries, and its consolidated FG VIEs. In addition, amounts for all periods prior to June 26, 2017 have been retrospectively adjusted to include the European Subsidiaries from the date the common control began for each subsidiary (combined basis). See Note 2, Common Control Acquisition for additional information.

Intercompany accounts and transactions between and among all consolidated and combined entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim condensed combined financial statements should be read in conjunction with the annual combined financial statements of AGM included in Exhibit 99.1 in AGL's Form 8-K dated March 20, 2018, filed with the U.S. Securities and Exchange Commission (the SEC).

AGM owns 100% of AGE, organized in the U.K., and 60.7% of Municipal Assurance Holdings Inc. (MAC Holdings), incorporated in Delaware. AGM's affiliate, AGC owns the remaining 39.3% of MAC Holdings. MAC Holdings owns 100% of MAC, domiciled in New York.

Adopted Accounting Standards

Financial Instruments

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, *Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU are intended to make targeted improvements to GAAP by addressing certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Amendments under this ASU apply to the Company's FG VIE 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 VIE liabilities with recourse, the portion of the change in fair value caused by changes in instrument specific credit risk (ISCR) must now be separately presented in other comprehensive income (OCI) as opposed to the statement of operations. See Note 9, Consolidated 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 recorded in other income in the condensed consolidated statements of operations effective January 1, 2018. Equity securities carried at cost as of December 31, 2017, are recorded at cost less impairment plus or minus the change resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. See Note 10, Investments and Cash for additional information.

Effective January 1, 2018, the Company adopted this ASU with a cumulative-effect adjustment to the statement of financial position as of January 1, 2018. This resulted in a reclassification of a net \$27 million loss, net of tax, from retained earnings to accumulated OCI (AOCI). See Note 16, Other Comprehensive Income, for additional information.

Income Taxes

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory*, which removes the current 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 is to be applied on a modified retrospective basis (i.e. by recording 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 ASU was adopted on January 1, 2018 with no material effect on the condensed combined 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. The Company does not expect this ASU to have a material effect on its condensed combined financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to present right-of-use assets and lease liabilities on the balance sheet. ASU 2016-02 is to be applied using a modified retrospective approach and is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company intends to adopt this ASU on January 1, 2019. The Company is evaluating the effect that this ASU will have on its condensed combined financial statements. The Company currently accounts for its lease agreements where the Company is the lessee as operating leases and, therefore, recognizes its lease expense on a straight-line basis.

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 amendments in this ASU are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will be required to use forward-looking information to better inform their credit loss estimates as a result of the ASU. While many of the loss estimation techniques applied today will still be permitted, the inputs to those techniques will change to reflect the full amount of expected credit losses. The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as credit quality and underwriting standards of an organization's portfolio.

In addition, the ASU amends the accounting for credit losses on available-for-sale securities and purchased financial assets with credit deterioration. The ASU also eliminates the concept of "other than temporary" from the impairment model for certain available-for-sale securities. Accordingly, the ASU states that an entity must use an allowance approach, must limit the allowance to an amount by which the security's fair value is less than its amortized cost basis, may not consider the length of time fair value has been less than amortized cost, and may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists. For purchased financial assets with credit deterioration, the ASU requires an entity's method for measuring credit losses to be consistent with its method for measuring expected losses for originated and purchased non-credit-deteriorated assets.

The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For debt instruments such as reinsurance recoverables, 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. The Company is evaluating the effect that this ASU will have on its condensed combined financial statements.

2. Common Control Acquisitions

The purchase of the European Subsidiaries on June 26, 2017 was an initial step in Assured Guaranty's efforts to merge the operations of its four affiliated European insurance companies (the European Subsidiaries and AGE). The acquisition from AGC of the European Subsidiaries was approved by the New York State Department of Financial Services, the Maryland Insurance Administration (MIA) and the PRA. While Assured Guaranty, the European Subsidiaries and AGE received regulatory approvals for this initial step of the proposed combination of the European Subsidiaries and AGE, that combination is subject to further regulatory approvals and to certain court approvals. As a result, the Company cannot predict whether, or when, such combination will be completed.

As the Company and the European Subsidiaries were under common control at the time of the acquisition, it is required under U.S. GAAP to account for this acquisition in a method that is similar to the pooling-of-interests method. Under this method of accounting, AGM's combined financial statements and disclosures reflect the European Subsidiaries' historical carryover basis in the assets and liabilities instead of reflecting the fair value of the assets and liabilities.

The financial statements and disclosures for all periods presented in this report prior to June 26, 2017 have been retrospectively adjusted, as applicable, to reflect the combination of AGM and the European Subsidiaries as if the combinations had been in effect from the date common control began for each of the subsidiaries. As such, AGUK and CIFGE are reflected within these financial statements for all periods presented, while AGLN is reflected for the periods subsequent to its purchase by Assured Guaranty on January 10, 2017. The consideration paid, which occurred on June 26, 2017, the date of transfer, is not reflected in First Quarter 2017 financial results.

See Note 2, Common Control Acquisitions, in the annual combined financial statements of AGM included in Exhibit 99.1 in AGL's Form 8-K dated March 20, 2018, filed with the SEC, for additional information.

3. Ratings

The financial strength ratings (or similar ratings) for AGM and its insurance company subsidiaries, 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, AGM periodically assesses the value of each rating assigned to it and its insurance company subsidiaries, 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.
AGM	AA (stable) (6/26/17)	AA+ (stable) (1/23/18)	A2 (stable) (5/7/18)
MAC	AA (stable) (6/26/17)	AA+ (stable) (7/14/17)	—
AGE	AA (stable) (6/26/17)	—	A2 (stable) (5/7/18)
AGUK	AA (stable) (6/26/17)	—	(1)
AGLN	BB (positive) (1/12/17)	—	(2)
CIFGE	—	—	—

(1) AGC requested that Moody's Investors Service, Inc. (Moody's) withdraw its financial strength ratings of AGC and AGUK in January 2017, but Moody's denied that request. Moody's continues to rate AGC A3 (stable) and AGUK A3. Moody's put AGUK on review for upgrade on June 27, 2017, following its transfer to AGM. On May 7, 2018, Moody's continued its review of AGUK for upgrade.

(2) Assured Guaranty did not request that Moody's rate AGLN. Moody's continues to rate AGLN, and upgraded its rating to Baa2 (stable) on January 13, 2017, following its acquisition by AGC, and then to Baa1 on review for further upgrade on June 27, 2017, following its transfer to AGM. On May 7, 2018, Moody's continued its review of AGLN for further upgrade.

There can be no assurance that any of the rating agencies will not take negative action on the financial strength ratings of AGM or its insurance subsidiaries in the future.

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

4. Outstanding Exposure

The Company primarily writes financial guaranty contracts in insurance form. Until 2008, the Company also wrote some of its 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, as part of its loss mitigation strategy for existing troubled exposures, it may underwrite new issuances that it views as below-investment-grade (BIG). The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, requires rigorous subordination or collateralization requirements. Reinsurance may be used in order to reduce net exposure to certain insured transactions.

The Company has issued financial guaranty insurance policies on public finance obligations and, prior to mid-2008, structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. The Company also includes within public finance similar obligations issued by territorial and non-U.S. sovereign and sub-sovereign issuers and governmental authorities.

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 9, Consolidated 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. While AGM has ceased insuring new originations of asset-backed securities, a significant portfolio of such obligations remains outstanding. AGM's wholly owned subsidiary, AGE, provides financial guarantees in the international public finance market and intends to provide such guarantees in the international structured finance market.

Debt service and par outstanding exposures presented in these financial statements are presented on a consolidated and combined basis. That is, amounts presented include 100% of the exposures of AGM, AGE, the European Subsidiaries and MAC, despite the fact that AGM indirectly owns only 60.7% of MAC.

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.

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. On the other hand, the Company uses risk-free rates, which are determined each quarter, to calculate the expected loss for financial statement measurement purposes.

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

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected.
- BIG Category 2: Below-investment-grade transactions for which future losses are expected but for which no claims (other than liquidity claims, which are claims that the Company expects to be reimbursed within one year) have yet been paid.
- BIG Category 3: Below-investment-grade transactions for which future losses are expected and on which claims (other than liquidity claims) have been paid.

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

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 March 31, 2018 and December 31, 2017, the Company excluded \$663 million and \$678 million, respectively, of net par attributable to loss mitigation securities (which are mostly BIG) and other loss mitigation strategies. 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 ⁽¹⁾	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
	(in millions)			
Public finance	\$ 334,813	\$ 341,451	\$ 241,386	\$ 247,424
Structured finance	7,114	7,386	6,643	6,828
Total financial guaranty	<u>\$ 341,927</u>	<u>\$ 348,837</u>	<u>\$ 248,029</u>	<u>\$ 254,252</u>

- (1) Includes 100% of MAC's gross and net debt service outstanding. However, AGM's indirect ownership of MAC is only 60.7%. The net debt service outstanding amount includes \$52.3 billion and \$56.3 billion as of both March 31, 2018 and December 31, 2017, respectively, from MAC.

Outstanding commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, any total commitment amount would not necessarily reflect actual future guaranteed amounts. All of the outstanding commitments AGM had as of March 31, 2018 have expired as of the date of this filing.

Financial Guaranty Portfolio by Internal Rating
As of March 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	\$ 728	0.6%	\$ 818	2.5%	\$ 701	15.7%	\$ 124	22.1%	\$ 2,371	1.5%
AA	17,977	14.3	201	0.6	1,728	38.7	28	5.0	19,934	12.2
A	73,000	58.2	12,263	37.6	54	1.2	70	12.5	85,387	52.3
BBB	30,601	24.4	17,896	54.8	59	1.3	248	44.3	48,804	29.9
BIG	3,154	2.5	1,478	4.5	1,924	43.1	90	16.1	6,646	4.1
Total net par outstanding (1)	<u>\$ 125,460</u>	<u>100.0%</u>	<u>\$ 32,656</u>	<u>100.0%</u>	<u>\$ 4,466</u>	<u>100.0%</u>	<u>\$ 560</u>	<u>100.0%</u>	<u>\$ 163,142</u>	<u>100.0%</u>

(1) Includes \$38.4 billion of net par outstanding as of March 31, 2018, from MAC, which represents 100% of MAC's net par outstanding. However, AGM's indirect ownership of MAC is only 60.7%.

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	\$ 736	0.6%	\$ 809	2.5%	\$ 666	14.6%	\$ 124	22.3%	\$ 2,335	1.5%
AA	19,797	15.2	200	0.6	1,822	39.7	27	4.8	21,846	13.0
A	74,860	57.5	12,011	37.4	74	1.6	71	12.7	87,016	51.9
BBB	31,453	24.1	17,680	55.0	60	1.3	246	44.2	49,439	29.5
BIG	3,403	2.6	1,452	4.5	1,965	42.8	89	16.0	6,909	4.1
Total net par outstanding (1)	<u>\$ 130,249</u>	<u>100.0%</u>	<u>\$ 32,152</u>	<u>100.0%</u>	<u>\$ 4,587</u>	<u>100.0%</u>	<u>\$ 557</u>	<u>100.0%</u>	<u>\$ 167,545</u>	<u>100.0%</u>

(1) Includes \$41.5 billion of net par outstanding as of December 31, 2017, from MAC, which represents 100% of MAC's net par outstanding. However, AGM's indirect ownership of MAC is only 60.7%.

