Assured Guaranty Municipal Corp. (AGM)

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Executive Summary

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

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

AGM has written primarily U.S. municipal business since the credit crisis (with a small amount of international infrastructure business). It retains a significant legacy exposure to structured finance although it has been declining. Within this structured finance portfolio the company has exposure to $5.3 billion of global residential mortgage backed securities (RMBS). This sector has produced the majority of the company's paid losses in recent years and represents the most significant source of expected losses going forward. Therefore, it was a focus of KBRA's analysis. In developing stress case losses for this sector, KBRA's RMBS team reviewed substantially all of the RMBS exposures individually and applied assumptions regarding a decline in residential property values of 40% and other stresses that produced estimated losses assumed to be borne by AGM that, in KBRA's opinion, it should be able to withstand to warrant a AA+ rating.

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

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

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

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

Key Rating Strengths
• Demonstrated ability to withstand KBRA's conservative stress case loss assumptions across the breadth of its insured portfolio.
• The substantial and continuing runoff in structured finance components of the company's portfolio should continue to moderate risk. Structured finance exposure is now $18.8 billion, down nearly 80% from $91.4 billion at year end 2009.
• A mature and high-functioning operating platform supported by strong governance and risk management systems.
• A tested management team that is well positioned to address future portfolio risk issues should they develop given their experience through the credit crisis.

Key Rating Concerns

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

Rating Summary

A key element of KBRA's analysis of AGM is testing the company's ability to provide for all claims under conservative stress case assumptions. The table below summarizes how KBRA segmented AGM's portfolio and stressed each component. The portfolio segments were (i) Global RMBS, (ii) Puerto Rico, (iii) distressed credits and liquidity claims, and (iv) the balance of the insured portfolio (Monte Carlo simulation). The table shows the net par outstanding of each of these segments and the assumed estimated stress losses on a future value basis incorporated within our analysis. These stress case losses do not represent KBRA's forecast of expected claims but were developed to reflect KBRA's best estimate of the level of losses that a AA+ rated entity should be able to meet so that an investor holding a bond insured by AGM would not expect to suffer principal and interest losses under these assumed conditions.

Stress Loss Treatment by Portfolio Segment($ in millions)

AGM Portfolio Segment	Net Par Insured 6/30/2015	Financial Guaranty Stress Losses[1] (Future Value)	Comments
Global RMBS	$5,263	$2,002	Substantially all RMBS individually analyzed with KBRA's RMBS methodology
Puerto Rico	$2,280	$977	Severities range from 10% to 55% based upon the issuer
Distressed credits & liquidity claims	$1,013	$31	Losses, net of expected recoveries
Balance of portfolio	$131,753	$1,820	Monte Carlo simulation losses
Totals	**$140,309**	**$4,830**	**Aggregate stress losses incorporated in Bond Insurer Financial model**

In our opinion, the aggregate of stress losses shown above ($4.8 billion on a future value basis over a 35 year period) represents that level of losses that AGM would need to cover to achieve a AA+ insurance financial strength rating. We assessed AGM's ability to meet these losses in the KBRA Bond Insurer financial model. The financial model begins with an asset base equal to AGM's claims paying resources according to KBRA's definition, which is $4.7 billion. These resources, plus a conservative estimate of installment premiums and interest earnings, must be sufficient to provide for the stress level claims and all other expenses. Based upon KBRA's model assumptions, AGM was projected to be able to pay all claims and expenses in full and on time under this scenario with a comfortable balance remaining, which is an outcome consistent with the AA+ KBRA rating.

The bulk of AGM's insured portfolio (94%) was analyzed with KBRA's Monte Carlo simulation model. KBRA's Monte Carlo simulation model runs a series of 100,000 paths where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults in a

[1] These are stress case loss assumptions that support an overall AA+ rating on the insured portfolio. KBRA is not forecasting this level of losses for AGM.

particular path, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time and a loss amount is calculated. The model runs 100,000 paths to produce a broad distribution of results. We focus on the tail of this distribution to construct a stress analysis which is reflected in the table above.

KBRA will continue to review AGM's rating and its performance related to portfolio quality, financial strength, and industry trends on an ongoing basis, but no less than annually.

Outlook: Stable

AGM's declining portfolio risk and improving leverage ratios provide a stable framework for the AA+ rating. Furthermore, KBRA's stress case loss analysis incorporates significant deterioration in the distressed sectors of AGM's portfolio from current performance. If ultimate losses do not approach or exceed these levels, downward pressure on the rating should be minimal. In KBRA's view, the following factors may contribute to a rating upgrade:

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

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

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

Key Rating Determinants

Rating Determinant 1: Corporate Assessment

Background

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

During 2007, an unprecedented collapse of the credit markets developed into a worldwide financial crisis and resulted in significant downgrades and subsequent demise of the financial guaranty industry. By September 2008, most financial guarantors were no longer issuing new insurance policies. Assured, the lone industry survivor not subject to restructuring or other type of impairment, has continued to write new financial guaranty policies in the municipal sector making the company the most active player in a substantially smaller bond insurance market.

