Assured Guaranty Municipal Corp. (AGM)

Analytical Contacts:

Peter Giacone, Senior Director
pgiacone@kbra.com, (646) 731-2407

Paul Kwiatkoski, Managing Director
pkwiatkoski@kbra.com, (646) 731-2387

Jack Morrison, Associate Director
jmorrison@kbra.com, (646) 731-2410

Josh Deligdish, Analyst
jdeligdish@kbra.com, (646) 731-2437

Karen Daly, Senior Managing Director
kdaly@kbra.com, (646) 731-2347

January 23, 2018

Table of Contents

Executive Summary

Kroll Bond Rating Agency (KBRA) has affirmed the following insurance financial strength rating (IFSR) on Assured Guaranty Municipal Corp. (AGM or "the Company") based on KBRA's **Financial Guaranty Rating Methodology** dated December 18, 2015.

Ratings				
Entity	**Type**	**Rating**	**Outlook**	**Action**
Assured Guaranty Municipal Corp.	IFSR	AA+	Stable	Affirmed

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. KBRA then assessed AGM's ability to meet these claims. In this stress case scenario, AGM satisfied all claims in full and on time and, in KBRA's opinion, their ability to do so supports this rating.

KBRA notes that significant uncertainty remains with respect to AGM's exposure to Puerto Rico. The financial position of the Commonwealth of Puerto Rico is in a state of distress as evidenced by widespread defaults by most Puerto Rican issuers and the implementation of Title III of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). The impacts of hurricanes Irma and Maria on Puerto Rico have further clouded and impeded the path to resolution and fiscal reform, causing, among other challenges, the Oversight Board to pursue revisions to the previously certified fiscal plan. Due to these conditions, KBRA has incorporated deeper severity assumptions in the losses it applies to AGM's Puerto Rico exposure. Specifically, the moratorium period has been extended from 5 years to 8, recoveries have been reduced from 50% of losses to 35%, and recoveries are realized beginning in year 11 instead of year 6. Additional details are provided later in this report.

AGM has written primarily U.S. municipal business since the credit crisis and this segment continues to represent an increasing majority of the company's insured portfolio. AGM's legacy exposure to structured finance continues to decline rapidly, decreasing by approximately 60.7% from KBRA's last review. Within AGM's structured finance portfolio, the Company has net exposure to approximately $3.6 billion of residential mortgage backed securities, which comprises approximately 2.9% of the total insured portfolio. In developing stress case losses for this sector, KBRA's RMBS analysts individually reviewed all of AGM's material RMBS exposures, applying stress assumptions based partially on the sub-sector (e.g. first lien, HELOC, CES) and incorporating the impact of specific transaction structures and subrogation recoveries.

Similarly, conservative assumptions were applied to a small number of other distressed credits within 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.

The company has made substantial progress in management's previously announced plan to combine its four affiliated European entities to create a consolidated platform for business origination in the region. KBRA has analyzed this combination as if it were fully completed. One result of the entity combination was to increase AGM's insured portfolio on a consolidated basis by about $14 billion, thereby halting the ongoing decline in financial leverage that has occurred steadily since the credit crisis. KBRA reviewed 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.

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 $4.7 billion, down nearly 95% from $91.4 billion at year-end 2009.
- Mature and high-functioning operating platform supported by strong governance and risk management systems.
- 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.
- The ultimate level of losses in Puerto Rico remains unclear.
- Significant industry risks are characterized by narrow credit spreads, low interest rates, vigorous competition and the increased loss profile manifested in the public finance market.
- Management is returning capital to holding company shareholders through ordinary dividends and a stock redemption plan from AGM. This capital extraction from AGM could place downward pressure on the rating if portfolio risk levels increase rapidly or are not visible in time to limit management's future dividend practices, recognizing management's stated intent to not take any capital management actions that fail to maintain or improve AGM's ratings and trading value.

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) Puerto Rico, (ii) other distressed credits, and (iii) 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 KBRA's 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.

