Assured Guaranty Ltd. (AGO)
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Q4 2013 Earnings Call

Robert Tucker
Managing Director, Corporate Communications and Investor Relations

Thank you operator.

Good morning and thank you for joining Assured Guaranty for our 4th quarter, 2013 financial results conference call.

Today's presentation is made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The presentation may contain forward-looking statements about our new business and credit outlooks, market conditions, credit spreads, financial ratings, loss reserves, financial results, future reps and warranty settlement agreements or other items that may affect our future results. These statements are subject to change due to new information or future events, therefore you should not place undue reliance on them, as we do not undertake any obligation to publicly update or revise them, except as required by law.

If you are listening to the replay of this call, or if you are reading the transcript of the call, please note that our statements made today may have been updated since this call. Please refer to the Investor Information section of our website for our recent presentations, SEC filings, most current financial filings, and for the risk factors.

In turning to the presentation, our speakers today are: Dominic Frederico, President and Chief Executive Officer of Assured Guaranty Ltd., and Rob Bailenson, our Chief Financial Officer. After their remarks, we will open the call to your questions. As the webcast is not enabled for Q&A, please dial in to the call if you would like to a ask question. I will now turn the call over to Dominic.

Dominic Frederico
President and Chief Executive Officer

Thank you Robert, and thank you all for joining us for the fourth quarter 2013 earnings call.

I'm pleased to report that we ended 2013 with Assured Guaranty's strongest production quarter of the year and increased our operating shareholders' equity per share to an all-time high of $33.83. Adjusted book value per share ended the year at $49.58, which reflects significant value to our shareholders.

Our 2013 operating income of $609 million was 14% higher than in 2012. This was our fourth consecutive year with an operating income that exceeded half a billion dollars, and during this four year period of difficult economic times and turmoil in the financial guaranty industry, we generated $2.4 billion in operating income despite paying $4 billion of insurance claims for RMBS and some other transactions – a truly remarkable result.

Also during this timeframe, we significantly deleveraged the company, reducing our insured portfolio by $181 billion – of which $101 billion of this decrease was structured finance – taking the portfolio from $640 billion of net par outstanding at year-end 2009 to $459 billion at year-end 2013. We also significantly changed the risk composition, with public finance exposure now representing 84% of our insured portfolio. At the same time, our statutory capital increased from $4.8 billion to $6.1 billion, or 27%, and the ratio of our net par outstanding to statutory capital decreased 45%.

It is important to note that since the beginning of the global financial crisis six years ago, we've paid a total of $6 billion in claims, yet we still added $1.4 billion to our statutory capital – a further confirmation of our sound performance and our ability to handle adverse credit.

As an aside, if you told me at the end of 2007 that we would pay $6 billion in claims over the next six years – but still increase our capital by $1.4 billion, significantly deleverage our insured portfolio and improve its risk profile – I would have concluded that our financial strength ratings today would be super AAA. But, I'm sorry to say, our financial guaranty ratings by some ratings agencies no longer reflect the amount or consistency of operating results or our capital adequacy.

What is undisputable is that we proved the financial resilience of our company during one of the worst economic cycles of the last century. Year after year, we have accurately assessed the market, defined our strategies accordingly and executed those strategies effectively.

Looking back, our assessment going into 2013 was that our insured portfolio would experience a net decrease in par outstanding during the year due to scheduled runoff, as well as the low interest rate environment that would likely continue to limit the demand for new bond insurance. Therefore, we enhanced our capital management strategy by returning $264 million to our shareholders through the repurchase of 12.5 million common shares as part of our ongoing share buyback program. These repurchases, at an average price of $21.12 per share, were accretive to earnings, operating book value and adjusted book value per share. We also increased our quarterly dividend per share by 11% in February of 2013, and further increased it by an additional 10% in February of 2014.

To strengthen our competitive position in the market, last year we established a new municipal-only bond insurance company that provides Assured Guaranty a response to the market's desire for a U.S. muni-only insurer, and gives us a valuable strategic flexibility as we assess market demand in the future. We successfully launched MAC in July of 2013, with $1.5 billion of claims-paying resources and an initial statutory unearned premium reserve of $709 million.

Unlike other start-ups, MAC started out in a strong competitive position because it does not have any of the key risks associated with many start-ups. From day one, MAC benefited from market acceptance through Assured Guaranty's ownership, and from a highly granular and geographically diversified insurance portfolio that produces positive operating results. We're pleased with the market's reception of MAC, which is rated in the AA category by both Kroll and S&P. Our Kroll rating of AA+ stable is the highest in the industry, despite what you might hear from some other financial guarantor.