Components of BIG Portfolio

Components of BIG Net Par Outstanding As of March 31, 2018

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG (1)	Outstanding
	(in millions)				
Public finance:					
U.S. public finance	\$ 1,086	\$ —	\$ 2,068	\$ 3,154	\$ 32,656
Non-U.S. public finance	1,256	222	—	1,478	125,460
Public finance	2,342	222	2,068	4,632	158,116
Structured finance:					
U.S. Residential mortgage-backed securities (RMBS)	173	160	1,517	1,850	2,851
Other structured finance	127	—	37	164	2,175
Structured finance	300	160	1,554	2,014	5,026
Total	\$ 2,642	\$ 382	\$ 3,622	\$ 6,646	\$ 163,142

(1) There is no BIG net par outstanding for credit derivatives as of March 31, 2018.

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

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG (1)	Outstanding
	(in millions)				
Public finance:					
U.S. public finance	\$ 1,334	\$ 264	\$ 1,805	\$ 3,403	\$ 130,249
Non-U.S. public finance	1,231	221	—	1,452	32,152
Public finance	2,565	485	1,805	4,855	162,401
Structured finance:					
U.S. RMBS	190	163	1,535	1,888	2,908
Other structured finance	90	38	38	166	2,236
Structured finance	280	201	1,573	2,054	5,144
Total	\$ 2,845	\$ 686	\$ 3,378	\$ 6,909	\$ 167,545

(1) There is no BIG net par outstanding for credit derivatives as of December 31, 2017.

Exposure to Puerto Rico

The Company has 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 \$2.3 billion net par as of March 31, 2018. Of that amount, \$2.2 billion was rated BIG, while the remainder was rated AA since it relates to second-to-pay policies on obligations insured by an affiliate of the Company. Puerto Rico 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 BIG Puerto Rico exposures except for Municipal Finance Agency (MFA).

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

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

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

On September 20, 2017, Hurricane Maria made landfall in Puerto Rico as a Category 4 hurricane on the Saffir-Simpson scale, causing loss of life and widespread devastation in the Commonwealth. Damage to the Commonwealth's infrastructure, including the power grid, water system and transportation system, was extensive, and rebuilding and economic recovery are expected to take years. While the federal government is expected to provide substantial resources for relief and rebuilding -- which is expected to help economic activity and address the Commonwealth's infrastructure needs in the intermediate and longer term -- economic activity in general and tourism in particular, as well as tax collections, have declined in the aftermath of the storm, and out migration to the mainland also has increased.

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

The Commonwealth released fiscal plans for itself and for a number of its authorities and public corporations, and in response to notices of violation from the Oversight Board and the enactment of a significant federal disaster relief package by the U.S. Congress, Puerto Rico released one or more revised fiscal plans for the Commonwealth and a number of its authorities and public corporations. The most recent fiscal plans submitted by the Commonwealth for the Commonwealth, PRHTA, PREPA and Puerto Rico Aqueduct and Sewer Authority (PRASA) were released on April 5, 2018. The Commonwealth and the Oversight Board did not agree on final fiscal plans, and on April 18 and April 19, 2018, the Oversight Board released its own versions of fiscal plans for the Commonwealth, PRHTA, PREPA and PRASA, which it certified on April 19 or 20, 2018.

On May 30, 2018, the Oversight Board certified a revised version of the fiscal plan for the Commonwealth as developed by the Oversight Board. The revised certified Commonwealth fiscal plan (which the Company believes covers its

general obligations as well as obligations of certain of its other authorities and public corporations) indicates a primary budget surplus of \$6.1 billion that would be available for debt service over the six-year forecast period (as compared to contractual debt service of approximately \$15.5 billion over the same period). The certified PRHTA fiscal plan projects very limited capacity to pay debt service over the six-year forecast period, as the Commonwealth anticipates continuing to retain approximately three-fourths of PRHTA's total revenues. The certified PREPA fiscal plan indicates that no funds will be available for legacy debt service payments over the six-year forecast period unless rates are adjusted. Additionally, the current governor of Puerto Rico (Governor) has announced an intention to privatize PREPA. The certified PRASA fiscal plan projects cash flows available for debt service to equal approximately 56% of aggregate debt service during the six-year projection period, based on projection assumptions (including receipt of certain federal funding). The Company does not believe the certified fiscal plans for the Commonwealth, PRHTA, PREPA or PRASA comply with certain mandatory requirements of PROMESA.

On June 7, 2018, the court-appointed agents for COFINA and the Commonwealth filed with the U.S. District Court for Puerto Rico an agreement in principle to resolve a dispute between the Commonwealth and COFINA regarding ownership of the 5.5% Sales and Use Taxes (SUT). The agreement in principle, which requires, among other things, that future challenges to it be barred by the court or made illegal, provides that, beginning July 1, SUT would be paid first to COFINA until it has received 53.65% of the pledged sales tax base amount (PTSBA) and that the remaining 46.35% of the PTSBA would be paid to the Commonwealth thereafter. The agreement in principle does not address the proportion of the amount to be paid to COFINA that would be paid to the senior versus the junior creditors, nor does it address the restructuring of COFINA. Additionally, it does not address whether the Commonwealth's portion of the proceeds will be used for debt service payments on the Commonwealth's General Obligation and Puerto Rico Public Buildings Authority bonds.

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.

Litigation and mediation related to the Commonwealth's debt have been delayed by Hurricane Maria. 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. Prior to the enactment of PROMESA, the Company sued various Puerto Rico governmental officials in the United States District Court, District of Puerto Rico asserting that Puerto Rico's attempt to "claw back" pledged taxes is unconstitutional, and demanding declaratory and injunctive relief. See "Puerto Rico Recovery Litigation" below.
- *Other Public Corporations.* The Company includes in this category the debt of public corporations that are supported by revenues it does not believe are subject to clawback.

Constitutionally Guaranteed

General Obligation. As of March 31, 2018, the Company had \$670 million insured net par outstanding of the general obligations of Puerto Rico, which are supported by the good faith, credit and taxing power of the Commonwealth. Despite the requirements of Article VI of its Constitution, the Commonwealth defaulted on the debt service payment due on July 1, 2016, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to the Commonwealth.

Puerto Rico Public Buildings Authority (PBA). As of March 31, 2018, the Company had \$9 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 March 31, 2018, the Company had \$252 million insured net par outstanding of PRHTA (transportation revenue) bonds and \$358 million insured net par of PRHTA (highways revenue) bonds. The transportation revenue bonds are secured by a subordinate gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to \$120 million annually of taxes on crude oil, unfinished oil and derivative products. The highways revenue bonds are secured by a gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The non-toll revenues consisting of excise taxes and fees collected by the Commonwealth on behalf of PRHTA and its bondholders that are statutorily allocated to PRHTA and its bondholders are potentially subject to clawback. Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments on these bonds since that date. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to PRHTA.

Other Public Corporations

PREPA. As of March 31, 2018, the Company had \$547 million insured net par outstanding of PREPA obligations, which are secured by a lien on the revenues of the electric system.

On December 24, 2015, AGM and AGC entered into a Restructuring Support Agreement (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 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. The Company has been making claim payments on these bonds since July 1, 2017.

MFA. As of March 31, 2018, the Company had \$221 million net par outstanding of bonds issued by MFA secured by a lien on local property tax revenues. The MFA bond accounts contained sufficient funds to make the MFA bond payments due through the date of this filing that were guaranteed by the Company, and those payments were made in full.

COFINA. As of March 31, 2018, the Company had \$264 million insured net par outstanding of junior COFINA bonds, which are secured primarily by a second lien on certain sales and use taxes. As noted above, the Oversight Board filed a petition on behalf of COFINA under Title III of PROMESA. COFINA bond debt service payments were not made on August 1, 2017, and the Company made its first claim payments on these bonds. The Company has continued to make claim payments on these bonds. Also as noted above, court-appointed agents have come to an agreement in principle regarding ownership of the sales and use taxes securing COFINA bonds.

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 U.S. District Court for the District of Puerto Rico (Federal District Court in 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, Puerto Rico Convention Center District Authority and Puerto Rico Infrastructure Financing Authority. The Commonwealth defendants filed a motion to dismiss the action for lack of subject matter jurisdiction, which the Court denied on October 4, 2016. On October 14, 2016, the Commonwealth

defendants filed a notice of PROMESA automatic stay. While the PROMESA automatic stay expired on May 1, 2017, on May 17, 2017, the Court stayed the action under Title III of PROMESA.

On May 16, 2017, The Bank of New York Mellon, as trustee for the bonds issued by COFINA, filed an adversary complaint for interpleader and declaratory relief with the Federal District Court in Puerto Rico to resolve competing and conflicting demands made by various groups of COFINA bondholders, insurers of certain COFINA Bonds and COFINA, regarding funds held by the trustee for certain COFINA bond debt service payments scheduled to occur on and after June 1, 2017. On May 19, 2017, an order to show cause was entered permitting AGM to intervene in this matter.

On June 3, 2017, AGM and AGC filed an adversary complaint in Federal District Court in 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 district court rendered an opinion dismissing the complaint and holding, among other things, that (i) even though the special revenue provisions of the Bankruptcy Code protect a lien on pledged special revenues, those provisions do not mandate the turnover of pledged special revenues to the payment of bonds and (ii) actions to enforce liens on pledged special revenues remain stayed. On February 9, 2018, AGC and AGM filed a notice of appeal of the district court's decision to the United States Court of Appeals for the First Circuit.

On June 26, 2017, AGM and AGC filed a complaint in Federal District Court in 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 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. That motion was denied on September 14, 2017. AGM and AGC are appealing the trial court's decision with the United States Court of Appeals for the First Circuit.

On May 23, 2018, AGM and AGC filed an adversary complaint in Federal District Court in 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.

Puerto Rico Par and Debt Service Schedules

All Puerto Rico exposures are internally rated BIG, except the General Obligation, PBA and PRHTA (Transportation revenue) second-to-pay policies on an affiliate exposure which are rated AA based on the obligation of the Company's affiliate to pay under its insurance policy if the obligor fails to pay. 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	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
	(in millions)			
Exposure to Puerto Rico	\$ 3,369	\$ 3,368	\$ 5,236	\$ 5,318

Puerto Rico
Net Par Outstanding

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Commonwealth Constitutionally Guaranteed		
Commonwealth of Puerto Rico - General Obligation Bonds (1)	\$ 669	\$ 669
Commonwealth of Puerto Rico - General Obligation Bonds (Second-to-pay policy on affiliate exposure)	1	1
Commonwealth of Puerto Rico - General Obligation Bonds total	670	670
PBA (Second-to-pay policies on affiliate exposure)	9	9
Public Corporations - Certain Revenues Potentially Subject to Clawback		
PRHTA (Transportation revenue) (1)	167	167
PRHTA (Transportation revenue) (Second-to-pay policies on affiliate exposure)	85	85
PRHTA (Transportation revenue) total	252	252
PRHTA (Highways revenue) (1)	358	358
Other Public Corporations		
PREPA (1)	547	547
COFINA (1)	264	263
MFA	221	221
Total net exposure to Puerto Rico	\$ 2,321	\$ 2,320

(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 rated BIG by the Company. The Company guarantees payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. In the event that obligors default on their obligations, the Company would only 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 BIG Net Par Outstanding
and Net Debt Service Outstanding
As of March 31, 2018**

	Scheduled BIG Net Par Amortization	Scheduled BIG Net Debt Service Amortization
	(in millions)	
2018 (April 1 - June 30)	\$ 0	\$ 2
2018 (July 1 - September 30)	77	131
2018 (October 1 - December 31)	0	2
Subtotal 2018	77	135
2019	107	215
2020	111	214
2021	69	167
2022	69	164
2023-2027	634	1,017
2028-2032	426	682
2033-2037	481	612
2038-2043	252	307
Total	\$ 2,226	\$ 3,513

Exposure to the U.S. Virgin Islands

As of March 31, 2018, the Company had \$331 million insured net par outstanding to the U.S. Virgin Islands and its related authorities (USVI), of which it rated \$148 million BIG. The \$183 million USVI net par the Company rated investment grade was comprised primarily of bonds secured by a lien on matching fund revenues related to excise taxes on products produced in the USVI and exported to the U.S., primarily rum. The \$148 million BIG USVI net par comprised (a) Public Finance Authority bonds secured by a gross receipts tax and the general obligation, full faith and credit pledge of the USVI and (b) bonds of the Virgin Islands Water and Power Authority secured by a net revenue pledge of the electric system.