KBRA's Stress Loss Treatment by AGM Portfolio Segment ($ in millions)

Portfolio segment	Net Par (9/30/2017)	Financial Guaranty Stress Losses[1] (Future Value)	Comments
Puerto Rico	$2,319	$1,494	8-year debt service moratorium (35% subsequent recovery in years 11-15) followed by severities of 7.5% to 30% based upon issuer as remaining debt service comes due
Distressed structured finance and other credits	$4,050	$921	Includes RMBS, XXX insurance securitizations and other distressed public finance credits
Balance of portfolio	$115,437	$1,580	Monte Carlo simulation losses
Totals	**$121,806**	**$3,995**	**Aggregate stress losses incorporated in Bond Insurer Financial model**

[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.

The bulk of AGM's insured portfolio (95%) 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 particular path, a sector-specific severity assumption is applied against the amount of debt outstanding at that point in time to calculate a loss amount. 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.

In KBRA's opinion, the aggregate of stress losses shown above ($4.0 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. KBRA 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 $4.9 billion. For the financial model, in order to account for ongoing actions by management to extract capital beyond AGM's ordinary dividend capacity, KBRA has assumed an additional near-term CPR reduction of $200 million. 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.

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 portfolio risk profile and 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 Puerto Rico and 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.
- Further developments in Puerto Rico which indicate ultimate recoveries approaching zero.
- 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.
- Levels of capital extraction or deployment that outpace the decrease in portfolio risk.

Key Rating Determinants

Rating Determinant 1: Corporate Assessment

Background

AGM's ultimate parent is Assured Guaranty Ltd. (AGL). AGL, together with its subsidiaries, (Assured Guaranty), 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.

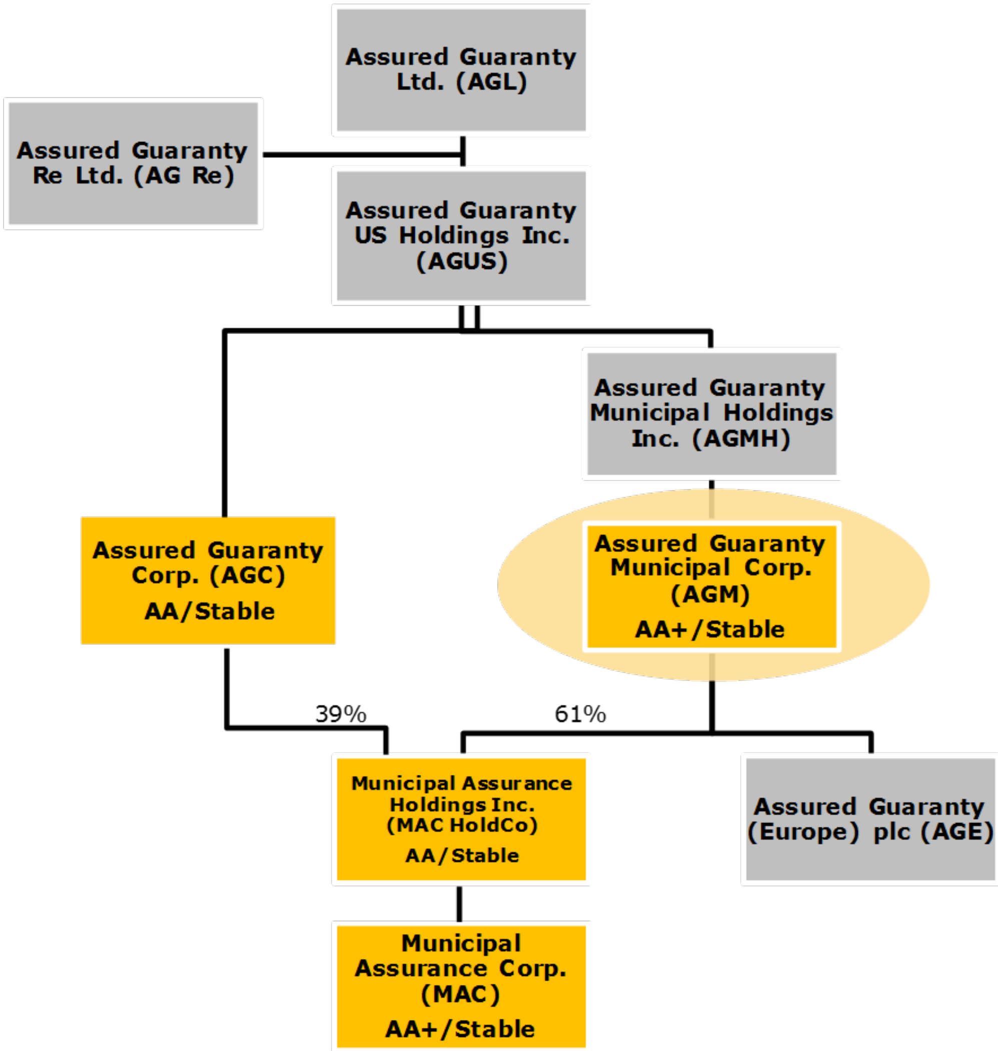
On July 1, 2009, Assured Guaranty acquired Financial Security Assurance Holdings Ltd., whose principal insurance subsidiary was Financial Security Assurance Inc. (FSA). Assured Guaranty continues to operate FSA and has changed its name to Assured Guaranty Municipal Corp. (AGM).