With regard to international business, during last year's fourth quarter earnings call, I talked about the growing international infrastructure finance opportunities that we envisioned for 2013. Our prediction was on target. In the second half of the year, we insured approximately £240 million of UK infrastructure bonds across three separate transactions to produce $18 million of PVP. Our years of commitment to international infrastructure finance clearly began to pay off in 2013. And we are confident that our U.S. structured finance business will also benefit from the same level of strategic commitment.

Companywide, in all of our markets, we generated a present value of new business production (PVP) totaling $141 million by writing $9.4 billion of financial guarantees. We achieved this in a market environment full of headwinds, as municipal issuance was down by 15%, interest rates generally remained low, and credit spreads were relatively tight.

With financial guaranty opportunities constrained over the past few years, we've demonstrated that we can develop and execute our alternative strategies for value creation. Specifically, in 2013:

- We repurchased $331 million of our wrapped bonds at 70% of their par value, generating a pre-tax adjusted book value benefit of $38 million;

- We terminated or agreed to terminate over $7 billion of net par outstanding on 84 policies on which we accelerated the earning of 100% of the expected premiums. Total terminations, including these 84 policies, contributed $144 million to pre-tax operating earnings for the year;

- And we caused rep and warranty providers and other responsible parties to pay or agree to pay over $700 million in RMBS recoveries. Our cumulative recovery to date from RMBS putbacks, settlements and litigation has now reached $3.6 billion.

On the subject of public finance loss mitigation, Assured Guaranty remains committed to working cooperatively with financially stressed municipalities, including those in default.

Jefferson County is an excellent example where we and other stakeholders devised an innovative solution to facilitate an exit from bankruptcy. As part of the County's restructuring plan, which involved the issuance of $1.8 billion in securities, our insurance facilitated an optimal sale of $600 million of senior sewer revenue warrants. We guaranteed the warrants based on the County's improved credit. And, Assured Guaranty's participation in the County's bankruptcy exit plan underscores our unique ability to assist issuers in accessing the capital markets to help them achieve critical financial objectives.

Additionally, we reached a final agreement with Harrisburg, Pennsylvania, and a tentative settlement with Stockton, California, in connection with debt restructuring plans that should contribute to stabilizing these cities' financial condition.

With direct insurance in force on approximately 10,000 municipal credits, our credit track record is outstanding. We expect ultimate losses on fewer than a dozen municipal credits, and during the fourth quarter of 2013, we made claim payments on only five.

Now I'd like to take a moment to address two of our credits that have been in the news lately: Detroit, which is negotiating a bankruptcy plan of adjustment, and Puerto Rico, which – although recently downgraded – is still current on all of its debt service payments.

In both cases, of course, holders of bonds that we insure are fully protected by our unconditional guaranty that they will receive their principal and interest payments on time and in full in accordance with the terms of Assured Guaranty's insurance policies. Even now, holders of Assured Guaranty-insured Puerto Rico and Detroit bonds are benefiting from their insured bonds' relative price stability when compared with the same issuers' uninsured obligations.

The City of Detroit has filed a plan of adjustment with the bankruptcy court that we believe is not confirmable. Besides unfairly discriminating against bondholders, the plan fails to respect state law restrictions on voter-approved special tax revenues and bankruptcy code protections for secured creditors. In the case of Detroit's water and sewer revenue bonds, which account for 85% of our insured Detroit exposure, the plan disregards the protections afforded to holders of special revenue bonds of solvent water and sewer systems.

While our exposure to the unlimited tax general obligation bonds is limited to $146 million, the plan's proposed treatment of those bonds has serious implications for Detroit, and more generally, for municipal finance in the State of Michigan. The plan proposes that ULTGO bondholders effectively receive 20% of what they are owed, and it proposes to divert special tax revenues specifically approved by the voters only to pay debt service on ULTGO bonds to the City's general fund and to fund distributions to other unsecured creditors. Additionally, the secured ULTGO bonds ultimately may be treated less favorably than other unsecured general fund debt, which challenges the fundamental principles underpinning the entire municipal bond market.

Further, there is no basis in law or morality for the City to insulate selected assets to obtain additional funding from outside sources – like foundations or the state – and then apply those funds preferentially to similarly situated or lower ranking classes of creditors. There is a true bankruptcy in Detroit, and that is in the moral and unethical behavior of state elected officials and their appointees.

In the case of Puerto Rico, we recognize that its administration has shown it knows the importance of finding solutions that both improve its financial stability and honor its obligations to creditors. However, based on our analysis of the economic conditions and dynamics regarding Puerto Rico, including its access and potential costs for future financing, we internally downgraded these credits and established reserves, which are reflected in our 2013 results. Rob will address this further in his commentary.