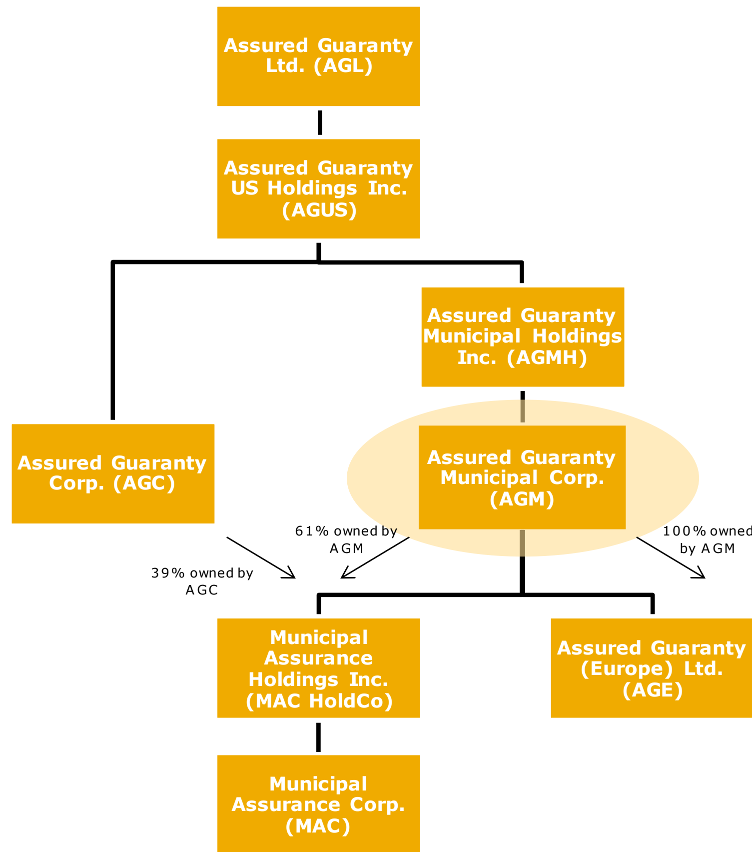
On July 1, 2009, Assured acquired Financial Security Assurance Holdings Ltd., whose principal insurance subsidiary was Financial Security Assurance Inc. (FSA). Assured continues to operate FSA and has changed its name to Assured Guaranty Municipal Corp. (AGM).

Assured Guaranty now conducts its financial guaranty business principally through five insurance companies. The most active writer is AGM which also owns Assured Guaranty Europe (AGE) based in the UK. Together they provide financial guaranty policies on global public finance and infrastructure debt obligations. AGM insured over $12 billion of direct par in 2014. The other AGL operating companies are Assured Guaranty Corp. (AGC), Assured Guaranty Re Ltd. (AG Re) and Municipal Assurance Corp. (MAC), the latter rated **AA+, Stable Outlook** by KBRA. The new business activity of AGC, AG Re and MAC is more limited. In 2014, AGC and MAC insured $779 million and $849 million of par, respectively. AG Re did not write any new business in 2014 except as a reinsurer of its affiliates, AGM and AGC.

Ownership Structure

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

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



Strategy

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

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

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

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

Corporate Governance

The Board of Directors of AGL ("Board") is responsible for the corporate governance of all of its subsidiaries, including AGM. In response to evolving regulatory requirements and market trends, over the last several years, the Board has modified certain key aspects of AGL's governance framework (e.g. executive compensation) and taken discrete actions (e.g. soliciting input directly from major shareholders) to establish a robust structure for oversight of company management and operations.

The AGL Board consists of 11 members following the appointment of Thomas W. Jones and Alan J. Kreczko in August 2015. Mr. Jones and Mr. Kreczko will each serve on the board's Audit and Finance Committees. Except for the CEO who is a Board member, the Board considers all of the other directors to be independent according to the listing standards of the New York Stock Exchange. KBRA notes that all directors have extensive professional backgrounds and appropriate qualifications for the oversight of a financial guaranty insurer.