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) plc (AGE) based in the UK. Together they provide financial guaranty policies on global public finance and infrastructure debt obligations. As reported, AGM insured $11.6 billion of direct par in the first nine months of 2017. The other AGL operating companies are Assured Guaranty Corp. (AGC), rated AA, Stable Outlook by KBRA; Municipal Assurance Corp. (MAC), rated AA+, Stable Outlook by KBRA and Assured Guaranty Re Ltd. (AG Re), not rated by KBRA.

Ownership Structure

AGM is a wholly-owned subsidiary of Assured Guaranty Municipal Holdings Inc. (AGMH), an intermediate holding company and a wholly owned, indirect 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 simplified 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 on smaller to medium size transactions in lower risk sectors. AGC underwrites primarily structured finance business but has done only a moderate number of transactions since the credit crisis. AG Re provides reinsurance capacity in all of these areas. KBRA notes that AGM and AGC have legacy exposures that differ from the risk profile of their current strategies. AGM's international infrastructure net par outstanding has significantly increased due to new business underwritten in 2017, corporate acquisitions, and the transfer of Assured Guaranty's European insurance subsidiaries to AGM's subsidiary, AGE.

AGM has been the most active writer of new business within the group. The number of direct international infrastructure transactions underwritten by AGM, separate from those incurred from acquisitions and consolidations, has been low in recent years but increased activity in this sector in 2017 is evidence of management's increased focus to expand AGM's role in this sector in the future.

As previously noted, Assured Guaranty has taken significant steps in 2017 to combine its European operations. In January 2017, AGC purchased MBIA UK Insurance Limited (MBIA UK). AGC subsequently changed the name of this entity to Assured Guaranty (London) plc. Note that AGC already maintained two other European subsidiaries, Assured Guaranty (UK) plc as well as a small French entity, CIFG Europe S.A. (resulting from a larger acquisition of CIFG in 2016).

Through a series of transactions, in mid-2017, AGC sold Assured Guaranty (UK) plc, Assured Guaranty (London) plc and CIFG Europe S.A. to AGM, which in turn contributed all three of these entities (the Other European Subsidiaries) to AGM's existing European subsidiary, Assured Guaranty (Europe) plc (AGE). The final stage of the European combination will involve merging the exposure of all four subsidiaries into Assured Guaranty (Europe) plc, with this company as the lone surviving entity and flagship company for new business origination in Europe. The result of the transfer of the Other European Subsidiaries to AGM was to add about $14 billion of net par exposure to AGM. U.S and European regulators have approved the actions taken thus far and Assured Guaranty is currently seeking final regulatory and court approvals to merge the Other European Subsidiaries into AGE.