That said, S&P and Moody's have both made clear that Assured Guaranty's exposures to Puerto Rico and Detroit have not affected the ratings or stable outlooks of AGM or AGC.

MAC, by the way, has no Puerto Rico or Detroit exposure.

While we don't believe these credits reflect a systemic trend in public finance, it is important to note that headlines about municipal risk do generate interest in bond insurance, reinforcing the value that our bondholder protection provides in troubled situations and the relative price stability of our insured bonds.

Looking ahead, we are well-positioned for 2014 with $12 billion in claims-paying resources, close to $400 million of annual investment income and $4.1 billion in consolidated net unearned premium reserves.

Ultimately, the need to replace the aging U.S. infrastructure and to fund new projects will support the issuance of municipal bonds. And, in the longer run, we are confident that interest rates will rise as the economy continues to improve and that credit spreads will in due course widen – creating improved conditions for new business origination.

So what is our vision for 2014?

- We believe we can achieve growth in new business production with contributions from all our business areas.

- We expect opportunities to augment both our production results and our unearned premium reserve through the reassumption of previously ceded business or acquisitions of insured portfolios from legacy insurers.

- We will continue to extract value where we find it through our loss mitigation strategies.

- Finally, we intend to continue optimizing our capital management across the group, which would include utilizing, when appropriate, our share repurchase authorization, which now stands at $400 million.

With our success in achieving greater capital flexibility, continuing to deleverage the company, launching MAC, capturing more recoveries, and resolving troubled credits – Assured Guaranty is clearly in a very good position for the future. We have proven that we have the strength, flexibility and human capital to deal with even the most challenging market conditions.

I'd like to thank our shareholders and policyholders for their continued support. I look forward to updating you on our business developments and financial results as the year progresses.

I'll now turn the call over to Rob.

Robert Bailenson
Chief Financial Officer

Thank you, Dominic, and good morning. The fourth contributed $134 million to 2013 full-year operating income of $609 million. Full-year 2013 operating income represents a 14% increase over 2012 operating income. On a per share basis, operating income was $0.73 for the fourth quarter bringing full-year 2013 operating income to $3.25.

I would like to discuss a few highlights of our finical results, which include the economic benefits of our strategic initiatives.

First, as part of our continued R&W recovery efforts, in the fourth quarter, we settled the two R&W providers as a result, realized $23 million of positive pre-tax economic development. In 2013, we had a total seven separate R&W settlements, bringing the year-to-date positive pre-tax economic development from R&W settlements to $314 million. The after tax effect on operating income was $9 million for the fourth quarter of 2013 and $154 million for the full year.

Second, we negotiated terminations of select exposures, which resulted in $38 million of pre-tax premium and CDS revenue accelerations in the fourth quarter. In addition to the immediate benefit to operating income, terminations - along with refundings - deleverage our portfolio and strengthen our capital position. Refundings were $32 million in the fourth quarter of 2013. For the full-year 2013, terminations and refundings contributed $284 million in pre-tax net earned premiums.

Third, we continue to purchase loss mitigation bonds for our investment portfolio. In the fourth quarter, we purchased $85 million in par bringing the full-year 2013 purchases to $331 million. Purchased loss mitigation bonds offset expected losses, boost investment yield and help offset the effects of lower reinvestment rates. As of December 31, 2013, we held $439 million in loss mitigation bonds at fair value in the investment portfolio, having a 9.7% yield.

Finally, we negotiated consensual restructurings with Jefferson County, Alabama and Harrisburg, Pennsylvania in the fourth quarter, which resulted in over $40 million of PVP on newly insured revenue bonds for both municipalities. As Dominic noted, Assured Guarantee's ability to help these municipalities restructure their debts and regain market access further demonstrates the value of our financial guarantee product. For the full year we wrote $141 million of PVP, including three UK infrastructure transactions that marked the reemergence of wrapped capital market infrastructure financings in the UK.
In total, operating income for the quarter of $134 million is down compared with $184 million of operating income in the fourth quarter of 2012 due primarily to lower terminations and refundings and the scheduled amortization of un-earned premiums. This was offset in part by lower loss expense primarily in the U.S. RMBS sector.
Pretax economic loss development was $89 million in the fourth quarter of 2013, which was primarily due to developments in U.S. public finance exposures including Puerto Rico and Detroit.

Full year 2013 economic loss development was $56 million. The U.S. public finance sector was the primary driver of economic loss development. These losses would largely offset R&W recoveries on RMBS.