The Board carries out its responsibilities through the operation of 6 committees: Audit, Compensation, Finance, Nominating and Governance, Risk Oversight, and Executive. The Chief Executive Officer (CEO) sits only on the Executive Committee which meets in between Board meetings exclusively in the event time-sensitive matters arise that require Board deliberation and authority prior to the next scheduled meeting of the full Board. In 2014, all of the committees met at least 4 times, except for the Executive Committee which did not meet.

In KBRA's view, a Board level committee that focuses exclusively on risk, such as AGL's Risk Oversight Committee, better positions a company to maintain a high level of focus on this area, one that is critically important for a financial guaranty insurance company.

The Board is responsible for defining the business strategy for the overall group of companies, meets quarterly to review progress towards meeting operational objectives and conducts separate sessions to discuss current or emerging issues that might impact the business.

The roles of Chairman and CEO are separate. The Board members meet regularly without the presence of the CEO which, in KBRA's view, contributes to the Board's independence.

Since 2012, the Board eliminated all employment contracts with individual executives, instituted uniform severance and change of control policies covering all executive officers and simplified the compensation program. In KBRA's view, this creates greater transparency with respect to overall management incentives.

Risk Management

Assured has established a risk management framework under the supervision of the Board's Risk Oversight Committee (ROC). The Risk Management Department is responsible for the oversight of the framework under the supervision of the Chief Risk Officer (CRO) and the Portfolio Risk Management Committee (PRMC). The PRMC is a management level committee that consists of the CEO, CRO, Chief Surveillance Officer, Chief Credit Officer, General Counsel, CFO, President of AG Re, President of AGE, and the Executive Officer.

The Risk Management Department is responsible for providing the PRMC with research and data used to establish, monitor and reassess policies and procedures on a regular basis. The Risk Management

Department is also responsible for the execution of policies established by the PRMC. The PRMC meets at least four times a year to review the insured portfolio and market trends. All decisions made by the PRMC are reported to the ROC. This ensures that representatives of Assured Guaranty's Board are adequately informed about risk positions and industry trends. These reporting mechanisms add discipline to the risk management process and enhance the ability of the Board and senior management to effectively execute company strategy.

The Risk Management Department is responsible for preparing the annual corporate-wide risk appetite statement which incorporates AGM. The Board reviewed and approved the most recent risk appetite statement in May, 2015. The company continues to identify preservation of capital, maintenance of the highest possible insurance financial strength ratings and consistent market access as key corporate objectives.

The Risk Management Department is also responsible for Enterprise Risk Management across Assured.

Surveillance

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

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

Individual credit reports and sector updates are presented to the Risk Management Committee (chaired by the Chief Surveillance Officer) at monthly meetings. The agenda for these meetings is generally centered on the surveillance group's compliance with its review schedule and on credit risk and sector risk reports. Any proposed internal credit rating changes are discussed and determined through this committee process. Additional presentations are made by the surveillance group to the ROC of the Board of Directors on a quarterly basis. KBRA views the internal reporting process as comprehensive and as providing a sufficient mechanism to inform senior management about the condition of the insured portfolio.

Rating Determinant 2: Insured Portfolio and Modeling Analysis

All par numbers discussed below are on a statutory basis and are as of June 30, 2015.

Insured Portfolio, Gross and Net

As of June 30, 2015, AGM's insured portfolio has a total of $261.7 billion of gross par and $140.3 billion of net par outstanding. Slightly less than half, $121.4 billion or 46.4%, is reinsured, as discussed further below. The portfolio is diversified with over 9,000 individual risks. The insured portfolio includes a range of public finance and structured finance sectors and continues to represent credit characteristics similar to those at the last portfolio review. The portfolio continues to run-off with net par outstanding declining by

almost 15% since June 30, 2014 as a result of scheduled debt maturities, bond refunding activity, and commutations.

Although a substantial amount of par is reinsured, the bulk of this is to AGM's affiliates, MAC and AG Re. MAC has reinsured 41.2% and AG Re has reinsured 43.3% of total ceded par, respectively, or 84.5% of total cessions. Further, AGC's acquisition of Radian Asset Assurance has improved the credit profile of this reinsurance exposure. AGM had reinsured $4.3 billion to Radian Asset Assurance prior to the acquisition.

AGM Portfolio

($ billions)		June 30, 2015
		Par Outstanding [1]
Gross Par		$261.7
Ceded Par		121.4
AG Re	$52.6	
MAC	50.0	
AGC	3.8	
Other	15.0	
Net Par		$140.3

[1] Excludes loss mitigation bonds purchased by AGM.

Net Par Exposure by Type

The net retained insured portfolio consists of both public finance and structured finance obligations. Of total net par of $140.3 billion, 72.4% or $101.6 billion consists of U.S. Public Finance exposures, 13.4% or $18.8 billion consists of global structured finance exposures, and 14.2% or $19.9 billion consists of international infrastructure exposures (includes international public finance). This portfolio composition has not changed materially since mid-2014.