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

5. Expected Loss to be Paid

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

Loss Estimation Process

The Company's loss reserve committees estimate expected loss to be paid for all contracts by reviewing analyses that consider various scenarios with corresponding probabilities assigned to them. Depending upon the nature of the risk, the Company's view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments, sector-driven loss severity assumptions and/or judgmental assessments. The Company monitors the performance of its transactions with expected losses and each quarter

the Company's loss reserve committees review and refresh their loss projection assumptions, scenarios and the probabilities they assign to those scenarios based on actual developments during the quarter and their view of future performance.

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

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

The Company does not use traditional actuarial approaches to determine its estimates of expected losses. Actual losses will ultimately depend on future events or transaction performance and may be influenced by many interrelated factors that are difficult to predict. As a result, the Company's current projections of losses may be subject to considerable volatility and may not reflect the Company's ultimate claims paid. For information on the Company's loss estimation process, see Note 5, Expected Loss to be Paid, of the annual combined financial statements of AGM for the year ended December 31, 2017 included in Exhibit 99.1 in AGL's Form 8-K dated March 20, 2018, filed with the SEC.

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

The following tables present a roll forward of net expected loss to be paid for all contracts. The Company used risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 3.11% with a weighted average of 2.82% as of March 31, 2018 and 0.0% to 2.78% with a weighted average of 2.40% as of December 31, 2017. Expected losses to be paid for transactions denominated in currencies other than the U.S. dollar represented approximately 5.5% and 5.5% of the total as of March 31, 2018 and December 31, 2017, respectively.

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

	First Quarter	
	2018	2017
	(in millions)	
Net expected loss to be paid, beginning of period	\$ 696	\$ 521
Net expected loss to be paid on the AGLN portfolio as of January 10, 2017	—	21
Economic loss development (benefit) due to:		
Accretion of discount	4	3
Changes in discount rates	(4)	4
Changes in timing and assumptions	(9)	(6)
Total economic loss development (benefit)	(9)	1
Net (paid) recovered losses	(40)	12
Net expected loss to be paid, end of period	<u>\$ 647</u>	<u>\$ 555</u>

**Net Expected Loss to be Paid
Roll Forward by Sector
First Quarter 2018**

	Net Expected Loss to be Paid (Recovered) as of December 31, 2017 (2)	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of March 31, 2018 (2)
		(in millions)		
Public finance:				
U.S. public finance	\$ 482	\$ (22)	\$ (52)	\$ 408
Non-U.S. public finance	36	(2)	0	34
Public finance	518	(24)	(52)	442
Structured finance:				
U.S. RMBS	163	17	12	192
Other structured finance	15	(2)	0	13
Structured finance	178	15	12	205
Total	\$ 696	\$ (9)	\$ (40)	\$ 647

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

	Net Expected Loss to be Paid (Recovered) as of December 31, 2016	Net Expected Loss to be Paid on AGLN as of January 10, 2017	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of March 31, 2017
	(in millions)				
Public finance:					
U.S. public finance	\$ 323	\$ —	\$ 30	\$ 0	\$ 353
Non-U.S. public finance	22	13	(3)	—	32
Public finance	345	13	27	0	385
Structured finance:					
U.S. RMBS	147	—	(12)	12	147
Other structured finance	29	8	(14)	0	23
Structured finance	176	8	(26)	12	170
Total	\$ 521	\$ 21	\$ 1	\$ 12	\$ 555

(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 \$2 million and \$1 million in loss adjustment expenses (LAE) for First Quarter 2018 and 2017, respectively.

(2) Includes expected LAE to be paid of \$7 million as of March 31, 2018 and \$9 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 March 31, 2018	As of December 31, 2017	First Quarter 2018	First Quarter 2017
	(in millions)			
Financial guaranty insurance	\$ 567	\$ 618	\$ (12)	\$ 12
FG VIEs (1)	80	78	3	(3)
Credit derivatives (2)	—	—	—	(8)
Total	<u>\$ 647</u>	<u>\$ 696</u>	<u>\$ (9)</u>	<u>\$ 1</u>

(1) See Note 9, Consolidated 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 \$2.3 billion net par as of March 31, 2018, \$2.2 billion of which was BIG. For additional information regarding the Company's exposure to general obligations of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, see "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

As of March 31, 2018, the Company had insured \$209 million net par outstanding of general obligation bonds issued by the City of Hartford, Connecticut, most of which was rated BIG at December 31, 2017. In First Quarter 2018, the State of Connecticut entered into a contract assistance agreement with the City of Hartford under which the state will pay the debt service costs of the City's general obligation bonds, including those insured by the Company. As a result, the Company reduced the corresponding expected losses as of March 31, 2018 and upgraded this exposure to investment grade.

On February 25, 2015, a plan of adjustment resolving the bankruptcy filing of the City of Stockton, California under chapter 9 of the U.S. Bankruptcy Code became effective. As of March 31, 2018, the Company's net par subject to the plan consisted of \$61 million of pension obligation bonds. As part of the plan of adjustment, the City will repay any claims paid on the pension obligation bonds from certain fixed payments and certain variable payments contingent on the City's revenue growth.

The Company projected that its total net expected loss across its troubled U.S. public finance exposures as of March 31, 2018, including those mentioned above, would be \$408 million, compared with a net expected loss of \$482 million as of December 31, 2017. The economic benefit in First Quarter 2018 was \$22 million, which was primarily attributable to the State of Connecticut's agreement to pay the debt service costs of certain bonds of the City of Hartford, including the bonds insured by the Company.

Selected Non - U.S. Public Finance Transactions

The Company insures and reinsures transactions with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the sub-sovereigns also to default. The Company's exposure net of reinsurance to these Spanish and Portuguese exposures is \$384 million and \$71 million, respectively. The Company rates all of these exposures BIG due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities. The Company's exposure net of reinsurance to these Hungarian exposures is \$161 million, all of which is rated BIG.

The Company also insures an obligation backed by the availability and toll revenues of a major arterial road into a city in the U.K. with \$222 million of net par outstanding as of March 31, 2018. This transaction has been underperforming due to higher costs compared with expectations at underwriting. In First Quarter 2018, the Company changed its traffic assumptions for this road, resulting in a benefit.

These transactions, together with other non-U.S. public finance insured obligations, had expected loss to be paid of \$34 million as of March 31, 2018, compared with \$36 million as of December 31, 2017. The economic benefit of approximately \$2 million during First Quarter 2018 was attributable mainly to the U.K. arterial road mentioned above.

Approach to Projecting Losses in U.S. RMBS

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

U.S. RMBS Loss Projections

Based on its observation during the period of the performance of its insured transactions (including delinquencies, liquidation rates and loss severities) as well as the residential property market and economy in general, the Company chose to make the changes to the assumptions it uses to project RMBS losses shown in the tables of assumptions in the sections below. In First Quarter 2018, the economic loss development was \$22 million for first lien U.S. RMBS and the economic benefit was \$5 million for second lien U.S. RMBS. In First Quarter 2017 the economic benefit was \$4 million for first lien U.S. RMBS and the economic benefit was \$8 million for second lien U.S. RMBS.

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

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

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

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

In the most heavily weighted scenario (the base case), after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 5.25 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 have reached historically high levels, and the Company is assuming in the base case that these high 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 direct vintage 2004 - 2008 first lien U.S. RMBS.

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

	As of March 31, 2018		As of December 31, 2017	
	Range	Weighted Average	Range	Weighted Average
Alt-A First Lien				
Plateau CDR	3.0% - 9.0%	5.0%	3.1% - 9.8%	5.5%
Final CDR	0.2% - 0.5%	0.2%	0.2% - 0.5%	0.3%
Initial loss severity:				
2005 and prior	60%		60%	
2006	80%		80%	
2007+	70%		70%	
Option ARM				
Plateau CDR	3.1% - 7.8%	6.1%	3.4% - 7.0%	6.0%
Final CDR	0.2% - 0.4%	0.3%	0.2% - 0.3%	0.3%
Initial loss severity:				
2005 and prior	60%		60%	
2006	70%		70%	
2007+	75%		75%	
Subprime				
Plateau CDR	4.3% - 11.2%	7.7%	4.3% - 11.5%	7.8%
Final CDR	0.2% - 0.6%	0.4%	0.2% - 0.6%	0.4%
Initial loss severity:				
2005 and prior	80%		80%	
2006	85%		90%	
2007+	95%		95%	

The rate at which the principal amount of loans is voluntarily prepaid may impact both the amount of losses projected (since that amount is a function of the CDR, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the voluntary conditional prepayment rate (CPR) follows a similar pattern to that of the CDR. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be 15% in the base case. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant and the final CPR is not used. These CPR assumptions are the same as those the Company used for 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 March 31, 2018.

Total expected loss to be paid on all first lien U.S. RMBS was \$133 million and \$109 million as of March 31, 2018 and December 31, 2017, respectively. The Company used a similar approach to establish its pessimistic and optimistic scenarios as of March 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 \$51 million for all first lien U.S. RMBS transactions.

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

U.S. Second Lien RMBS Loss Projections

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

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

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

Most of the HELOC loans underlying the Company's insured HELOC transactions are now past their interest-only reset date, although a significant number of HELOC loans were modified to extend the 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 third quarter 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 March 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.

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 possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company used five scenarios at March 31, 2018 and December 31, 2017. 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 \$59 million and \$54 million as of March 31, 2018 and December 31, 2017, respectively.

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 direct vintage 2004 - 2008 HELOCs.

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

	As of March 31, 2018		As of December 31, 2017	
	Range	Weighted Average	Range	Weighted Average
Plateau CDR	2.5% - 18.4%	10.6%	2.7% - 19.9%	11.4%
Final CDR trended down to	2.5% - 3.2%	2.5%	2.5% - 3.2%	2.5%
Liquidation rates:				
Delinquent/Modified in the Previous 12 Months	20%		20%	
30 - 59 Days Delinquent	40		45	
60 - 89 Days Delinquent	60		60	
90+ Days Delinquent	75		75	
Bankruptcy	55		55	
Foreclosure	65		70	
Real Estate Owned	100		100	
Loss severity	98%		98%	

The Company's base case assumed a six month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults. Increasing the CDR plateau to eight months and increasing the ramp-down by three months to 31-months (for a total stress period of 39 months) would increase the expected loss by approximately \$8 million for HELOC transactions. On the other hand, reducing the CDR plateau to four months and decreasing the length of the CDR ramp-down to 25 months (for a total stress period of 29 months), and lowering the ultimate prepayment rate to 10% would decrease the expected loss by approximately \$8 million for HELOC transactions.

Breaches of Representations and Warranties

As of March 31, 2018, the Company had a net R&W payable of \$13 million to R&W counterparties, compared to an R&W payable of \$25 million as of December 31, 2017.

Other Structured Finance

The Company's other structured finance sector has BIG net par of \$164 million, comprising transactions backed by manufactured housing loans, international RMBS and perpetual repackagings and triple-X life insurance transactions. The amounts initially raised by the sale of the notes insured by the Company in triple-X life insurance transactions were used to capitalize special purpose vehicles that provide life reinsurance; the special purpose vehicles' funds were invested in accounts

managed by third-party investment managers. The economic benefit during First Quarter 2018 was \$2 million, which was attributable primarily to increased expected payouts from the primary insurer of a second-to-pay policy.