Assured Guaranty has selectively invested in alternative investments, including private equity asset managers, and leveraged debt funds. These relatively small investments reflect the execution of an initiative to deploy capital from Assured Guaranty's operating companies, including AGM, that management deems excess capital. These investments are expected to be admitted assets under statutory accounting policies and standards. In our stress case financial model, however, KBRA reviews each investment on a case by case basis with respect to the funds available to pay claims and applies haircuts that KBRA deems appropriate to reflect the increased risk and lower liquidity of these assets. KBRA will continue to monitor the company's progress in building out its alternative investment strategy and any potential impacts on AGM's claims paying resources and risk profile.

Corporate Governance

The Board of Directors of AGL ("Board") is responsible for the corporate governance of all of its subsidiaries, including AGM. The AGL Board consists of 10 members and, except for the Chief Executive Officer (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 six committees: Audit, Compensation, Finance, Nominating and Governance, Risk Oversight, and Executive. The 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 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.

Risk Management

Assured Guaranty 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, the Executive Officer, President AGE/UK, Chief Actuary, and SMD Alternative Strategies

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 PRMC meets about four times a year to establish risk policies, risk limits, credit standards and committees, approve new products and 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 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 maintaining and updating AGM's internal economic capital model. This model assesses the level of capital required to provide for stress scenario losses developed by the company and applied to AGM's insured portfolio. The company endeavors to maintain a capital cushion above these stress losses. The economic capital analysis is performed at least quarterly as well as prior to the payment of any ordinary or extraordinary dividend as part of the company's objective to pursue only those capital management actions that maintain or improve ratings or trading values.

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

Surveillance

AGM's surveillance of its insured risk is integrated with the surveillance process for all of Assured Guaranty. 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 one to six that also determine the level of ongoing review. Category one and two credits are considered to be performing in accordance with expectations and are generally reviewed on an annual or semi-annual basis. Category three generally requires quarterly reviews. At Category four the intensity of review increases further and generally requires the creation of a team that includes legal resources. Categories five and six 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 (four, five and six). In addition, for many sectors, AGM's entire exposure to the sector is reviewed in one report.

KBRA views the surveillance 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

The following section contains a detailed review of AGM's insured portfolio followed by a discussion of KBRA's modeling and stress analysis of the portfolio. All par exposure numbers shown below are on a statutory basis as of September 30, 2017, excluding the purchase of AGM insured bonds.

Insured Portfolio, Gross and Net

AGM's insured portfolio has a total of $201.3 billion of gross par and $121.8 billion of net par outstanding. Nearly $80 billion, or 40%, is reinsured, as discussed further below. The portfolio remains diversified with over 7,500 individual risks. The insured portfolio includes a range of public finance, international infrastructure, and structured finance sectors and contains credit characteristics similar to those at the last portfolio review. In past reviews, AGM's portfolio on a net par basis was running off as new business written was not sufficient to replace run-off due to scheduled debt maturities, bond refunding activity, and loss mitigation efforts. However, AGM's portfolio, as of September 30, 2017, reflects an increase of approximately 2% of net par as reported from 12 months prior. The small increase is largely the result of acquisitions on the Assured Guaranty platform and the resulting consolidation of all international infrastructure exposure under AGE (which is owned by AGM) as well as continued modest volumes of new business written.

Although a substantial amount of par is reinsured, the bulk of this is to AGM's affiliates, MAC and AG Re. Over 95% of total cessions are to Assured Guaranty entities.

AGM Portfolio		
Par Outstanding ($ mm)		**9/30/2017**
Gross Par		$ 201,268
Ceded Par		79,461
AG Re	$ 50,723	
MAC	21,173	
AGC	3,850	
Other	3,715	
Net Par		$ 121,807

Note: Excludes bond purchases.