U.S. Public Finance

A breakout of the U.S. public finance exposure by sub sector and rating is shown below. The distribution across sub sectors has not changed meaningfully as the portfolio decreases in size.

U.S. Public Finance Portfolio

($ billions)	June 30, 2015	
	Net Par Outstanding	**% of NPO**
General Obligation	$36.5	35.9%
Tax-supported	22.1	21.7%
Municipal Utility Revenue	19.2	18.9%
Transportation Revenue	10.4	10.3%
Health Care Revenue	7.0	6.9%
Education/University	3.0	3.0%
Infrastructure Finance	1.3	1.3%
Housing Revenue	1.3	1.3%
Other Public Finance	0.8	0.8%
Investor Owned Utilities	0.0	0.0%
Total	$101.6	100.0%

U.S. Public Finance Portfolio, Internal Ratings		
($ billions)	June 30, 2015	
	Net Par Outstanding	% of NPO
AAA	$0.7	0.7%
AA	21.5	21.1%
A	58.2	57.3%
BBB	17.7	17.4%
BIG [1]	3.5	3.5%
Total	$101.6	100.0%

[1] Below investment grade.

Structured Finance

AGM has not written any structured finance business since the beginning of the credit crisis and this segment of the portfolio has declined significantly since that time. At year-end 2009, AGM's structured finance portfolio was $91.4 billion. As of June 30, 2015, net par outstanding was $18.8 billion, a decline of nearly 80%. Structured finance exposures include both US and international risks.

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

Non-RMBS Portfolio

The non-RMBS portfolio is the larger of the two components at $13.5 billion, down approximately 40% from $23.1 billion at June 30, 2014. The non-RMBS portfolio still largely consists of CLOs ($6.4 billion) and IG CDOs ($5.8 billion). These sub sectors are characterized by short remaining tenors and higher credit quality. Substantially all exposure in these two sub sectors matures by year end 2017. Moreover, 84.1% of the CLO's and 100% of the IG CDOs have AGM internal ratings of AAA.

The balance of the non-RMBS portfolio consists of structured finance exposures with a broader distribution of credit ratings and includes a mix of commercial and consumer ABS, insurance securitizations and securitizations of perpetual preferred securities of larger international banks (PERPs).

Global Structured Finance Portfolio, Non-RMBS		
($ billions)	June 30, 2015	
	Net Par Outstanding	% of NPO
CLO	$6.4	47.0%
IG CDO	5.8	43.0%
Other	0.8	5.9%
PERPs	0.6	4.1%
Total	$13.5	100.0%

Residential Mortgage Backed Securities (RMBS)

The sub sector profile of the RMBS portfolio is shown below. The net par outstanding of RMBS decreased by 16% from June 30, 2014 and the distribution across sub sectors did not change significantly although the proportion of Option ARMS fell from 4.8% to 2.5%.

Global Structured Finance Portfolio, RMBS		
($ billions)	June 30, 2015	
	Net Par Outstanding	% of NPO
Subprime	$2.4	46.4%
HELOCs	1.1	20.9%
Alt A	0.8	14.7%
Prime	0.6	11.3%
CES	0.2	3.2%
Option ARMS	0.1	2.5%
Other	0.1	1.0%
Total	$5.3	100.0%

International Infrastructure

AGM's international infrastructure portfolio, which includes international public finance, has a total of $19.9 billion of net par outstanding as of June 30, 2015. The insured net exposure consists of: 46.1% infrastructure finance, 31.7% regulated utilities and 22.3% other public finance. AGM internally rates 62.3% of this exposure BBB and 5% below investment grade.

International Infrastructure Portfolio		
($ billions)	June 30, 2015	
	Net Par Outstanding	% of NPO
Infrastructure Finance	$9.2	46.1%
Other Public Finance	4.4	22.3%
Regulated Utilities	6.3	31.7%
Total	$19.9	100.0%

International Infrastructure Portfolio, Internal Ratings		
($ billions)	June 30, 2015	
	Net Par Outstanding	% of NPO
AAA	$0.5	2.7%
AA	0.3	1.7%
A	5.6	28.2%
BBB	12.4	62.3%
BIG [1]	1.0	5.0%
Total	$19.9	100.0%

[1] Below investment grade.

Portfolio Stress Analysis

KBRA subjected AGM's insured portfolio to a conservative stress analysis. A discussion of the stress losses applied to each component of the portfolio is provided below.