Turning to Puerto Rico, I would like to start by noting that all of our obligors have made all the debt service payments, and we believe that the commonwealth is taking appropriate steps to address its budget issues. However, we recognized that the rating agencies' announcements that Puerto Rico had been put on watch due to budget deficits and a weak economy, could hurt the Commonwealth's prospects for accessing the capital market. As a result, the Company downgraded most of its Puerto Rico credits to below-investment-grade and the rating agencies subsequently announced they had also downgrade Puerto Rico. After the downgrade of Puerto Rico, Moody's reaffirmed our ratings and S&P stated that the incremental capital charge to assure guarantee for all our Puerto Rico closure would be approximately $65 million.
Under our loss estimation process with taking into account estimates of both the probability and severity of default of each issuer, we established a loss reserve for our BIG Puerto Rico exposures.

The effective tax rate on operating income was 25.2% for the fourth quarter. On a year-to-date basis it was 26.7%, which is slightly higher than 25% for 2012. The primary driver of effective tax rates in recent years has been the allocation of loss expense between taxable and non-taxable jurisdictions, which increased the full year effective tax rate.

Adjusted book value per share increased to $49.58 from $47.17 at December 31, 2012, primarily due to share repurchases. Operating shareholders' equity per share increased to a record $33.83 from $30.05 at December 31, 2012, primarily as a result of share repurchases and year-to-date operating income.

On a per share basis, 2013 share buybacks added $1.84 to adjusted book value, $0.83 to operating book value.

Seeing that we would benefit from greater capital flexibility within our corporate structure, we took two further important steps during 2013. First, we obtained regulatory permission from Maryland and New York insurance regulators that increased unencumbered assets at AG Re, a key source of funding for our share repurchase program. Second, we became a tax resident of the United Kingdom. Both of these actions will make it easier to manage capital efficiently across our group, as we continue to evaluate and respond to business opportunities and market conditions. While we have not repurchased any shares since the third quarter of 2013 under our $400 million authorization, we have moved funds in place in order to be able to efficiently buy shares in 2014 depending on market conditions.

As of December 31, 2013, we had unencumbered assets of $238 million at AG Re, $228 million of liquid assets at the U.S. holding companies, and $33 million at AGL.

Looking forward, I would like to point you to our financial supplement for detail on some of our expectations for 2014, where we provide you with estimates for net premiums earned and loss expense. Premium estimates did not include refundings and terminations. We expect 2014 net earned premiums and CDS revenues to be less than prior years based on scheduled amortization of par and the fact that we terminated $24 billion in par over the past three years. With respect to loss expense, we have fewer R&W providers left to pursue and therefore expect that the benefit to operating income and economic loss development in 2014 to be less than the amounts we have recognized in the past several years.

I expect 2014 net investment income and operating expenses to be relatively flat compared with prior years, with the first quarter operating expenses being slightly higher than the rest of the year due to accelerations of compensation expense for retirement eligible employees.
I'll now turn the call over to our operator to give you the instructions for the Q&A period. Thank you.

Q&A Session

Operator
Thank you. We will now begin the question-and-answer session. And our first question comes from Sean Dargan of Macquarie. Please go ahead.

Sean Dargan
Thanks and good morning. I just have a question about share repurchase or lack of it in the fourth quarter. You had dividend capacity in most of the statutory entities, why did you choose not to repurchase shares in the quarter?

Robert Bailenson
Hi, Sean, we have been making plans and moving money to the right legal vehicles and we plan on exercising and moving forward with our share repurchase plan. We just want to make sure we had all of the regulatory approvals and moving money into the right places. So we've had regulators and making sure we have the right liquidity in place making sure that we were cognizant of all of our responsibilities with respect to our insurance collateral posting requirements, but as you can see I've just disclosed exactly what we have available at all the holding companies and we're fully expecting to utilize our share repurchase program in the coming months.

Dominic Frederico
Sean, just so you understand, there's not really an official waiting period, but on the advice of our tax counsel, they had preferred that we have a semblance of operations for period of time, relative to the UK residency qualification and we wanted to honor that, and at the same time we still had to look at year end where typically you'll see a lot of activity from our reinsurers in terms of posting new reserves for the year-end financials, so obviously the expenses that would increase encumbered assets at AG Re we had to be cognizant of that as well. So, it's just us being cautious and to provide what I'll call a cure period for the restructuring.

Sean Dargan
Q: All right. Thank you. And then question on Puerto Rico, I recognize that the commonwealth is doing the hard things, is making the right decisions. Just in thinking of the possibility of that at some point down the road there may be a restructuring, what might that entail? Would that be Puerto Rico going to the bond holders and saying, you have to accept $0.60 on the dollar or you get zero, or what might be some possible options if Puerto Rico at some point had to restructure its debt?