AGM Portfolio		
Distribution of Par ($ mm)	**9/30/2017**	**% NPO**
U.S. Public Finance	$ 85,151	69.91%
International Infrastructure	31,970	26.25%
Global Structured Finance	4,686	3.85%
Total Net Par	$ 121,807	100.00%

Net Par Exposure by Type

AGM's insured portfolio consists of both public and structured finance obligations. The portfolio composition remains relatively unchanged since last review. However, as a result of Assured Guaranty's strategy of acquisitions and the consolidation of international infrastructure exposures into AGE, AGM's international infrastructure exposure has nearly doubled in size since last review. Global structured finance exposure now comprises less than 4% of net par.

U.S. Public Finance

A breakout of the U.S. public finance exposure by sector and rating is shown below. The distribution across sectors has not changed meaningfully since last review.

US Public Finance, NPO ($ mm)			
Sectors		**9/30/2017**	
General Obligation	$	32,819	38.5%
Tax-supported		20,663	24.3%
Municipal Utility Revenue		14,736	17.3%
Transportation Revenue		7,738	9.1%
Health Care Revenue		4,371	5.1%
Education/University		2,791	3.3%
Infrastructure Finance		865	1.0%
Housing Revenue		747	0.9%
Other Public Finance		390	0.5%
Investor Owned Utilities		31	0.04%
Total	$	85,151	100.0%

As a whole, the weighted average internal rating remains in the A category. Below investment grade (BIG) rated exposures, as a percentage of U.S. public finance net par, is 3.6%, up slightly from last year's review. This is mainly a result of internal downgrades across a handful of credits in combination with the continuing run-off across the public finance sector.

US Public Finance, NPO ($ mm)			
Rating Category[1]		**9/30/2017**	
AAA	$	173	0.2%
AA		10,077	11.8%
A		48,040	56.4%
BBB		23,773	27.9%
BIG		3,087	3.6%
Total	$	85,151	100.0%

(1) AGM Internal Rating

Structured Finance

AGM has not written any structured finance business since the beginning of the credit crisis. 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 September 30, 2017, it was $4.7 billion, a decline of nearly 95%. Since KBRA's last review, AGM's structured finance exposures have declined nearly 61%.

Structured finance exposures include both U.S. 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 approximately $1.1 billion of net par, down significantly from last review. The non-RMBS portfolio largely consists of pooled corporate obligations and consumer receivables.

Over 88% of the non-RMBS portfolio is rated investment grade, down slightly from last year, primarily as a result of over $6 billion of net par that ran off, consisting of IG pooled corporate and CLO exposures, both of which were highly rated.

Non-RMBS Portfolio, NPO			
Sector ($ mm)	**9/30/2017**		
IG Corp CDOs	$	543	48.2%
CLOs		183	16.2%
PERPs		112	10.0%
TRUPs		3	0.2%
Other		285	25.3%
Total	$	1,126	100.0%

Non-RMBS Portfolio, NPO			
Rating Category (1)	**9/30/2017**		
AAA	$	789	70.1%
AA		103	9.2%
A		60	5.3%
BBB		39	3.5%
BIG		134	11.9%
Total	$	1,126	100.0%

(1) AGM Internal Rating

Residential Mortgage Backed Securities (RMBS)

The sector profile of the RMBS portfolio is shown below. At September 30, 2017, AGM had $3.6 billion of net RMBS exposure outstanding. RMBS net par outstanding decreased over 12% since KBRA' last portfolio review. The distribution across sub sectors did not change significantly.

RMBS Portfolio, NPO ($ mm)			
Sectors	**9/30/2017**		
Subprime	$	1,768	49.6%
HELOCs		675	19.0%
Alt A		394	11.1%
Int'l RMBS		512	14.4%
Closed-End Seconds		130	3.7%
Option ARMs		49	1.4%
Prime/Other		32	0.9%
Total	$	3,560	100.0%

International Infrastructure

AGM's international infrastructure portfolio, which includes international public finance, has a total of $32 billion of net par outstanding as of September 30, 2017. This reflects an increase of over 80% since last year. This is a direct result of Assured Guaranty's strategic acquisitions and their resulting effort to consolidate their international infrastructure exposure at AGE. The majority of this exposure is rated internally within the BBB category by AGM. The weighted average internal rating remains in the BBB category for the sector. Just over 5% is rated below investment grade.