Recovery Litigation

In the ordinary course of their respective businesses, 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.

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 to insurance contracts. See Note 8, Contracts Accounted for as Credit Derivatives for amounts that relate to CDS and Note 9, Consolidated Variable Interest Entities for amounts that relate to FG VIEs.

Net Earned Premiums

	First Quarter	
	2018	2017
	(in millions)	
Scheduled net earned premiums	\$ 54	\$ 57
Accelerations:		
Refundings	14	18
Terminations	6	1
Total Accelerations	20	19
Accretion of discount on net premiums receivable	2	2
Net earned premiums (1)	\$ 76	\$ 78

(1) Excluded \$3 million and \$4 million for First Quarter 2018 and 2017, respectively, related to consolidated FG VIEs.

**Gross Premium Receivable
Roll Forward**

	First Quarter	
	2018	2017
	(in millions)	
December 31,	\$ 730	\$ 358
Premiums receivable from acquisitions	—	274
Gross written premiums (2)	74	110
Gross premiums received	(57)	(86)
Adjustments:		
Changes in the expected term	(1)	0
Accretion of discount	(5)	3
Foreign exchange translation	24	9
March 31, (1)	<u>\$ 765</u>	<u>\$ 668</u>

- (1) Excluded \$4 million and \$4 million as of March 31, 2018 and March 31, 2017, respectively, related to consolidated FG VIEs.
- (2) For transactions where the Company replaces a previous financial guaranty contract of the Company, gross premiums written represents only the incremental gross premium written in excess of the original gross premiums written.

Foreign exchange translation relates to installment premiums receivable denominated in currencies other than the U.S. dollar. Approximately 90%, 89% and 88% of installment premiums at March 31, 2018, December 31, 2017 and March 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 tables below due to factors such as foreign exchange rate fluctuations, counterparty collectability issues, accelerations, commutations and changes in expected lives.

**Expected Collections of
Financial Guaranty Insurance Gross Premiums Receivable
(Undiscounted)**

	As of March 31, 2018 (in millions)
2018 (April 1 - June 30)	\$ 30
2018 (July 1 - September 30)	23
2018 (October 1 - December 31)	13
2019	66
2020	79
2021	62
2022	56
2023-2027	240
2028-2032	165
2033-2037	87
After 2037	95
Total (1)	<u>\$ 916</u>

- (1) Excluded expected cash collections on consolidated FG VIEs of \$5 million.

Scheduled Financial Guaranty Insurance Net Earned Premiums

	As of March 31, 2018
	(in millions)
2018 (April 1 - June 30)	\$ 53
2018 (July 1 - September 30)	51
2018 (October 1 - December 31)	49
Subtotal 2018	153
2019	176
2020	161
2021	145
2022	133
2023-2027	516
2028-2032	333
2033-2037	199
After 2037	175
Net deferred premium revenue(1)	1,991
Future accretion	106
Total future net earned premiums	\$ 2,097

(1) Excluded scheduled net earned premiums on consolidated FG VIEs of \$66 million.

Selected Information for Financial Guaranty Insurance Policies Paid in Installments

	As of March 31, 2018	As of December 31, 2017
	(dollars in millions)	
Premiums receivable	\$ 765	\$ 730
Gross deferred premium revenue	983	994
Weighted-average risk-free rate used to discount premiums	2.2%	2.3%
Weighted-average period of premiums receivable (in years)	9.5	9.6

Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides information on net reserve (salvage), comprised of loss and LAE reserves and salvage and subrogation recoverable, both net of reinsurance. The Company used risk-free rates for U.S. dollar denominated financial guaranty insurance obligations that ranged from 0.0% to 3.11% with a weighted average of 2.82% as of March 31, 2018 and 0.0% to 2.78% with a weighted average of 2.40% as of December 31, 2017.

Net Reserve (Salvage)

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Public finance:		
U.S. public finance	\$ 373	\$ 447
Non-U.S. public finance	15	15
Public finance	388	462
Structured finance:		
U.S. RMBS	79	53
Other structured finance	9	10
Structured finance	88	63
Subtotal	476	525
Elimination of losses attributable to FG VIEs	(53)	(47)
Total	\$ 423	\$ 478

Components of Net Reserves (Salvage)

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Loss and LAE reserve	\$ 822	\$ 931
Reinsurance recoverable on unpaid losses	(191)	(227)
Loss and LAE reserve, net	631	704
Salvage and subrogation recoverable	(275)	(297)
Salvage and subrogation payable(1)	67	71
Salvage and subrogation recoverable, net	(208)	(226)
Net reserves (salvage)	\$ 423	\$ 478

(1) Recorded as a component of reinsurance balances payable.

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 March 31, 2018 (in millions)
Net expected loss to be paid - financial guaranty insurance (1)	\$ 567
Contra-paid, net	33
Salvage and subrogation recoverable, net of reinsurance	208
Loss and LAE reserve, net of reinsurance	(631)
Net expected loss to be expensed (present value) (2)	<u>\$ 177</u>

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

(2) Excluded \$44 million as of March 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 March 31, 2018 (in millions)
2018 (April 1 - June 30)	\$ 4
2018 (July 1 - September 30)	5
2018 (October 1 - December 31)	5
Subtotal 2018	14
2019	23
2020	19
2021	16
2022	13
2023-2027	52
2028-2032	24
2033-2037	13
After 2037	3
Net expected loss to be expensed	177
Future accretion	38
Total expected future loss and LAE	<u>\$ 215</u>

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

**Loss and LAE
Reported on the
Condensed Combined Statements of Operations**

	Loss (Benefit)	
	First Quarter	
	2018	2017
	(in millions)	
Public finance:		
U.S. public finance	\$ (22)	\$ 40
Non-U.S. public finance	(1)	0
Public finance	(23)	40
Structured finance:		
U.S. RMBS	23	(13)
Other structured finance	(1)	(9)
Structured finance	22	(22)
Loss and LAE on insurance contracts before FG VIE consolidation	(1)	18
Gain (loss) related to FG VIE consolidation	(7)	(2)
Loss and LAE	<u>\$ (8)</u>	<u>\$ 16</u>

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

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

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	65	(53)	5	(4)	53	(51)	123	—	123
Remaining weighted-average contract period (in years)	8.9	7.4	4.9	3.2	9.6	10.1	9.1	—	9.1
Outstanding exposure:									
Principal	\$ 3,356	\$ (714)	\$ 436	\$ (54)	\$ 4,742	\$ (1,120)	\$ 6,646	\$ —	\$ 6,646
Interest	1,679	(277)	126	(9)	2,300	(538)	3,281	—	3,281
Total(2)	<u>\$ 5,035</u>	<u>\$ (991)</u>	<u>\$ 562</u>	<u>\$ (63)</u>	<u>\$ 7,042</u>	<u>\$ (1,658)</u>	<u>\$ 9,927</u>	<u>\$ —</u>	<u>\$ 9,927</u>
Expected cash outflows (inflows)	\$ 87	\$ (20)	\$ 74	\$ (7)	\$ 2,640	\$ (569)	\$ 2,205	\$ (261)	\$ 1,944
Potential recoveries (3)	(245)	34	(37)	1	(1,709)	457	(1,499)	160	(1,339)
Subtotal	(158)	14	37	(6)	931	(112)	706	(101)	605
Discount	43	(8)	(3)	0	(53)	(38)	(59)	21	(38)
Present value of expected cash flows	<u>\$ (115)</u>	<u>\$ 6</u>	<u>\$ 34</u>	<u>\$ (6)</u>	<u>\$ 878</u>	<u>\$ (150)</u>	<u>\$ 647</u>	<u>\$ (80)</u>	<u>\$ 567</u>
Deferred premium revenue	\$ 67	\$ (15)	\$ 77	\$ (3)	\$ 280	\$ (31)	\$ 375	\$ (67)	\$ 308
Reserves (salvage)	\$ (139)	\$ 11	\$ 15	\$ (5)	\$ 724	\$ (130)	\$ 476	\$ (53)	\$ 423

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

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	65	(54)	7	(6)	51	(49)	123	—	123
Remaining weighted-average contract period (in years)	9.1	8.0	11.6	5.0	9.0	10.2	9.3	—	9.3
Outstanding exposure:									
Principal	\$ 3,712	\$ (867)	\$ 751	\$ (65)	\$ 4,517	\$ (1,139)	\$ 6,909	\$ —	\$ 6,909
Interest	1,860	(351)	481	(24)	2,027	(544)	3,449	—	3,449
Total(2)	<u>\$ 5,572</u>	<u>\$ (1,218)</u>	<u>\$ 1,232</u>	<u>\$ (89)</u>	<u>\$ 6,544</u>	<u>\$ (1,683)</u>	<u>\$ 10,358</u>	<u>\$ —</u>	<u>\$ 10,358</u>
Expected cash outflows (inflows)	\$ 140	\$ (42)	\$ 325	\$ (16)	\$ 2,451	\$ (591)	\$ 2,267	\$ (258)	\$ 2,009
Potential recoveries (3)	(255)	36	(64)	1	(1,692)	462	(1,512)	161	(1,351)
Subtotal	(115)	(6)	261	(15)	759	(129)	755	(97)	658
Discount	30	(3)	(73)	3	20	(36)	(59)	19	(40)
Present value of expected cash flows	<u>\$ (85)</u>	<u>\$ (9)</u>	<u>\$ 188</u>	<u>\$ (12)</u>	<u>\$ 779</u>	<u>\$ (165)</u>	<u>\$ 696</u>	<u>\$ (78)</u>	<u>\$ 618</u>
Deferred premium revenue	\$ 73	\$ (15)	\$ 88	\$ (4)	\$ 283	\$ (35)	\$ 390	\$ (69)	\$ 321
Reserves (salvage)	\$ (110)	\$ (3)	\$ 160	\$ (10)	\$ 631	\$ (143)	\$ 525	\$ (47)	\$ 478

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

Ratings Impact on Financial Guaranty Business

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

Since the filing with the SEC of the annual combined financial statements of AGM for the year ended December 31, 2017, there have been no material changes to (i) the Company's potential termination payments under interest rate swaps, (ii) the variable rate demand obligations exposure, and (iii) the potential payment obligations under guaranteed investment contracts and availability of sufficient eligible and liquid assets to AGMH's former subsidiary FSA Asset Management LLC to satisfy any expected withdrawal and collateral posting obligations. See Note 6, Contracts Accounted for as Insurance, in the annual combined financial statements of AGM included in Exhibit 99.1 in AGL's Form 8-K dated March 20, 2018, filed with the SEC for additional information.

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 First Quarter 2018, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's condensed combined balance sheets or statements of operations and comprehensive income.

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

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

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

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

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

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1, Level 2 and Level 3.

Measured and Carried at Fair Value

Fixed-Maturity Securities and Short-Term Investments

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

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

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

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

The Company, on a quarterly basis:

- reviews methodologies for Level 3 securities, any model updates and inputs for Level 3 securities, and compares such information to management's own market information and, where applicable, the internal models,
- reviews internally developed analytic packages for all securities that highlight, at a CUSIP level, price changes from the previous quarter to the current quarter, and evaluates, documents, and resolves any significant pricing differences with the assistance of the third party pricing source, and
- compares prices received from different third party pricing sources for Level 3, and evaluates, documents the rationale for, and resolves any significant pricing differences for Level 3.

As of March 31, 2018, the Company used models to price 43 securities (primarily securities that were purchased or obtained for loss mitigation or other risk management purposes), which were 9% or \$523 million of the Company's fixed-maturity securities and short-term investments at fair value. Most Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price appreciation/depreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

As of March 31, 2018 and December 31, 2017, other invested assets included investments carried and measured at fair value on a recurring basis of \$43 million and \$47 million, respectively, and included primarily preferred stock investments in the global property catastrophe risk market and in a fund that invested primarily in senior loans and bonds. Fair values for the preferred stock investments are based on their respective net asset value (NAV) per share or equivalent and are classified as Level 2.