Dominic Frederico
A: Well Sean, your guess is as good as mine and I'm sure both of us have read thousands of pages of various projections on Puerto Rico. What can we say? In most cases, about 50% of our exposure is in general obligation and 50% of our exposure is revenue. Both have had historically very, very low levels of both defaults as well as severity into defaults, based on the revenue streams that are attached to both.

Number two, Puerto Rico does not have a chapter nine option or opportunity, therefore settlement has to be negotiated as opposed to, as in Detroit's case, kind of like blustering rhetoric through ridiculous plans being aired. So you would think there will be a consensual kind of view to it, much like Jefferson County, where things get worked out into the market to hopefully a fairness and equitable settlement with all stakeholders. And as we – we've always looked at in Puerto Rico, debt service in total, was roughly about 10% of the budget. So the budget has a structural deficit of 2% to 3% that would appear to be more than enough funds to be able to fully satisfy the debt.

And because the debt is critical to the continued development of any recovery and I don't care what municipality or organization you look at, the access to bonds is as critical to stimulating economic growth going forward as anything else, so at least Puerto Rico of most creditors obviously fully understands that, have made every proper statement in the full support of that.

So I look at our track record and you can't ever come out with any concrete answer here, but we have done very, very well even with the troubled credits that are truly troubled and they really don't want to respect the bondholders and therefore, I'm pretty optimistic, we've got a troubled credit that really does respect bondholders, appreciates the value of the access to the markets and it's trying to work cooperatively with all stakeholders.

So we're very optimistic on Puerto Rico and obviously stand there in full support to help them accomplish their goals. And if that means a restructuring, where we extend terms, lower rates, things you typically do in a lot of municipal workouts, then so be it. Obviously, we look to preserve our economic integrity and that's the goal we've always looked at as we work in any of these things, but at the same time, try to help the municipality to achieve some level of balance or at least support for the current years that they need that and obviously push the obligation out to the future.

Sean Dargan
Okay. Thank you.

Dominic Frederico
You're welcome.

Operator
Our next question comes from Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Dunn
Thank you. Good morning.

Dominic Frederico
Good morning, Geoff.

Geoffrey Dunn
Dominic, can you – or Rob maybe too, can you talk about how you think about going about reserving on such uncertain exposures like Detroit and Puerto Rico. I know its probability and scenario weighted, and I look back on the example of Greece where you were doing that same thing and all of a sudden at the end you had this big true-up, because the loss exposure just changed with the reality of the settlement. How do people get comfortable that each quarter goes by and you get more information, you update your probabilities, maybe you bleed more into reserves or a little less? But how do you get comfortable that all of a sudden things just don't change like they did in

Greece and we have a big loss sitting in front of us. How does the world you're facing now influence how you think about reserving and the practice of reserving?

Dominic Frederico

Well, Geoff, I want to thank you for opening up an old wound. And we have said repeatedly – I think we've done a fairly new job in assessing troubled credits and credit impairment, I do not think we did a very good job in Greece. We gave a value to the substitute bonds that weren't there and we misread that situation entirely, and we'll take the beating and we will give you our apologies repeatedly.

In the municipal world, Rob will work through the mechanics, but you do start-off with some premise here, you've got a type of security that you're familiar with. You've got all sorts of published, both default and severity probabilities by every rating agency including our own experience, that gives you kind of a guideline as you try to assess the various scenarios that you want to evaluate as possible outcomes in developing your reserve calculation. That's always been the premise and you're right, we update it based on new facts that we see, and obviously we also assess, remember in a lot of cases, we'll always tell you that the first thing we start off with is, what is the issuer's attitude? Is he looking to cooperatively work this thing out? Is it an antagonistic or confrontational situation? Because that's going to obviously dictate a lot of things. LAE, how much money we're going to have to spend in litigation if it comes to that, as well as substantial size of the settlement. So now, I'll give it to Rob, I think you've got to… Greece was Greece, and we will continue to take the appropriate amount of lashes from you and our shareholders for the misestimate on our part, but this is muni.

Robert Bailenson

I mean, Jeff, just to add a little color, like Dominic said, we look at new available information in the market, I mean with respect to Puerto Rico, we went through a risk management process where we downgraded all the Puerto Rico credits. And you look at our process, when you downgrade some into below investment grade, you look at the probability and severity of default for each individual credit. These probability and severity factors are based on a number of factors. We look at statistics that are out there in the market, we look at rating agency statistics, and we evaluate that information. And as Dominic said, it's very important to look at the willingness of that issuer to pay its obligation.

And, with respect to all municipal credits and all credits, we look at new information and we go through a robust reserving process where we evaluate and we come up with, it's not an exact science, we come up with a probability weight of what we think is ultimately going to happen. I mean with Greece, as Dominic says, we missed it, but we were looking at information that we thought was appropriate. Ultimately, the estimate was, I would not say it was incorrect. It was just, we gathered new information that showed that we were not correct at the time. So, that's how we look at this and we continue to evaluate it and we look at this available data to come up with our reserving process.