International Infrastructure Portfolio, NPO			
Sectors ($ mm)		**9/30/2017**	
Infrastructure Finance	$	15,208	47.6%
Regulated Utilities		11,088	17.7%
Other Public Finance		5,674	34.7%
Total	$	31,970	100.0%

International Infrastructure Portfolio, NPO			
Rating Category[1]		**9/30/2017**	
AAA	$	801	2.5%
AA		332	1.0%
A		11,908	37.2%
BBB		17,235	53.9%
BIG		1,693	5.3%
Total	$	31,970	100.0%

[1] AGM Internal Rating

Portfolio Stress Analysis

KBRA utilized several methods to develop a stress case forecast of losses across AGM's entire insured portfolio of $121.8 billion. The methods used included a (i) Monte Carlo simulation and (ii) deterministic analysis for the (a) Puerto Rico exposures, (b) RMBS, and (c) distressed credits.

Puerto Rico Stress Case Losses

AGM has substantial exposure to the Commonwealth of Puerto Rico. As of September 30, 2017, AGM has approximately $2.3 billion in aggregate net par exposure to the Commonwealth across its various bond issuing entities, representing nearly 2% of AGM's total portfolio. The largest exposures are to the Commonwealth's General Obligation, to the Highways and Transportation Authority, and to the Electric Power Authority, which total $670, $610, and $547 million, respectively. As a whole, AGM's insured Puerto Rico exposures on a net par basis are slightly larger when compared to last year's review primarily as a result of reinsurance re-assumptions across the Assured Guaranty platform.

KBRA applied a discrete stress case scenario to AGM's $2.3 billion of Puerto Rico net par exposure. KBRA's Puerto Rico stress case assumes a complete moratorium on all debt service payments by the Commonwealth and all of its bond issuing entities for a period of eight years (i.e. AGM pays 100% of scheduled principal and interest for the next eight years). At the end of the moratorium period, beginning in year nine and continuing for all subsequent years, KBRA applied loss severity assumptions to each Commonwealth bond issuer ranging from 7.5% to 30% as the remaining debt service payments come due. For all claim payments made by AGM during the moratorium period, KBRA assumes AGM receives recoveries of 35% (65% severity) over an eight-year period beginning in year eleven. In addition, under AGM's stress case scenario, KBRA assumed that two of AGM's external reinsurers would not perform and those reinsured losses would be borne by AGM.

The table below displays the applied stress case loss payout pattern for AGM's Puerto Rico exposure in five-year increments. The negative "losses" in years 2028-2032 and 2033-37 represent the impact of 35%

recoveries on claim payments made during the initial moratorium period of eight years. The total stress case loss amount ($1.5 billion on a future value basis) equates to approximately 60% of AGM's current net par exposure to Puerto Rico on a present value basis.

Puerto Rico Stress Case Losses							
$ Thousands	Years						Total
	2018-22	2023-27	2028-32	2033-37	2038-42	2043-47	
Stress Case	1,094,170	807,230	(276,954)	(153,264)	22,641	108	1,493,931

KBRA also analyzed the impact of substantially higher severity assumptions for the Puerto Rico exposures on AGM's claims paying resources and, all else equal, these greater levels of losses did not have a rating impact, in KBRA's view. However, should ultimate recoveries approach zero, there would be downward pressure on the rating.

RMBS Stress Case Losses

All material exposures within AGM's RMBS portfolio were 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 September 30, 2017. For all insured, first-lien backed U.S. positions, 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 the majority of first-lien transactions were stressed by assuming economic conditions that included property value declines of 40% from current levels. KBRA's analysis applied these aggregated residential loan level losses to the insured tranches based on the waterfall provisions of the RMBS trusts and further allocated losses to AGM on those positions according to AGM's net exposure. The representation and warranty agreements AGM has with several financial institutions as well as projected subrogation recoveries were factored into this analysis on a transaction level basis and served to decrease the ultimate losses to AGM.