Other Assets

Committed Capital Securities (CCS)

The fair value of AGM Committed Preferred Trust Securities (the AGM CPS), which is recorded in "other assets" on the condensed combined balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGM CPS agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 15, Credit Facilities). The AGM CPS are carried at fair value with changes in fair value recorded in other income in the condensed combined statement of operations. The estimated current cost of the AGM CPS is based on several factors, including AGM 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 consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The following is a description of the fair value methodology applied to the Company's insured CDS that are accounted for as credit derivatives, which constitute the vast majority of the net credit derivative liability in the condensed combined balance sheets. The Company did not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate such contracts; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. In transactions where the counterparty does not have the right to terminate, such transactions are generally terminated for an amount that approximates the present value of future premiums or for a negotiated amount, rather than at fair value.

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

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

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay at the reporting date for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual premium cash flows are the most readily observable inputs since they are based on the CDS contractual terms. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. Consistent with previous years, market conditions at March 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.

The following spread hierarchy is utilized in determining which source of gross spread to use. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company

compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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

The rates used to discount future expected premium cash flows ranged from 2.43% to 2.72% at March 31, 2018 and 1.97% to 2.29% at December 31, 2017.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed to the daily closing price of the market index related to the specific asset class and rating of the transaction. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on a similar transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transaction's current spread.

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

In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 1% based on fair value, of the Company's CDS contracts were fair valued using this minimum premium as of March 31, 2018 and December 31, 2017. The percentage of transactions that price using the minimum premiums fluctuates due to changes in AGM's credit spreads. In general when AGM's credit spreads narrow, the cost to hedge AGM's name declines and more transactions price above previously established floor levels. Meanwhile, when AGM's credit spreads widen, the cost to hedge AGM'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 AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGM's own credit spread has resulted in the bank or transaction originator hedging a significant portion of its exposure to AGM. This reduces the amount of contractual cash flows AGM can capture as premium for selling its protection.

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads assuming all other assumptions remain constant. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to

the fact that the contractual terms of the Company's contracts typically do not require the posting of collateral by the guarantor. The extent of the hedge depends on the types of instruments insured and the current market conditions.

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

Strengths and Weaknesses of Model

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

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

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

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

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

Fair Value Option on FG VIEs' Assets and Liabilities

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

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

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

Not Carried at Fair Value

The following financial instruments are not carried at fair value:

- Certain investments within Other Invested Assets:
 - Surplus Note issued by AGC to AGM (classified as Level 3 for fair value disclosure).
 - As of March 31, 2018, Other Invested Assets included equity securities of \$24 million that are accounted for under the equity method.
- Other Assets and Other Liabilities, which consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.
- Financial Guaranty Insurance Contracts (classified as Level 3 for fair value disclosure).
- Notes Payable, which are included in other liabilities (classified as Level 3 for fair value disclosure).

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value As of March 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	\$ 3,464	\$ —	\$ 3,440	\$ 24
U.S. government and agencies	25	—	25	—
Corporate securities	939	—	877	62
Mortgage-backed securities:				
RMBS	371	—	82	289
Commercial mortgage-backed securities (CMBS)	278	—	278	—
Asset-backed securities	156	—	8	148
Non-U.S. government securities	326	—	326	—
Total fixed-maturity securities	5,559	—	5,036	523
Short-term investments	274	146	128	—
Other invested assets (2)	5	—	—	5
FG VIEs' assets, at fair value (3)	534	—	—	534
Other assets (3)	30	—	—	30
Total assets carried at fair value	\$ 6,402	\$ 146	\$ 5,164	\$ 1,092
Liabilities:				
FG VIEs' liabilities with recourse, at fair value (4)	\$ 473	—	—	\$ 473
FG VIEs' liabilities without recourse, at fair value (3)	108	—	—	108
Other liabilities (3)	49	—	—	49
Total liabilities carried at fair value	\$ 630	\$ —	\$ —	\$ 630

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	\$ 3,615	\$ —	\$ 3,594	\$ 21
U.S. government and agencies	25	—	25	—
Corporate securities	941	—	874	67
Mortgage-backed securities:				
RMBS	374	—	74	300
CMBS	257	—	257	—
Asset-backed securities	142	—	4	138
Non-U.S. government securities	305	—	305	—
Total fixed-maturity securities	5,659	—	5,133	526
Short-term investments	364	220	144	—
Other invested assets (2)	6	—	—	6
FG VIEs' assets, at fair value (3)	577	—	—	577
Other assets (3)	30	—	—	30
Total assets carried at fair value	\$ 6,636	\$ 220	\$ 5,277	\$ 1,139
Liabilities:				
FG VIEs' liabilities with recourse, at fair value (3)	\$ 495	\$ —	\$ —	\$ 495
FG VIEs' liabilities without recourse, at fair value (3)	128	—	—	128
Other liabilities (3)	49	—	—	49
Total liabilities carried at fair value	\$ 672	\$ —	\$ —	\$ 672

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

(2) Excludes investments of \$42 million and \$45 million as of March 31, 2018 and December 31, 2017, respectively, measured using NAV per share with fair value recorded in the condensed combined statement of operations. Includes Level 3 mortgage loans that are recorded at fair value on a non-recurring basis.

(3) Change in fair value is included in net income.

(4) Change in fair value attributable to ISCR is recorded in OCI with remainder of fair value recorded in net income.

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 First Quarter 2018 and 2017.

Fair Value Level 3 Rollforward Recurring Basis First Quarter 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	Corporate Securities	RMBS	Asset-Backed Securities					
					(in millions)				
Fair value as of December 31, 2017	\$ 21	\$ 67	\$ 300	\$ 138	\$ 577	\$ 31	\$ (48)	\$ (495)	\$ (128)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	1 (2)	(5) (2)	6 (2)	1 (2)	0 (3)	(1) (4)	(1) (6)	0 (3)	1 (3)
Other comprehensive income (loss)	3	0	(6)	0	—	0	—	(2)	—
Purchases	—	—	—	9	—	—	—	—	—
Settlements	(1)	—	(11)	0	(26)	—	1	23	3
FG VIE deconsolidations	—	—	—	—	(17)	—	—	1	16
Fair value as of March 31, 2018	<u>\$ 24</u>	<u>\$ 62</u>	<u>\$ 289</u>	<u>\$ 148</u>	<u>\$ 534</u>	<u>\$ 30</u>	<u>\$ (48)</u>	<u>\$ (473)</u>	<u>\$ (108)</u>
Change in unrealized gains/(losses) related to financial instruments held as of March 31, 2018	<u>\$ 3</u>	<u>\$ 0</u>	<u>\$ (6)</u>	<u>\$ 1</u>	<u>\$ 2 (3)</u>	<u>\$ (1) (4)</u>	<u>\$ (1) (6)</u>	<u>\$ (2) (3)</u>	<u>\$ 0 (3)</u>

Fair Value Level 3 Rollforward
Recurring Basis
First Quarter 2017

	Fixed-Maturity Securities									
	Obligations of State and Political Subdivisions	Corporate Securities	RMBS	Asset- Backed Securities	FG VIEs' Assets at Fair Value (in millions)	Other (7)	Credit Derivative Asset (Liability), net (5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value	
Fair value as of December 31, 2016	\$ 36	\$ 60	\$ 327	\$ 314	\$ 644	\$ 31	\$ (90)	\$ (602)	\$ (110)	
AGLN Acquisition	—	—	—	7	—	—	—	—	—	
Total pretax realized and unrealized gains/ (losses) recorded in:(1)										
Net income (loss)	1 (2)	2 (2)	(3) (2)	2 (2)	13 (3)	(1) (4)	21 (6)	(6) (3)	(2) (3)	
Other comprehensive income (loss)	4	0	27	6	—	0	—	—	—	
Purchases	—	—	27	—	—	—	—	—	—	
Settlements	(2)	—	(13)	(7)	(33)	—	(13)	33	2	
FG VIE consolidations	—	—	—	—	21	—	—	—	(21)	
Fair value as of March 31, 2017	<u>\$ 39</u>	<u>\$ 62</u>	<u>\$ 365</u>	<u>\$ 322</u>	<u>\$ 645</u>	<u>\$ 30</u>	<u>\$ (82)</u>	<u>\$ (575)</u>	<u>\$ (131)</u>	
Change in unrealized gains/(losses) related to financial instruments held as of March 31, 2017	<u>\$ 4</u>	<u>\$ 0</u>	<u>\$ 26</u>	<u>\$ 6</u>	<u>\$ 17</u> (3)	<u>\$ (1)</u> (4)	<u>\$ 2</u> (6)	<u>\$ (5)</u> (3)	<u>\$ (2)</u> (3)	

- (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 net position of credit derivatives. The condensed combined balance sheet presents gross assets, included in other assets, and gross liabilities, included in other liabilities, based on net counterparty exposure.
- (6) Reported in net change in fair value of credit derivatives.
- (7) Included CCS and other invested assets.

Level 3 Fair Value Disclosures

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

Financial Instrument Description (1)	Fair Value at March 31, 2018 (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	\$ 24	Yield	4.5% - 22.5%	10.2%
Corporate securities	62	Yield	22.8%	
RMBS	289	CPR	3.7% - 13.0%	5.8%
		CDR	3.5% - 8.6%	5.9%
		Loss severity	55.0% - 100.0%	82.5%
		Yield	5.0% - 7.8%	5.7%
Asset-backed securities:				
Triple-X life insurance transactions	59	Yield	6.3% - 6.9%	6.6%
Collateralized loan obligations (CLO)	89	Yield	3.0% - 3.8%	3.6%
FG VIEs' assets, at fair value	534	CPR	1.7% - 17.8%	8.9%
		CDR	1.3% - 21.9%	5.2%
		Loss severity	60.0% - 100.0%	77.3%
		Yield	4.1% - 10.4%	6.6%
Other assets	29	Implied Yield	5.5%	
		Term (years)	10 years	
Liabilities:				
Credit derivative liabilities, net	(48)	Hedge cost (in bps)	5.5 - 40.5	18.4
		Bank profit (in bps)	16.5 - 354.5	74.5
		Internal floor (in bps)	10.0 - 30.0	10.9
		Internal credit rating	AA+ - BBB-	A-
FG VIEs' liabilities, at fair value	(581)	CPR	1.7% - 17.8%	8.9%
		CDR	1.3% - 21.9%	5.2%
		Loss severity	60.0% - 100.0%	77.3%
		Yield	3.7% - 10.4%	5.2%

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

(2) Excluded several investments recorded in other invested assets with fair value of \$5 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	\$ 21	Yield	4.5% - 39.5%	15.7%
Corporate securities	67	Yield	22.5%	
RMBS	300	CPR	3.5% - 13.0%	5.9%
		CDR	3.7% - 9.2%	6.1%
		Loss severity	55.0% - 100.0%	82.4%
		Yield	4.7% - 7.5%	5.4%
Asset-backed securities:				
Triple-X life insurance transactions	58	Yield	6.2% - 6.4%	6.3%
CLO	80	Yield	3.0% - 3.4%	3.2%
FG VIEs' assets, at fair value	577	CPR	3.0% - 14.9%	9.4%
		CDR	1.3% - 21.7%	5.5%
		Loss severity	60.0% - 100.0%	77.2%
		Yield	3.7% - 10.0%	6.2%
Other assets	29	Implied Yield	5.2%	
		Term (years)	10 years	
Liabilities:				
Credit derivative liabilities, net	(48)	Hedge cost (in bps)	20.5 - 61.5	25.5
		Bank profit (in bps)	16.5 - 366.9	90.1
		Internal floor (in bps)	10.0 - 30.0	10.9
		Internal credit rating	AA+ - BBB-	A-
FG VIEs' liabilities, at fair value	(623)	CPR	3.0% - 14.9%	9.4%
		CDR	1.3% - 21.7%	5.5%
		Loss severity	60.0% - 100.0%	77.2%
		Yield	3.4% - 10.0%	4.9%

- (1) Discounted cash flow is used as the primary valuation technique for all financial instruments listed in this table.
- (2) Excluded several investments recorded in other invested assets with fair value of \$6 million.