Global Residential Mortgage Backed Securities (RMBS)

Substantially all of AGM's global RMBS portfolio was analyzed on an individual transaction basis by KBRA's RMBS analytical team. KBRA obtained transaction detail at the CUSIP and insured tranche level from AGM which represented the individual insured positions outstanding as of June 30, 2015. For each insured U.S.

position, the loan level data of the underlying collateral pool was updated and loan level losses were projected consistent with KBRA's **U.S. RMBS Rating Methodology**. Collateral pools supporting each transaction were stressed by assuming economic conditions that produce a 40% decline in residential housing values from current levels with accompanying increases in delinquency, default and severity rates. KBRA's analysis then assigned the residential loan level losses to individual tranches based on the waterfall provisions of the RMBS trusts and further allocated losses to AGM on those positions they insure.[2] The representation and warranty agreements AGM has with several financial institutions were factored into this analysis on a transaction level basis and served to decrease the ultimate losses to AGM.

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

The losses attributed to each insured RMBS position of AGM were aggregated by year. Over the term of the insured RMBS the total amount of aggregate losses assessed against this exposure was $2.0 billion on a future value basis. This aggregate annual stream of loss payments was added to all other stress loss payments that became annual cash outflows in the KBRA Bond Insurer Financial Model.

The stress case losses are higher than they were at the time of AGM's initial KBRA rating in November 2014 ($2.0B currently vs. $1.7B previously) to reflect the fact that KBRA has refined its treatment of seasoned mortgage loans.

Puerto Rico

AGM has substantial exposure to the various issuers of the Commonwealth of Puerto Rico as shown in the table below.

Puerto Rico Exposure, Net Par	
($ millions)	**June 30, 2015**
Issuing Entity	
GO	$753.6
PREPA	485.7
PRHTA (Transportation)	303.0
COFINA	261.5
MFA	237.3
PRHTA (Highway)	221.2
Building Authority	17.9
Total	$2,280.2

In light of the Commonwealth's significant financial strain that remains unresolved, KBRA applied stress losses resulting from AGM's insurance of Puerto Rico debt. We applied severities ranging from 10% to 55% to different Commonwealth issuers and assumed the losses to AGM would be realized annually as insured principal and interest come due, with higher severities in the first three years. We further assumed that two of AGM's external reinsurers would not perform under this scenario and those reinsured losses would have to be borne by AGM.

Under the assumptions applied by KBRA, total net losses to AGM were $977 million on an undiscounted basis over the life of the insured Puerto Rico debt. KBRA's stress case for Puerto Rico has become more

[2] AGM's HELOC exposure was not analyzed at the loan level. KBRA applied pool level assumptions that were constructed by stressing the transactions' recent historical performance.

severe than it was at KBRA's initial rating of AGM in November 2014 due to the deteriorating credit environment and increased uncertainty surrounding the Commonwealth. Insured Puerto Rico stress case losses for AGM in November 2014 were less than $800 million.

In KBRA's opinion, AGM should be able to withstand claims of this level from such a large and strained exposure to achieve a AA+, Stable Outlook rating.

Distressed Credits and Liquidity Claims

We also treated separately the debt of certain municipal defaults and the Chicago Skyway toll road infrastructure project. For Chicago Skyway, the existing debt structure incorporates shorter term maturities with the expectation that these shorter term maturities would be refinanced prior to maturity. KBRA applied stress assumptions to these liquidity events which incorporated the following: (i) no refinancing takes place and the maturity is met with a claim on AGM's insurance policy, (ii) failure of two reinsurers and (iii) a discount to the ultimate recoveries.

KBRA understands that three Canadian pension funds have reached an agreement to purchase the Skyway Concession Company LLC, which operates the Chicago Skyway toll road, subject to regulatory approvals and customary closing conditions. KBRA will monitor this development and make adjustments on a going forward basis as appropriate to AGM's stress case analysis.

Monte Carlo Simulation Model

As discussed in KBRA's Financial Guaranty Rating Methodology, KBRA performs a stochastic analysis of the insured portfolio risk by applying a Monte Carlo simulation model that produces a distribution of loss outcomes for that portfolio. KBRA views this as the most appropriate approach for modeling the large, diverse portfolios typical of the financial guaranty industry. As part of our analysis KBRA ran AGM's portfolio with details for each insured position as of June 30, 2015 through the KBRA Monte Carlo loss simulation model, not including those items discussed above that were separately stressed.

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

The Monte Carlo model runs a series of 100,000 paths where each path assesses the probability of future defaults for each credit in each year of its remaining life. If a credit defaults, a severity assumption based upon its sector is applied against the amount of debt outstanding at that point in time and a loss amount is calculated. The model runs 100,000 paths to produce a broad distribution of results. We focus on the tail of this distribution to construct a stress analysis. The aggregate of all annual loss payments in this loss profile of this stress analysis was $1.8 billion on a future value basis. These losses are then added to our deterministic losses and incorporated in our financial model.