Distressed Credits

KBRA estimated specific stress losses for a handful of distressed or impaired municipal exposures and insurance securitizations.

In the financial model, combined with stress losses on AGM's RMBS portfolio, net outflows totaled approximately $921.1 million on a future value basis.

Monte Carlo Simulation Model

KBRA uses a Monte Carlo simulation model to quantify the amount of stress scenario claims within the AGM insured portfolio. KBRA views this as the most appropriate approach for modeling loss expectations for large, diverse portfolios typical of the financial guaranty industry.

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 and includes conservative assumptions for refunding activity. KBRA's analysts assessed AGM's internal ratings by sector and made various adjustments. In this process, KBRA selected a cross-section of credits to review from various sectors within AGM's insured portfolio.

The Monte Carlo model produces 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 sector-specific severity assumption is applied against the amount of debt outstanding at that point in time to calculate loss amount. The model generates 100,000 paths to produce a broad distribution of results. We focus on the tail of this distribution to construct a stress analysis. For AGM, the aggregate of all annual loss payments at the 98.5% confidence level, or that level associated with a AA+ rating, was $1.6 billion over the life of the portfolio on a future value basis.

The total loss amounts produced by the Monte Carlo model also incorporates, in KBRA's opinion, conservative assumptions for refunding activity in AGM's insured municipal portfolio.

Bond Insurer Financial Model

KBRA's bond insurer financial model ("model") calculates projected cash flows over a 35-year forecast period under assumed stress scenario conditions. KBRA then evaluates the outputs of the model from both a present and future value perspective to develop a comprehensive view of an insurer's overall financial strength.

The model starting point is AGM's Claims Paying Resources (defined in the "Claims Paying Resources" section below) which reflects the Company's beginning base of available invested assets. The model assumes that assets earn interest at Company's current yield levels, with some downward adjustment by KBRA based on tenor and average rating. This adjustment is intended to capture credit, interest rate and liquidity risks. The model also incorporates the Company's estimate of future installment premiums with a haircut by KBRA of 10%. For operating expenses, KBRA assumes the Company goes into run off immediately and, after some initial increases, expenses are assumed to decline sharply.

The model projects the ability of the Company to pay annual stress losses and other expenses as they come due through the 35-year forecast period. For AGM, the stress scenario 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 $1,580 million, (ii) Puerto Rico losses of $1,494 million, and (iv) distressed credit outflows of $921 million.

KBRA analyzes the outputs of the bond insurer financial model to evaluate the ability of a financial guarantor to pay projected claims and expenses over time on a future value basis. AGM is able to pay all claims and other expenses in this analysis with a positive asset balance remaining at the end of the 35-year forecast period.

Stress Capital Balance

In order to supplement its financial analysis, KBRA has developed an additional metric, the Stress Capital Balance (SCB), to provide a present value measure of capital adequacy. While an analysis of AGM's projected asset balances across the entire 35-year forecast period remains an important aspect of KBRA's review, an examination of capital adequacy in current (i.e. present value) terms provides an additional useful perspective for KBRA's credit assessment. As outlined in further detail below, the SCB utilizes key components of the bond insurer financial model to calculate a metric that summarizes AGM's capital position at its current rating level.

KBRA defines the SCB as the amount of the present value of projected assets minus the present value of projected liabilities as captured within the model. KBRA calculates the two components of the SCB as follows:

- The current present value of assets reflects the discounted CPR for the Company at the end of year 12 as projected within the financial model. In addition, any remaining installment premium beyond year 12 (i.e. year 13 and after) is discounted to a current present value and added to the discounted year 12 CPR to determine the total current asset position. The discount rate for both components of assets is the investment yield utilized within the model.