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

Fair Value of Financial Instruments

	As of March 31, 2018		As of December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Assets:				
Fixed-maturity securities	\$ 5,559	\$ 5,559	\$ 5,659	\$ 5,659
Short-term investments	274	274	364	364
Other invested assets	349	342	354	359
FG VIEs' assets, at fair value	534	534	577	577
Other assets	94	94	89	89
Liabilities:				
Financial guaranty insurance contracts (1)	1,748	2,923	1,861	3,137
FG VIEs' liabilities with recourse, at fair value	473	473	495	495
FG VIEs' liabilities without recourse, at fair value	108	108	128	128
Other liabilities	90	90	55	55

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

8. Contracts Accounted for as Credit Derivatives

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

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

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 6.4 years at March 31, 2018 and 6.7 years at December 31, 2017. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives

Asset Type	As of March 31, 2018		As of December 31, 2017	
	Net Par Outstanding	Net Fair Value	Net Par Outstanding	Net Fair Value
	(in millions)			
Regulated utilities	\$ 183	\$ 0	\$ 177	\$ 0
U.S. RMBS	24	(1)	25	(1)
Other(1)	795	(47)	922	(47)
Total	<u>\$ 1,002</u>	<u>\$ (48)</u>	<u>\$ 1,124</u>	<u>\$ (48)</u>

(1) This comprises numerous transactions across various asset classes, such as commercial receivables, international RMBS, municipal utilities and healthcare.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of March 31, 2018		As of December 31, 2017	
	Net Par Outstanding	% of Total	Net Par Outstanding	% of Total
	(dollars in millions)			
AA	\$ 168	16.8%	\$ 185	16.5%
A	472	47.1	526	46.8
BBB	362	36.1	413	36.7
Credit derivative net par outstanding	<u>\$ 1,002</u>	<u>100.0%</u>	<u>\$ 1,124</u>	<u>100.0%</u>

Fair Value of Credit Derivatives

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

	First Quarter	
	2018	2017
	(in millions)	
Realized gains on credit derivatives	\$ 0	\$ 4
Net credit derivative losses (paid and payable) recovered and recoverable and other settlements	0	10
Realized gains (losses) and other settlements	0	14
Net unrealized gains (losses):		
U.S. RMBS	0	6
Other	(1)	1
Net unrealized gains (losses)	<u>(1)</u>	<u>7</u>
Net change in fair value of credit derivatives	<u>\$ (1)</u>	<u>\$ 21</u>

During First Quarter 2018, unrealized fair value losses were generated primarily as a result of prices widening on the underlying collateral of the Company's CDS related to healthcare and municipal utilities. This was the primary driver of the unrealized fair value losses in the Other sector. The cost to buy protection in AGM's name did not have a material impact on the Company's unrealized fair value gains and losses on CDS during the period.

During First Quarter 2017, unrealized fair value gains were generated primarily as a result of CDS terminations and tighter implied spreads. During the quarter the Company agreed to terminate several CDS transactions, which was the primary driver of the unrealized fair value gains in the U.S. RMBS sector. The tighter implied spreads were primarily a result of price improvements on the underlying collateral of the Company's CDS and the increased cost to buy protection in AGM's name as the market cost of AGM's credit protection increased during the period. These transactions were pricing at or above their floor levels, therefore when the cost of purchasing CDS protection on AGM increased, the implied spreads that the Company would expect to receive on these transactions decreased.

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

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

	As of March 31, 2018	As of December 31, 2017	As of March 31, 2017	As of December 31, 2016
Five-year CDS spread	109	145	181	158
One-year CDS spread	22	28	31	29

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

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Fair value of credit derivatives before effect of AGM credit spread	\$ (51)	\$ (51)
Plus: Effect of AGM credit spread	3	3
Net fair value of credit derivatives	<u>\$ (48)</u>	<u>\$ (48)</u>

The fair value of CDS contracts at March 31, 2018, before considering the implications of AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. The asset classes that remain most affected are U.S. RMBS and regulated utility securities. Offsetting the benefit attributable to AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity.

Credit Derivatives (1)

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Credit derivative assets	\$ 1	\$ 1
Credit derivative liabilities	49	49

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

9. Consolidated Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGM 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 special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate interest income that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

AGM 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. AGM'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 VIE liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and net claims paid by AGM under the financial guaranty insurance contract. The Company's estimate of expected loss to be paid for FG VIEs is included in Note 5, Expected Loss to be Paid.

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

Adoption of 2016-01

Amendments under this ASU apply to the Company's FG VIE liabilities which the Company has historically elected to measure through the consolidated statements of operations in "fair value gains (losses) on FG VIE" under the fair value option. For FG VIE 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. Interest income and interest expense are derived from the trustee reports and also included in "fair value gains (losses) on FG VIEs".

The inception to date change in fair value of the FG VIE liabilities with recourse attributable to the ISCR (i.e., the Company's own credit risk) 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 approximately \$28 million of loss, net of tax, from retained earnings to AOCI. This amount represents the portion of the fair value of the FG VIE 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 VIE liabilities without recourse are unchanged.

Consolidated FG VIEs

Number of FG VIEs Consolidated

	First Quarter	
	2018	2017
Beginning of the period, December 31	24	23
Consolidated	—	1
Deconsolidated	(1)	—
End of the period, March 31	23	24

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately \$77 million at March 31, 2018 and \$84 million at December 31, 2017. The aggregate unpaid principal of the FG VIEs' assets was approximately \$311 million greater than the aggregate fair value at March 31, 2018. The aggregate unpaid principal of the FG VIEs' assets was approximately \$313 million greater than the aggregate fair value at December 31, 2017.

The change in the instrument-specific credit risk of the FG VIEs' assets held as of March 31, 2018 that was recorded in the condensed combined statements of operations for First Quarter 2018 were gains of \$1 million. The change in the ISCR of the FG VIEs' assets held as of March 31, 2017 that was recorded in the condensed combined statements of operations for First Quarter 2017 were gains of \$10 million. To calculate the ISCR, the changes in the fair value of the FG VIE assets are allocated between changes that are due to the ISCR and changes due to other factors, including interest rates. The ISCR amount is determined by using expected cash flows at the date of consolidation versus current expected cash flows discounted at original contractual rate. The net present value is calculated by discounting the expected cash flows of the underlying security at the relevant effective interest rate.

The unpaid principal for FG VIE liabilities with recourse, which represent obligations insured by AGM, was \$511 million and \$535 million as of March 31, 2018 and December 31, 2017, respectively. FG VIE liabilities with recourse will mature at various dates ranging from 2025 to 2038. The aggregate unpaid principal balance of the FG VIE liabilities with and without recourse was approximately \$63 million greater than the aggregate fair value of the FG VIEs' liabilities as of March 31, 2018. The aggregate unpaid principal balance was approximately \$64 million greater than the aggregate fair value of the FG VIEs' liabilities as of December 31, 2017. For First Quarter 2018, the change in fair value of the FG VIE liabilities with recourse that is attributable to changes in the Company's own credit risk was \$4 million loss pretax. See Note 16, Other Comprehensive Income, for additional information.

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

Consolidated FG VIEs By Type of Collateral

	As of March 31, 2018		As of December 31, 2017	
	Assets	Liabilities	Assets	Liabilities
	(in millions)			
With recourse:				
U.S. RMBS first lien	\$ 322	\$ 350	\$ 337	\$ 363
U.S. RMBS second lien	104	123	112	132
Total with recourse	426	473	449	495
Without recourse	108	108	128	128
Total	\$ 534	\$ 581	\$ 577	\$ 623

The consolidation of FG VIEs affects net income and shareholder's equity due to (i) changes in fair value gains (losses) on FG VIE assets and liabilities (effective January 1, 2018 the change in fair value of FG VIE liabilities with recourse attributable to ISCR is recorded in OCI, instead of net income), (ii) the elimination of premiums and losses related to the FG VIE liabilities with recourse and (iii) the elimination of investment balances related to the Company's purchase of AGM-insured FG VIE 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

	First Quarter	
	2018	2017
	(in millions)	
Net earned premiums	\$ (3)	\$ (4)
Net investment income	(1)	(1)
Fair value gains (losses) on FG VIEs	2	8
Loss and LAE	7	2
Effect on income before tax	5	5
Less: tax provision (benefit)	1	2
Effect on net income (loss)	\$ 4	\$ 3
Effect on OCI	\$ (2)	\$ 0
Effect on cash flows from operating activities	\$ 2	\$ 5

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Effect on shareholder's equity (decrease) increase	\$ 12	\$ 10

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities (effective January 1, 2018 the change in fair value of FG VIE liabilities with recourse attributable to ISCR is recorded in OCI, instead of the condensed combined statement of operations). During First Quarter 2018 the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of \$2 million.

During First Quarter 2017 the Company recorded a pre-tax net fair value gain on consolidated FG VIEs of \$8 million. The primary driver of the gain during First Quarter 2017 in fair value of FG VIE assets and liabilities was price appreciation on the FG VIE assets resulting from improvement in the underlying collateral.

Non-Consolidated VIEs

As of March 31, 2018 and December 31, 2017 the Company had financial guaranty contracts outstanding for 300 and 280 VIEs, respectively, that it monitored and did not consolidate based on the Company's analyses which indicate that it is not the primary beneficiary of any other VIEs. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 4, Outstanding Exposure.

10. Investments and Cash

Adoption of ASU 2016-01

Up until December 31, 2017, the change in fair value of the preferred stock investments was recorded in OCI. Effective January 1, 2018, in accordance with ASU 2016-01, the change in the fair value of the preferred stock investments is recorded in other income in the condensed combined statements of operations. On adoption of ASU 2016-01, on January 1, 2018, the Company reclassified a loss of approximately \$1 million, net of tax, from AOCI to retained earnings.

Net Investment Income and Realized Gains (Losses)

Net investment income is a function of the yield that the Company earns on invested assets (which include a surplus note issued by AGC to the Company) 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 \$64 million and \$59 million as of March 31, 2018 and December 31, 2017, respectively.

Net Investment Income

	First Quarter	
	2018	2017
	(in millions)	
Income from fixed-maturity securities managed by third parties	\$ 40	\$ 40
Income from internally managed securities	12	19
Gross investment income	52	59
Investment expenses	(1)	(1)
Net investment income	\$ 51	\$ 58

Net Realized Investment Gains (Losses)

	First Quarter	
	2018	2017
	(in millions)	
Gross realized gains on available-for-sale securities	\$ 8	\$ 2
Gross realized losses on available-for-sale securities	(2)	(1)
Net realized gains (losses) on other invested assets	(1)	0
Other-than-temporary impairment (OTTI)	(8)	(8)
Net realized investment gains (losses)	\$ (3)	\$ (7)

The following table presents the roll-forward of the credit losses of fixed-maturity securities for which the Company has recognized an OTTI and where the portion of the fair value adjustment related to other factors was recognized in OCI.