Geoffrey Dunn

All right, just two follow-ups then and just trying to understand it and being a little bit of a devil's advocate. So on Puerto Rico, what changed this quarter versus last quarter that prompted a downgrade now versus a quarter or two ago? It doesn't seem like too many things are different other than a lot of positive talking out of the government. And on Detroit, how do you gauge the probabilities when kind of all the old guidelines are thrown out the window by the officials who don't seem to really care about the full faith that's supposed to be behind GOs?

Robert Bailenson

Well, with Puerto Rico we looked at what all rating agencies were putting them on watch. Once, I think it was S&P, Moody's, and Fitch all put them on watch, we felt it was a high likelihood that they were going to be downgraded. So, we looked at that analysis and we looked at our exposures and we felt it was necessary, as we do in our risk management committee meanings, to evaluate the likelihood that this should be below investment grade. And because they put them on watch and because we believe that one was going to eventually downgrade them, it does affect, it could affect, their access to the capital markets. If some issuer will have a problem accessing the capital markets based upon all you've read on Puerto Rico, we think most of those credits deserve to have a below investment grade credit, below investment grade rating. So that's what happened this quarter, which caused us to downgrade Puerto Rico's credits.

Dominic Frederico

I'm going to interject. So, you said, what would change in the quarter? Obviously all three rating agencies putting them on negative outlook or negative watch was one of the key factors. And yet, to be very honest with you, it was still a high level of discussion in the company for us to make a move. And one of the things that led us, believe or not, to further revaluate it was S&P was the last one to move and when you had all three rating agencies then put them on a negative watch, we believe the impact that would have on their ability to access the market if they chose to do so, would create a bigger structural deficit because of the higher cost of financing. So, that was, for us, the big kicker and we were probably still trying to hold this at investment grade as we looked at the quarter and the quarterly results trying to prepare the final year end 10-K, as you're all aware what kind of a production that is for any company in light of everything you've got to put in these things.

So, it was really a close call, but that last kind of straw on the camel's back was S&P on the Friday, as we were looking to finalize the results, that also then put them on negative watch, led us to conclude that there was a high probability of a downgrade. This downgrade would definitely increase at a minimum the cost of financing and therefore, we really had to take a hard look at the credit and make the determination we did.

In Detroit's case, I can tell you, we're going to get paid 100%. That's about got as much basis as that plan of adjustment that was just filed last week. This thing will ultimately be determined in the courts. We're very comfortable with our position vis-à-vis how we view our protections that are provided within the specific documents to support the bond issuance including the city council's vote and authorization, the citizens' vote and approval, the fact that some of the projects that were financed with those bond offerings actually dealt with the art museum, and now they claim that that's not even an asset of the city. I think they've not done this the right way. As I said, I look at the moral and ethical behavior of these people to be absolutely deplorable, and we're very confident that as this thing plays out in the courts, there will be some justice served, and things will be righted as they should be.

Geoffrey Dunn
Okay. Thank you.

Operator
Our next question comes from Brian Meredith of UBS. Please go ahead.

Brian Meredith
Good morning. Couple questions for you here Dominic. The first, I'm just curious, when you go through a restructuring like you did with Jefferson County and Harrisburg and wrapped some debt, what do the terms of that debt look like? Is it any different than you typically do? Did you get more money there? Do you have any other protections that you get?

Dominic Frederico
Each of them are kind of unique. You used a few that really took very divergent paths. I will tell you that the flavor of the day appears to be and kind of came out of Stockton and we think it ultimately be included in a lot of other restructurings. You wind up taking some fixed and absolute payment of some reasonable value against the obligation. There's typically some contingency payment that really looks to the future development and expansion of the revenue base of the specific municipality. So you think about the old fashioned bankruptcy, you got the equity in the company. In municipal bankruptcy, you don't have an equity opportunity here, but you can structure contingent type securities that participate in the recovery and growth of the specific municipality. So Stockton is a perfect example of that. Jeff Co, these are just senior sewer warrants that we would have insured every day of the week, every month of the year because they were really highly preferred, highly structured, based on the new rate structure that was agreed as part of the bankruptcy, we think had great cash flow protection. And yet, they needed us to affect that solution, which once again validated the product, validated Assured Guaranty's value into the marketplace. So, Jefferson County is very different than Stockton, very different than Harrisburg. Harrisburg has the same type of a contingency plan and its case it's on a specific asset, the parking garages versus in Stockton's case, it's really on the entire city revenue source. So they're starting to take a flavor of kind of a quasi-equity type participation, but what are you providing? You're providing some relief in the current period to allow them the opportunity to restructure and make some investment to grow and then you participate in the growth going out into the future.