Bond Insurer Financial Model

KBRA assesses the ability of a financial guarantor to pay claims in a financial model. The model uses AGM's Claims Paying Resources (defined in the "Claims Paying Resources" section below) as a beginning base of assets. These assets earn interest at rates adjusted downward by KBRA from the company's current yield levels to offset the incremental yield the company realizes from its loss mitigation bond purchase strategy and to incorporate credit losses in the asset portfolio. In addition, the company's estimate of future installment premiums (KBRA haircut by 10%) provides additional resources.

The model assesses the ability of the company with these defined resources to pay annual stress losses and other expenses through the 35 year forecast period. For AGM, the stress losses (all on a future value basis) were the sum of (i) the aggregate annual losses generated in the loss profile KBRA developed from the tail distribution of the Monte Carlo simulation model of $1.8 billion, (ii) the RMBS stress losses of $2.0 billion, (iii) Puerto Rico stress losses of $977 million, and (iv) other net stress outflows of about $30 million described above under "Distressed Credits and Liquidity Claims".

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

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

Rating Determinant 3: Claims Paying Resources and Financial Profile

KBRA focuses its analysis of financial resources on statutory results as it is our opinion that statutory accounting principles provide the most appropriate benchmark for assessing an insurer's ability to meet policyholder obligations. Unless otherwise noted, all amounts are based on statutory reports as filed or reported by the company.

Claims Paying Resources

KBRA defines claims paying resources (CPR) as the sum of statutory policyholder surplus, contingency reserves, loss and loss adjustment reserves and unearned premium reserves. As of June 30, 2015, AGM's CPR, before adjustments, totals $5.4 billion. However, KBRA's definition of CPR also excludes certain investments in affiliates, namely the surplus notes of Assured Guaranty Corp. and MAC as well as the equity of MAC because KBRA views these assets as illiquid and deeply subordinate.[3] KBRA includes AGM's equity holdings in AGE in its definition of CPR because AGM owns 100% of AGE, AGM reinsures over 90% of AGE's insured exposure and AGM guarantees all AGE net par. Therefore, all AGE exposure is included in AGM's net par and, accordingly, in KBRA's portfolio analysis of AGM. After these adjustments, AGM's CPR is $4.7 billion and this amount is used as the beginning base of assets in KBRA's Bond Insurer financial model.

KBRA also notes that AGM's total insured portfolio continues to run off more rapidly than new business production and is reflected in ongoing declines in leverage ratios through the first six months of 2015.

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

Select AGM Statutory Balance Sheet Data				
$ Thousands	**6/30/2015**	**12/31/2014**	**12/31/2013**	**12/31/2012**
Claims paying resources:				
Unearned premium reserves	$1,382,974	$1,438,865	$1,489,865	$1,344,889
Loss & LAE reserves	520,076	487,177	339,719	(12,428)
Contingency reserve	1,349,941	1,310,796	1,586,565	993,555
Policyholder surplus	2,181,430	2,266,850	1,733,149	1,780,051
Adjustments†	(723,066)	(704,657)	(651,534)	(300,000)
Total claims paying resources (KBRA definition)	**$4,711,355**	**$4,799,031**	**$4,497,765**	**$3,806,067**
Net statutory par outstanding (NPO)	$140,951,000	$151,320,000	$171,279,000	$281,739,000
Net statutory debt service outstanding (NDSO)	$218,848,000	$234,490,000	$263,089,000	$425,766,000
Leverage: NPO/Claims paying resources (X)	**30x**	**32x**	**38x**	**74x**
Leverage: NDSO/Claims paying resources (X)	**46x**	**49x**	**58x**	**112x**

Source: AGM statutory statements and financial supplements

† Reflects investment in MAC and MAC surplus note since 2013, AGC surplus note since 2012.

Balance Sheet

Over the last twelve months, AGM's balance sheet has remained relatively stable relative to prior reporting periods, with a strong liquidity position and a substantial policyholder surplus balance. The amounts reported under common stock reflect AGM's ownership of MAC (61%) and AGE (100%).

As of June 30, 2015, net unearned premium reserves (after deductions ceded to reinsurers of $1.08 billion) are the largest component of AGM's balance sheet liabilities at $1.4 billion. In the first half of 2015, AGM repaid the remaining balance of $25 million of outstanding surplus notes; AGM has now fully repaid $300 million of funds borrowed from its immediate parent company, Assured Guaranty Municipal Holdings, in 2008.