Roll Forward of Credit Losses in the Investment Portfolio

	First Quarter	
	2018	2017
	(in millions)	
Balance, beginning of period	\$ 148	\$ 124
Additions for credit losses on securities for which an OTTI was previously recognized	7	8
Balance, end of period	\$ 155	\$ 132

Investment Portfolio

**Fixed-Maturity Securities and Short-Term Investments
by Security Type
As of March 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	59%	\$ 3,382	\$ 97	\$ (15)	\$ 3,464	\$ 0	AA
U.S. government and agencies	0	23	2	0	25	—	AA+
Corporate securities	16	919	37	(17)	939	(6)	A+
Mortgage-backed securities(4):							
RMBS	7	377	13	(19)	371	(6)	BB-
CMBS	5	280	2	(4)	278	—	AAA
Asset-backed securities	2	139	17	0	156	9	BBB+
Non-U.S. government securities	6	330	9	(13)	326	—	AA
Total fixed-maturity securities	95	5,450	177	(68)	5,559	(3)	AA-
Short-term investments	5	274	0	0	274	—	AAA
Total investment portfolio	100%	\$ 5,724	\$ 177	\$ (68)	\$ 5,833	\$ (3)	AA-

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 Gain (Loss) on Securities with OTTI	Weighted Average Credit Rating(3)
(dollars in millions)							
Fixed-maturity securities:							
Obligations of state and political subdivisions	60%	\$ 3,473	\$ 149	\$ (7)	\$ 3,615	\$ (3)	AA
U.S. government and agencies	1	23	2	0	25	—	AA+
Corporate securities	16	916	40	(15)	941	(6)	A+
Mortgage-backed securities(4):							
RMBS	6	373	15	(14)	374	(1)	B+
CMBS	4	253	6	(2)	257	—	AAA
Asset-backed securities	2	126	16	0	142	9	BBB+
Non-U.S. government securities	5	315	7	(17)	305	0	AA
Total fixed-maturity securities	94	5,479	235	(55)	5,659	(1)	AA-
Short-term investments	6	364	0	0	364	—	AAA
Total investment portfolio	100%	\$ 5,843	\$ 235	\$ (55)	\$ 6,023	\$ (1)	AA-

(1) Based on amortized cost.

(2) See also Note 16, Other Comprehensive Income.

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

(4) U.S. government-agency obligations were approximately 18% of mortgage backed securities as of March 31, 2018 and 13% as of December 31, 2017 based on fair value.

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

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

Fixed-Maturity Securities
Gross Unrealized Loss by Length of Time
As of March 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	\$ 560	\$ (8)	\$ 149	\$ (7)	\$ 709	\$ (15)
U.S. government and agencies	7	0	1	0	8	0
Corporate securities	176	(3)	156	(14)	332	(17)
Mortgage-backed securities:						
RMBS	139	(7)	107	(12)	246	(19)
CMBS	120	(1)	34	(3)	154	(4)
Asset-backed securities	17	0	—	—	17	0
Non-U.S. government securities	21	0	119	(13)	140	(13)
Total	<u>\$ 1,040</u>	<u>\$ (19)</u>	<u>\$ 566</u>	<u>\$ (49)</u>	<u>\$ 1,606</u>	<u>\$ (68)</u>
Number of securities (1)		<u>345</u>		<u>141</u>		<u>478</u>
Number of securities with OTTI (1)		<u>7</u>		<u>11</u>		<u>17</u>

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	\$ 96	\$ (2)	\$ 165	\$ (5)	\$ 261	\$ (7)
U.S. government and agencies	7	0	0	0	7	0
Corporate securities	47	0	167	(15)	214	(15)
Mortgage-backed securities:						
RMBS	123	(4)	111	(10)	234	(14)
CMBS	—	0	35	(2)	35	(2)
Asset-backed securities	9	0	—	—	9	0
Non-U.S. government securities	19	0	140	(17)	159	(17)
Total	<u>\$ 301</u>	<u>\$ (6)</u>	<u>\$ 618</u>	<u>\$ (49)</u>	<u>\$ 919</u>	<u>\$ (55)</u>
Number of securities (1)		<u>101</u>		<u>148</u>		<u>243</u>
Number of securities with OTTI (1)		<u>9</u>		<u>10</u>		<u>18</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.

Of the securities in an unrealized loss position for 12 months or more as of March 31, 2018, 23 securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of March 31, 2018 was \$24 million. As of December 31, 2017, of the securities in an unrealized loss position for 12 months or more, 24 securities had unrealized losses greater than 10% of book value with an unrealized loss of \$26 million. The Company had determined that the unrealized losses recorded as of March 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 March 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 March 31, 2018**

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	\$ 172	\$ 169
Due after one year through five years	872	894
Due after five years through 10 years	1,314	1,344
Due after 10 years	2,435	2,503
Mortgage-backed securities:		
RMBS	377	371
CMBS	280	278
Total	<u>\$ 5,450</u>	<u>\$ 5,559</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 restricted totaled \$13 million and \$10 million, as of March 31, 2018 and December 31, 2017, respectively. In addition, the total collateral required to be funded into a reinsurance trust account by AGM for the benefit of AGE as of March 31, 2018 and December 31, 2017 was approximately \$209 million and \$199 million, respectively, based on fair value.

No material investments of the Company were non-income producing for First Quarter 2018 and First Quarter 2017, respectively.

Externally Managed Portfolio

As of March 31, 2018, the majority of the investment portfolio is managed by seven outside managers (including Wasmer, Schroeder & Company LLC, in which the Company has a minority interest). The Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. The Company's investment guidelines generally do not permit its outside managers to purchase securities rated lower than A- by S&P or A3 by Moody's, excluding a minimal allocation to corporate securities not rated lower than BBB by S&P or Baa2 by Moody's.

Internally Managed Portfolio

The investment portfolio tables shown above include both assets managed externally and internally. In the table below, more detailed information is provided for the component of the total investment portfolio that is internally managed (excluding short-term investments and surplus note from affiliate). The internally managed portfolio (other than short term investments and surplus note from affiliate) represents approximately 8% of the investment portfolio, on a fair value basis as of March 31, 2018 and December 31, 2017. The internally managed portfolio consists primarily of the Company's investments in securities for (i) loss mitigation purposes, (ii) other risk management purposes and (iii) where the Company believes a particular security presents an attractive investment opportunity.

One of the Company's strategies for mitigating losses has been to purchase loss mitigation securities, at discounted prices. In addition, the Company 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).

Alternative investments include various funds investing in both equity and debt securities, including catastrophe bonds, as well as investments in investment managers.

The unrealized gains (losses) recognized during First Quarter 2018 on equity investments held as of March 31, 2018 were \$(3) million.

Internally Managed Portfolio Carrying Value

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Assets purchased for loss mitigation and other risk management purposes:		
Fixed-maturity securities, at fair value	\$ 445	\$ 458
Other invested assets	7	8
Alternative investments	66	69
Total	<u>\$ 518</u>	<u>\$ 535</u>

Cash and Restricted Cash

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

Cash and Restricted Cash

	As of March 31, 2018	As of December 31, 2017	As of March 31, 2017	As of December 31, 2016
	(in millions)			
Cash	\$ 66	\$ 36	\$ 79	\$ 32
Restricted cash (1)	3	—	—	8
Total cash and restricted cash	<u>\$ 69</u>	<u>\$ 36</u>	<u>\$ 79</u>	<u>\$ 40</u>

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

11. Insurance Company Regulatory Requirements

Dividend Restrictions and Capital Requirements

Dividends and Return of Capital By Insurance Company

	First Quarter	
	2018	2017
	(in millions)	
Dividends paid by AGM to AGMH	\$ 73	\$ 79
Dividends paid by MAC to MAC Holdings (1)	—	12

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

United States

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

The maximum amount available during 2018 for AGM to distribute as dividends without regulatory approval is estimated to be approximately \$176 million. Of such \$176 million, nothing is estimated to be available for distribution in the second quarter of 2018. The maximum amount available during 2018 for MAC to distribute as dividends to MAC Holdings, which is owned by AGM and AGC, without regulatory approval is estimated to be approximately \$28 million, of which approximately \$16 million is available for distribution in the second quarter of 2018.

United Kingdom

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

12. Income Taxes

Overview

The Company files its U.S. federal tax return as a part of the consolidated group for Assured Guaranty US Holdings Inc. (AGUS), an indirect 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. On June 26, 2017, AGM purchased the European Subsidiaries from AGC; see Note 1, Business and Basis of Presentation and Note 2, Common Control Acquisition for additional information.

For First Quarter 2018, AGM is taxed at the U.S. corporate income tax rate of 21% and its foreign subsidiaries, AGE, AGUK and AGLN, are taxed at the corporate tax rate of 19% in U.K. and CIFGE is taxed at 33.33% in France. For year ended December 31, 2017, AGM was taxed at the U.S. corporate income tax rate of 35% and its foreign subsidiaries, AGE, AGUK and AGLN, were taxed at the blended marginal corporate tax rate of 19.25% in U.K. and CIFGE was taxed at 33.33% in France. 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 31, 2017 the U.K. corporation tax rate was 20%. AGE, the Company's U.K. subsidiary, had previously elected under U.S. Internal Revenue Code Section 953(d) to be taxed as a U.S. company. In January 2017, AGE filed a request with the U.S. Internal Revenue Service (IRS) to revoke the election, which was approved in May 2017. As a result of the revocation of the Section 953(d) election, AGE is no longer liable to pay future U.S. taxes beginning in 2017.

Effect of the 2017 Tax Cuts and Jobs Act

On December 22, 2017, the Tax Act was signed into law. The Tax Act changed many items of U.S. corporate income taxation, including a reduction of the corporate income tax rate from 35% to 21%, implementation of a territorial tax system and imposition of a tax on deemed repatriated earnings of non-U.S. subsidiaries. At December 31, 2017, the Company had not completed accounting for the tax effects of the Tax Act; however, the Company made a reasonable estimate of the effects on the existing deferred tax balances and the one-time transition tax. The Company recognized a provisional amount of \$44 million, which was included as a component of income tax expense from continuing operations in 2017. The Company will continue to assess its provision for income taxes as future guidance is issued. Any adjustments, if necessary, during the measurement period guidance outlined in Staff Accounting Bulletin No. 118 will be included in the statement of operations as an adjustment to income tax expense in the reporting period when such adjustments are determined.

Provision for Income Taxes

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

The effective tax rates reflect the proportion of income recognized by AGM and each of its operating subsidiaries, with AGM taxed at the U.S. marginal corporate income tax rate of 21% in 2018 and 35% in 2017, the U.K. subsidiaries taxed at the U.K. marginal corporate tax rate of 19% unless taxed as a U.S. controlled foreign corporation, and the French subsidiary taxed at 33.33%. For periods subsequent to April 1, 2017, the U.K. corporation tax rate has been reduced to 19%. For the periods between April 1, 2015 and March 31, 2017, the U.K. corporation tax rate was 20%. The Company's overall effective tax rate fluctuates based on the distribution of income across jurisdictions.

Deferred and Current Tax Assets (Liabilities) (1)

	As of March 31, 2018	As of December 31, 2017
	(in millions)	
Deferred tax assets (liabilities)	\$ 11	\$ 11
Current tax assets (liabilities)	(110)	(121)

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

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

	First Quarter	
	2018	2017
	(in millions)	
Expected tax provision (benefit) at statutory rate in taxable jurisdictions	\$ 25	\$ 68
Tax-exempt interest	(4)	(9)
Change in liability for uncertain tax positions	(7)	—
Foreign tax	(4)	—
Other	(1)	(3)
Total provision (benefit) for income taxes	\$ 9	\$ 56
Effective tax rate	7.4%	29.1%

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

The following table presents pretax income and revenue by jurisdiction.