Robert Bailenson

And just to be clear with Jefferson County, we provided a significant amount of savings with that issuance in wrapping a de-levered sewer authority that we were very comfortable with the credit and provided savings and got paid a very nice premium. So, we were very pleased with that execution.

Brian Meredith
Got it, thanks. And then a follow-up, looking at kind of what's going on in Detroit right now and is there anything that you could do or thinking about or contemplating doing with your contract wording to maybe alleviate a situation like that occurring again?

Dominic Frederico
Yeah, we like the contract. So we'll see all this plays on core, when you get to the senior levels of court, they tend to redesign and when you look at our documents and how they specifically state that the tax will only be used to repay the debt that the tax is both city council and board approved and only specifically to repay the debt. Yeah, can you make the wording better? I guess we can make them all, put their hands in their chest, but since they don't believe in pledges, I'm not really sure that gets us anything, but of course we'll look at, as this thing play out, whether there is going to be any – we try to learn from every credit situation there is, obviously, we're learning a lot about pension obligation bonds, as you can well appreciate, no pun intended.

So, we look at that, as an ongoing part of how we view the underwriting process, and Steve Donnarumma who is the chief underwriter in the company, this year we went through a major revision of limits kind of aggregate exposures, we redefined what businesses where we look to insure, so we constantly upgraded, and if we think that there is an ability to upgrade the contract, we will definitely research and make those changes as we see fit.

Brian Meredith
Great. And then, last question. Any update on any progress with Credit Suisse?

Dominic Frederico
We haven't heard anything yet.

Brian Meredith
I think that answers it.

Dominic Frederico
We had a very good year in the rep and warranty space. I count seven different settlements of either whole or part of transactions with several different providers. You can see there is a lot more press now. They seem to be in a rather large settlement right now as I remember reading the other day about them. So, when they turn to us, it's going to be very expensive for them, the longer they wait, the more expensive it's going

to become. We have the luxury of being able to wait, I think we believe the case, we'll go to trial somewhere in 2015. So, hey, we're more than happy to play.

Brian Meredith
Great. Thanks.

Operator
And our next question comes from Larry Vitale of Moore Capital. Please go ahead.

Larry Vitale
Hi, thanks. Good morning. Can you guys hear me okay?

Dominic Frederico
Yes, Larry. How are you there?

Robert Bailenson
Hey, Larry.

Larry Vitale
I just wanted to go into a little bit of detail on the way the reserves ceded to Bermuda and the posting of collateral works. So, can you give us some flavor or quantify the amount of losses ceded to Bermuda, and how much collateral you had to post? My understanding is it's dollar for dollar, and that this would have taken up at least some of the cash that might have gone to share repurchasing in Q4.

Robert Bailenson
Well. I think, Larry, as we said, everything that we cede to Bermuda, not just us but anybody that is a third-party that ceded to AG Re, we have to collateralize the UPR losses and contingency reserve. We, as I said in my script, we have stated that we made great efforts this year with our regulators to recapture for own account, they can skip contingency reserve that was ceded to AG Re. And that freed up about $160 million in 2013, we do have a scheduled release in 2014 based on regulatory approval that hopefully would be another $240 million. So, that's how that process works.

Larry Vitale
Hopefully $240 million, Rob, what could make it less than that?

Robert Bailenson
Well, it's always at their discretion, so, they have to evaluate AG Re as credit. They've agreed to this schedule, but they've also agreed, they've also asked to have it reviewed before they give us final approval. So, they would evaluate AG Re as a credit, and they will let us know by July. In addition to which I just want to make sure, it's clear that we don't – with this agreement with the regulators we will not be posting additional contingency reserves on ceded business from our affiliates to AG Re as well. So the problem won't exacerbate.

Dominic Frederico
There are three things where you've got to consider when you look at the unencumbered assets at AG Re, so Rob's right. We have reinsurance that we have to post, reserves, UPR, contingency reserves except now for the internal, but you have both internal reinsurance and external reinsurance. So in the fourth quarter, we got advised on a very large reserve related to our friends in Detroit by a ceding company that we had to post dollar for dollar and it was significant. I don't know if we've ever released the number, but a large number.

Number two, in addition to having to post the reserves because your reserve posting is constituted in asset to marketable securities to the extent the valuation of the portfolio goes down because of a rise in interest rates, you have to top up the shortfall. So, you have ceded reserves both internal and external that post dollar-for-dollar and then the fourth quarter, we got a large cede of reserve.