AGM Statutory Balance Sheet				
$ Thousands	**6/30/2015**	**12/31/2014**	**12/31/2013**	**12/31/2012**
Bonds	$4,225,870	$4,331,217	$3,921,116	$2,800,547
Stocks (includes Investments in Affiliates)	634,777	619,149	535,666	820,936
Cash & short term investments	345,754	334,483	647,084	398,397
Derivatives, receivables, other invested assets	503,671	516,163	419,449	309,383
Total cash and invested assets, net admitted	**$5,710,072**	**$5,801,011**	**$5,523,317**	**$4,329,264**
Investment income due and accrued	43,342	41,911	37,916	29,416
Receivable from parent	1,156	2,169	2,032	1,552
Other assets	98,743	116,131	148,870	138,278
Total Assets, net admitted	**$5,853,311**	**$5,961,222**	**$5,712,135**	**$4,498,510**
Loss and LAE Reserves	520,076	487,177	339,719	(12,428)
Unearned Premium Reserve	1,382,974	1,438,865	1,489,865	1,344,889
Contingency reserve	1,349,941	1,310,796	1,586,565	993,555
Other liabilities	418,890	457,534	562,836	392,443
Total Liabilities	**$3,671,881**	**$3,694,372**	**$3,978,986**	**$2,718,458**
Common capital stock	15,000	15,000	15,000	15,000
Surplus Notes	-	25,000	75,000	125,000
Gross paid-in and contributed surplus	777,009	776,876	778,266	776,884
Unassigned Funds	1,389,421	1,449,974	864,883	863,167
Policyholder Surplus	**$2,181,430**	**$2,266,850**	**$1,733,149**	**$1,780,051**
Total Liabilities and Policyholder Surplus	**$5,853,311**	**$5,961,222**	**$5,712,135**	**$4,498,510**
Cash & short term assets/Total assets (%)	5.9%	5.6%	11.3%	8.9%
Bonds/Total assets (%)	72.2%	72.7%	68.6%	62.3%

Source: AGM Statutory Statements

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Investments

As of June 30, 2015, AGM had total invested assets of $5.0 billion, including $362 million of cash and short term investments. On a statutory basis the average pre-tax book yield is 3.80%. The overall portfolio yield is enhanced by the company's loss mitigation strategy of purchasing AGM-wrapped bonds where AGM has paid and/or expects to pay claims. These non-investment grade positions typically generate higher yields and currently comprise approximately 10% of the portfolio.

The largest segment of the investment portfolio is municipal bonds which consisted of 49% of the entire investment pool while mortgage-backed securities and corporate bonds contributed of 13% and 9% of the total book, respectively. The average security rating is AA-.

AGM Investment Portfolio Composition (6/30/2015)				
$ Millions			---Book Yields*---	
Sector	**Fair Value**	**% of portfolio**	**Pre-tax**	**After-tax**
State and Political Subdivisions	$2,463	49%	3.69%	3.47%
Insured State and Political Subdivision	460	9%	4.68%	4.41%
U.S Treasury Securities	15	0%	3.56%	2.31%
U.S Agency Obligations	26	1%	2.96%	1.93%
Corporate Securities	466	9%	3.91%	2.54%
RMBS	671	13%	5.69%	3.70%
CMBS	192	4%	3.41%	2.22%
Asset-backed securities	136	3%	5.30%	3.45%
Foreign Governments	198	4%	2.23%	1.45%
Total Fixed Maturities	**$4,627**	**93%**	**4.03%**	**3.38%**
Short term investments and cash	362	7%	0.02%	0.01%
Grand Total†	**$4,989**	**100%**	**3.80%**	**3.19%**

Source: AGM financial supplement

** Reflects yields on consolidated AGM/MAC investment portfolio*

† Excludes $155 million attributable to FG Variable Interest Entities (VIE's)

Income Statement

AGM's underwriting results have fluctuated over the last several years reflecting large rep and warranty loss recoveries related to certain RMBS exposures as well as the cession of a significant portion of the Company's insured portfolio to AGL affiliate, MAC. For the first half of 2015, net income was positive, although increased loss reserves on AGM's Puerto Rico exposure as well as depressed investment income from the low interest rate environment have pushed the return on surplus below 10% on an annualized basis. Sluggish market conditions continue to depress new business activity. As a result, despite relatively stable expenses for the first half of 2015, below average gross premium writings pushed the Company's expense ratio above historical benchmarks.

The low level of premium volume reflects the significant decline in production for the entire financial guaranty sector since the credit crisis. At current depressed business levels, combined with the unique financial guaranty reserving methodology, traditional insurance industry benchmarks such as expense and loss ratios can highlight trends for a particular company but have limited comparability across the sector or with other insurance industries.