Pretax Income (Loss) by Tax Jurisdiction

	First Quarter	
	2018	2017
	(in millions)	
United States	\$ 90	\$ 161
U.K.	29	33
Total	<u>\$ 119</u>	<u>\$ 194</u>

Revenue by Tax Jurisdiction

	First Quarter	
	2018	2017
	(in millions)	
United States	\$ 113	\$ 212
U.K.	33	30
Total	<u>\$ 146</u>	<u>\$ 242</u>

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

Valuation Allowance

The Company has \$30 million of Foreign Tax Credits (FTCs) due to the Tax Act for use against regular tax in future years. FTCs will 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 this deferred tax asset. The Company will continue to analyze the need for a valuation allowance on a quarterly basis.

Audits

As of March 31, 2018, AGUS had open tax years with the IRS for 2014 to present. In April 2017, AGUS received a final letter from the IRS to close the audit for tax years 2009-2012 with no additional findings or changes, and as a result the Company released previously recorded uncertain tax position reserves and accrued interest of approximately \$11.5 million in the second quarter of 2017. The Company's U.K. subsidiaries are not currently under examination and have open tax years of 2016 forward. The Company's French subsidiary, CIFGE, is under examination for the period January 1, 2015 through December 31, 2016, and has open tax years of 2014 to present.

Uncertain Tax Positions

The Company's policy is to recognize interest related to uncertain tax positions in income tax expense and has accrued \$0.2 million for First Quarter 2018 and \$1 million for the full year 2017. As of March 31, 2018 and December 31, 2017, the Company has accrued \$1.6 million and \$2.5 million of interest, respectively.

The total amount of reserves for unrecognized tax positions, including accrued interest, as of March 31, 2018 and December 31, 2017 that would affect the effective tax rate, if recognized, was \$17 million and \$24 million, respectively. The

Company released \$7 million of previously recorded uncertain tax position reserves and accrued interest in the First Quarter 2018 due to the closing of the 2013 audit year.

13. Reinsurance and Other Monoline Exposures

The Company assumes exposure (Assumed Business) and may cede portions of exposure it has insured (Ceded Business) in exchange for premiums, net of ceding commissions. The Company historically entered into ceded reinsurance contracts in order to obtain greater business diversification and reduce the net potential loss from large risks. More recently, the Company has commuted several of those previously ceded portfolios.

Ceded and Assumed Business

The Company has ceded financial guaranty business to affiliated and non-affiliated companies to limit its exposure to risk. Under these relationships, the Company ceded a portion of its insured risk to the reinsurer in exchange for the reinsurer receiving a share of the Company's premiums for the insured risk (typically, net of a ceding commission). The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. A number of the financial guaranty insurers to which the Company has ceded par have experienced financial distress and been downgraded by the rating agencies as a result. In addition, state insurance regulators have intervened with respect to some of these insurers. The Company's ceded contracts generally allow the Company to recapture ceded financial guaranty business after certain triggering events, such as reinsurer downgrades.

The Company has assumed business primarily from its affiliate, AGC. Under this relationship, the Company assumes a portion of AGC's insured risk in exchange for a portion of AGC's premium for the insured risk (typically, net of any ceding commission). The Company may be exposed to risk in this portfolio in that the Company may be required to pay losses without a corresponding premium in circumstances where AGC is experiencing financial distress and is unable to pay premiums. The Company's agreement with AGC is generally subject to termination at the option of AGC if the Company fails to meet certain financial and regulatory criteria or to maintain a specified minimum financial strength rating. Upon termination due to one of the foregoing events, the Company may be required to return to AGC unearned premiums (net of any ceding commission) and loss reserves calculated on a statutory basis of accounting, attributable to the reinsurance assumed, after which the Company would be released from liability with respect to its Assumed Business from AGC. In addition, in lieu of termination due to one of the aforementioned events, the Company may be obligated to increase the level of ceding commission paid.

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

Effect of Reinsurance on Statement of Operations

	First Quarter	
	2018	2017
	(in millions)	
Premiums Written:		
Direct	\$ 73	\$ 110
Ceded	(35)	(29)
Net	<u>\$ 38</u>	<u>\$ 81</u>
Premiums Earned:		
Direct	\$ 90	\$ 101
Assumed	8	10
Ceded	(22)	(33)
Net	<u>\$ 76</u>	<u>\$ 78</u>
Loss and LAE:		
Direct	\$ (15)	\$ (44)
Assumed	(2)	0
Ceded	9	60
Net	<u>\$ (8)</u>	<u>\$ 16</u>

Exposure to Reinsurers and Other Monolines (1)

	As of March 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	\$ 1	\$ 10	\$ 1	\$ 10
Ceded premium, net of commissions	(105)	(29)	(103)	(24)
Ceded loss paid	(48)	(17)	(49)	(19)
Ceded expected loss to be paid	127	24	157	29
Outstanding Exposure:				
Ceded par outstanding (2)	\$ 55,663	\$ 3,839	\$ 56,200	\$ 3,974
Assumed par outstanding (3)	12,750	387	13,994	380
Second-to-pay insured par outstanding (4)	149	3,201	151	3,662

- (1) The total collateral posted by all affiliated and non-affiliated reinsurers required to post, or that had agreed to post, collateral as of March 31, 2018 and December 31, 2017, was approximately \$1.2 billion and \$1.3 billion, respectively. The collateral excludes amounts posted by AGM for the benefit of AGE.
- (2) Of the total ceded par to unrated or BIG rated reinsurers, \$261 million and \$296 million is rated BIG as of March 31, 2018 and December 31, 2017, respectively.
- (3) Assumed par outstanding includes \$12,750 million and \$13,994 million assumed by MAC from AGC as of March 31, 2018 and December 31, 2017, respectively.
- (4) The par on second-to-pay exposure where the primary insurer and underlying transaction rating are both BIG and/or not rated is \$64 million and \$65 million as of March 31, 2018 and December 31, 2017, respectively. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monoline financial guaranty insurers. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer.

Commutations

The table below summarizes the effect of commutations.

Commutations of Ceded Reinsurance Contracts

	First Quarter	
	2018	2017
	(in millions)	
Increase (decrease) in net unearned premium reserve	\$ 4	\$ 18
Increase (decrease) in net par outstanding	42	1,173
Commutation gains (losses)	1	73

During First Quarter 2017, the Company entered into a commutation agreement to reassume the entire portfolio previously ceded to one of its unaffiliated reinsurers, consisting predominantly (over 97%) of U.S. public finance and international public and project finance exposures.

Commutation of Business Ceded to Syncora Guarantee Inc.

On June 1, 2018, Assured Guaranty entered into an agreement with Syncora Guarantee Inc. (SGI), whereby AGC reinsures, substantially all of SGI's insured portfolio. The agreement also includes the commutation of a substantial portion of a

small book of business ceded to SGI by AGM. At May 31, 2018, such business to be commuted totaled approximately \$1.2 billion principal outstanding. As consideration for the commutation transactions, SGI is expected to pay approximately \$19 million to AGM.

Excess of Loss Reinsurance Facility

Effective January 1, 2018, AGC, AGM and MAC entered into a \$400 million aggregate excess of loss reinsurance facility of which \$180 million was placed with an unaffiliated reinsurer. This facility replaces a similar \$400 million aggregate excess of loss reinsurance facility, of which \$360 million was placed with unaffiliated reinsurers, that AGC, AGM and MAC had entered into effective January 1, 2016 and which terminated on December 31, 2017. The new facility covers losses occurring either from January 1, 2018 through December 31, 2024, or January 1, 2019 through December 31, 2025, at the option of AGC, AGM and MAC. It terminates on January 1, 2020, unless AGC, AGM and MAC choose to extend it. The new facility covers certain U.S. public finance exposures insured or reinsured by AGC, AGM and MAC as of September 30, 2017, excluding exposures that were rated non-investment grade as of December 31, 2017 by Moody's or S&P or internally by AGC, AGM or MAC and is subject to certain per credit limits. Among the exposures excluded are those associated with the Commonwealth of Puerto Rico and its related authorities and public corporations. The new facility attaches when AGC's, AGM's and MAC's net losses (net of AGC's and AGM's reinsurance (including from affiliates) and net of recoveries) exceed \$0.8 billion in the aggregate. The new facility covers a portion of the next \$400 million of losses, with the reinsurer assuming \$180 million of the \$400 million of losses and AGC, AGM and MAC jointly retaining the remaining \$220 million. The reinsurer is required to be rated at least AA- or to post collateral sufficient to provide AGM, AGC and MAC with the same reinsurance credit as reinsurers rated AA-. AGM, AGC and MAC are obligated to pay the reinsurer their share of recoveries relating to losses during the coverage period in the covered portfolio. AGC, AGM and MAC paid approximately \$3.2 million of premiums in 2018 (of which AGM and MAC paid approximately \$2.8 million) for the term January 1, 2018 through December 31, 2018 and deposited approximately \$3.2 million in cash into a trust account (of which AGM and MAC deposited approximately \$2.8 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).

14. Commitments and Contingencies

Legal Proceedings

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

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 U.S. District Court for the District of 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. 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.

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

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 would be disclosed. 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.

15. Credit Facilities

Committed Capital Securities

AGM has entered into put agreements with four separate custodial trusts allowing AGM to issue an aggregate of \$200 million of non-cumulative redeemable perpetual preferred securities to the trusts in exchange for cash. Each of the custodial trusts was created for the primary purpose of issuing \$50 million face amount of AGM CPS, investing the proceeds in high-quality assets and entering into put options with AGM. 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 AGM access to new equity capital at its sole discretion through the exercise of the put options. Upon AGM's exercise of its put option, the relevant trust will liquidate its portfolio of eligible assets and use the proceeds to purchase the AGM preferred stock. AGM may use the proceeds from its sale of preferred stock to the trusts for any purpose, including the payment of claims. The put agreements have no scheduled termination date or maturity. However, each put agreement will terminate if (subject to certain grace periods) specified events occur. AGM continues to have the ability to exercise its put options and cause the related trusts to purchase its preferred stock.

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

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

16. Other Comprehensive Income

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

Changes in Accumulated Other Comprehensive Income by Component First Quarter 2018

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Net Unrealized Gains (Losses) on FG VIE Liabilities with Recourse	Cumulative Translation Adjustment	Total Accumulated Other Comprehensive Income
	(in millions)				
Balance, December 31, 2017	\$ 135	\$ (1)	\$ —	\$ (16)	\$ 118
Effect of adoption of ASU 2016-01 (see Note 1)	1	—	(28)	—	(27)
Other comprehensive income (loss) attributable to AGM before reclassifications	(40)	(9)	(3)	4	(48)
Amounts reclassified from AOCI to:					
Net realized investment gains (losses)	(7)	9	—	—	2
Fair value gains (losses) on FG VIEs	—	—	2	—	2
Total before tax	(7)	9	2	—	4
Tax (provision) benefit	0	(1)	(1)	—	(2)
Total amount reclassified from AOCI, net of tax	(7)	8	1	—	2
Net current period other comprehensive income (loss) attributable to AGM	(47)	(1)	(2)	4	(46)
Balance, March 31, 2018	\$ 89	\$ (2)	\$ (30)	\$ (12)	\$ 45

Changes in Accumulated Other Comprehensive Income by Component
First Quarter 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	\$ 49	\$ (8)	\$ (29)	\$ 12
Other comprehensive income (loss) attributable to AGM before reclassifications	30	15	1	46
Amounts reclassified from AOCI to:				
Net realized investment gains (losses)	(2)	9	—	7
Net investment income	(1)	—	—	(1)
Total before tax	(3)	9	—	6
Tax (provision) benefit	0	(3)	—	(3)
Total amount reclassified from AOCI, net of tax	(3)	6	—	3
Net current period other comprehensive income (loss) attributable to AGM	27	21	1	49
Balance, March 31, 2017	\$ 76	\$ 13	\$ (28)	\$ 61

17. Subsequent Events

Subsequent events have been considered through June 18, 2018, the date on which these financial statements were issued.