Number two, you then have to top up the value of those collateralized assets based on any change in interest rates and therefore the carrying value of the securities and understand we can't go too far because the ability to recover money and paying maturity is not something that's available to us day to day.

Now we do and have put in plans to make the capital a lot more flexible. So the UK tax revenue fee will be big and allowing us once we go through the cure period time, whatever you want to call it to start to move funds out of the U.S. holding companies and therefore it gives us protection that if we do have a shortfall somehow we can easily make it up based on a significant rise in interest rates or a new advised posting of a loss reserve.

As Rob said, we do have a scheduled release further in 2014 of contingency reserves for both the state of New York and the state of Maryland that will add significantly to free assets. So as we look down the pipe, it appears to be while a lot more flexibility in freedom in terms of how we can apply excess funds that are in the current structure in the company.

Robert Bailenson
And Larry, we would like, as Dominic just noted, we would like to keep a cushion at AG Re, and we have $238 million at year-end free at AG Re, and this UK tax residency is going to allow us to use other funds and not consistently hit a subsidiary, which I think is a very good rating agency fact as well. We don't want to constantly hit AG Re to be the sole source of our equity and share repurchase.

Larry Vitale
Okay. So to be clear, the 240 that you're hoping to be released in July or by July, is in addition to the 238 at AG Re, the 228 at the U.S. Holdco and the 33 million at AGO, is that correct?

Robert Bailenson

That's correct.

Larry Vitale
Okay. And then last question. Your willingness and ability to use these funds to repurchase your shares at deep discounts to, however you want to look at it, adjusted book or operating book, is a timing issue and in no way reflects a change in your attitude as to your willingness to do so or your view of the attractiveness of your shares at these prices?

Dominic Frederico
I will continue to restate, one of our critical strategic objectives is capital management in 2014. And there's nothing that has changed that strategic view to date nor do I see as I look out for the future.

Larry Vitale
All right. Very good. Thank you guys.

Robert Bailenson
Thank you.

Dominic Frederico
You're welcome.

Operator
Our next question is a follow-up question from Mr. Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Dunn
Thanks. So, Dominic, I wanted to ask you in terms of a mid to long term capital management effort, I've asked you about the prospects of special dividends in the past, and I'm curious, how do you think maybe the two to three year capital management plan might have been altered by the downgrade of Puerto Rico, and the moving of your BIG list to close to 5% of par now?

Dominic Frederico
Well, since, we've really – BIG for us is really cautionary; it's how we want to surveille the credits more than anything else. We have a lot of things on BIG that never result in an ultimate economic loss, so it's more of a management tool than anything else, and it's obviously something that we do track, and our surveillance team is very religious in providing detail and discussion almost on a weekly basis, if you are Detroit or Puerto Rico, maybe monthly on some other things. We're getting to do less meetings on RMBS, I'm happy to report.

So for us, it really is a placeholder as opposed to an economic, so it hasn't changed at all my view or my attitude as to the amount and the timing of share repurchases. So, I don't think it has a long-term implication. Hopefully, Puerto Rico is going to achieve this financing; we think that will relieve a significant amount of pressure. Whether they'll have everybody take a relook at ratings, we will take a relook at our own internal ratings, as to how we manage it. But as I said, our below investment grade is more like a placeholder than anything else for us to manage it internally within the company.

Geoffrey Dunn
And do you think that that attitude holds for the regulators and how they might view your request?

Dominic Frederico
Well, we don't believe, as we look at the amount and the volume of share repurchasing, we don't believe we have the need at this point in time to access the special dividend. We think there's going to be enough available funds flowing through the operating companies. And now with the timing of the structure that we've been able to achieve, and in terms of the UK residency, we should be able to move enough funds on a reasonable basis to keep a good momentum, around share repurchasing without the need for special dividend. Obviously, we are looking to potentially do some raising of debt which will further relieve the pressure on special dividends. I think we've got a lot of tools in the toolbox before we go to special dividends but obviously we are not concerned by that. If the need arises, we have no issue with going to the regulators and asking for that. We think just with the size of portfolio runoff, and the amount of capital we're still holding relative to a lot smaller portfolio. I think there is more than enough justification, but at this point in time, Geoff, we think we have enough throughput from the operating subsidiaries to continue to fund a rather reasonably aggressive share repurchase program.

Geoffrey Dunn
And that's great. Thank you.

Dominic Frederico
You're welcome.

Operator
This concludes our question and answer session. I would like to now turn the conference back over to Mr. Tucker for any closing remarks.

Robert Tucker
Thank you, operator. I'd like to thank everyone for joining us on today's call. If you have additional questions, please feel free to give us a call. Thank you very much.