Select AGM Statutory Income Data				
$ Thousands	**6/30/2015**	**12/31/2014**	**12/31/2013**	**12/31/2012**
Gross Premiums Written (GPW)	$69,788	$245,042	$262,322	$263,642
Net Premiums Written	50,255	173,887	(191,293)	196,094
Net premiums Earned (NPE)	104,938	203,133	296,018	257,235
Loss & loss adjustment expenses (L&LAE)	68,387	(120,663)	(56,914)	168,729
Other underwriting expenses	36,227	86,508	101,830	56,907
Total losses & operating expenses	104,614	(34,154)	44,916	225,636
Net underwriting gain (loss)	324	237,287	251,102	31,599
Net investment gain	70,042	159,261	230,009	169,468
Other income, net gain (loss)	39,296	9,243	(19,366)	42,434
Earnings Before Taxes	109,662	405,791	461,744	$243,501
Net Income	$88,449	$303,884	$339,635	$203,314
Dividends Paid	$106,000	$160,000	$163,000	$30,000
Expense ratio (Underwriting exp. / GPW)	51.9%	35.3%	38.8%	21.6%
Loss ratio (L&LAE / NPE)	65.2%	NM	NM	65.6%
Combined ratio	117.1%	NM	NM	87.2%
Return on Surplus (ROS) Pre-tax basis *	9.9%	20.3%	26.3%	16.3%
Return on Surplus (ROS) After-tax basis *	8.0%	15.2%	19.3%	13.6%

Source: AGM statutory statements

** Return on Surplus was annualized for the 1H 2015 by multiplying the earnings by 2.*

Dividends

AGM's ability to pay dividends is subject to limitations imposed by New York insurance law, which provides that a New York financial guaranty insurer generally cannot pay a dividend except out of the portion of the insurer's earned surplus that represents the net earnings, gains or profits which that insurer has not otherwise utilized. Additionally, without regulatory approval, a New York financial guaranty insurer may not pay dividends in aggregate during any 12-month period in excess of the lesser of 10% of its surplus and 100% of its adjusted net investment income for such 12-month period. The contingency reserve established by a financial guaranty insurer further limits its dividend capacity as regulators require sufficient liquidity to protect policyholders against loss during periods of financial constraint.

Over the past three years AGM has up-streamed dividends at or near the maximum amount allowed. In 2014, AGM declared and paid dividends of $160 million; during the first six months of 2015, the Company has paid dividends of $106 million. As of 3Q2015, the total amount of dividends available for AGM to distribute in 2015 without regulatory approval is estimated by the Company to be approximately $216 million. Absent significant near-term changes in management strategy or market conditions, KBRA expects AGM to continue to pay the full amount of dividends permitted under New York insurance law.

AGM does not currently expect AGE to distribute any dividends in the near-term. UK corporate and insurance regulations impose no explicit dividend restrictions and, in general, permit the payment of dividends out of an entity's cumulative retained realized profits. However, since dividend payments reduce capital resources, AGE's future dividend capacity to AGM could effectively be limited by the Prudential Regulation Authority's insurance solvency requirements.

XOL Reinsurance

AGM, jointly with MAC and AGC, has entered into an aggregate excess of loss reinsurance facility with a number of reinsurers rated AA- or higher or who have posted collateral. The facility attaches when the group's combined net losses in certain defined US municipal risk exceeds $1.5 billion in aggregate. It covers $450 million of the next $500 million of losses on a pro rata basis, while AGM, MAC, and AGC jointly retain the remaining $50 million. AGM, MAC and AGC have jointly paid $19 million of annual premium at the outset of 2014. The reinsurance agreement terminates on January 1, 2016 although Assured has indicated it may extend the agreement subject to reaching acceptable terms with reinsurers.

Because of its joint nature and the potential for losses at MAC or AGC to limit the support available for AGM, this facility is not incorporated in KBRA's analysis of AGM's rating.

Conclusion

AGM's AA+ rating, Stable Outlook, is based on the company's strong base of claims paying resources which can withstand KBRA's conservative stress case loss assumptions under the Bond Insurer financial model. AGM's rating also benefits from a tested management team supported by strong governance and risk management systems. The substantial and continuing runoff in the structured finance segments of the company's portfolio should continue to lower AGM's overall risk profile.

Balanced against these favorable trends are AGM's expected future dividend practices which could reduce the Company's capital resources, ongoing industry challenges in the face of a persistently low interest rate environment and strong competition, and the prospect of an increasing credit loss profile in the public finance market.

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