- The current present value of liabilities reflects the discounted remaining projected stress case losses beyond year 12 (i.e. year 13 and after). Operating expenses for years 13 through 18 are also discounted and added to the present value of claims to determine the total current liability position. The discount rate for both components of liabilities is the investment yield utilized within the model plus an increment designed to capture additional risk associated with the liabilities. The increment is currently 50 basis points and may be adjusted by KBRA from time to time.

Please see the following sample SCB calculation using illustrative data.

Illustration of Stress Scenario Capital Balance Calculation

Beginning CPR:	**100,000**	
Investment Yield:	**2.50%**	

Year	Stress Scenario Claims	Expenses	Installment Premiums	CPR
0				100,000
1	4,000	1,000	750	
2	3,950	1,030	730	
3	3,900	1,061	710	
4	3,850	902	690	
5	3,800	767	670	
6	3,750	652	650	
7	3,700	554	630	
8	3,650	471	610	
9	3,600	400	590	
10	3,525	340	570	
11	3,450	289	550	
12	3,375	246	530	82,763
13	3,300	221	510	
14	3,225	199	490	
15	3,150	179	470	
16	3,075	161	450	
17	3,000	145	430	
18	2,925	131	410	
19	2,850		390	
20	2,775		370	
21	2,700		350	
22	2,625		330	
23	2,550		310	
24	2,475		290	
25	2,400		270	
26	2,200		250	
27	2,000		230	
28	1,800		210	
29	1,600		190	
30	1,400		170	
31	1,200		150	
32	1,000		120	
33	800		75	
34	600		50	
35	400		25	

A	61,539	PV of Year 12 CPR
B	3,960	PV of Installment (years 13-35)
C=A+B	**65,499**	PV of Assets (Discounted at Investment Yield)
D	45,005	PV of Claims (years 13-35)
E	1,021	PV of Expenses (years 13-18)
F=D+E	**46,026**	PV of Liabilities (Discounted at Yield +50 bp)
C-F	**19,473**	**Stress Capital Balance (SCB)**

Based on KBRA's stress scenario assumptions, AGM achieves a SCB in the range of $750-950 million.

In KBRA's opinion, these bond insurer financial model results are consistent with an insurance financial strength rating of AA+.

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 September 30, 2017, AGM's CPR, before adjustments, totals $5.3 billion. However, KBRA's definition of CPR also excludes certain investments in affiliates, namely the surplus notes of Assured Guaranty Corp. as well as the equity of MAC because KBRA views these assets as illiquid and deeply subordinate.[2] 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 all of these adjustments, AGM's CPR is $4.9 billion and this amount is used as the beginning base of assets in KBRA's Bond Insurer Financial Model.

KBRA also notes that due to the transfer of the Other European subsidiaries to AGE, AGM's total insured portfolio has increased relative to year-end 2016. This has effectively halted the ongoing decline in leverage ratios that have occurred throughout the financial guaranty industry since the credit crisis. AGM's projected leverage will depend on whether the company's new business production increases sufficiently to offset future portfolio run-off.

Select AGM Statutory Balance Sheet Data					
$ Thousands	**9/30/2017**	**12/31/2016**	**12/31/2015**	**12/31/2014**	**12/31/2013**
Claims paying resources:					
Unearned premium reserves	$1,237,195	$1,155,247	$1,341,063	$1,438,865	$1,489,865
Loss & LAE reserves	542,108	410,519	438,134	487,177	339,719
Contingency reserve	1,200,647	1,073,839	1,182,629	1,310,796	1,586,565
Policyholder surplus	2,322,353	2,321,005	2,440,809	2,266,850	1,733,149
Adjustments†	(432,233)	(583,399)	(776,269)	(704,657)	(651,534)
Total claims paying resources (KBRA definition)	**$4,870,071**	**$4,377,212**	**$4,626,366**	**$4,799,031**	**$4,497,765**
Net statutory par outstanding (NPO)	$122,505,000	$113,955,000	$133,409,000	$151,320,000	$171,279,000
Net statutory debt service outstanding (NDSO)	$194,711,000	$175,688,000	$206,779,000	$234,490,000	$263,089,000
Leverage: NPO/Claims paying resources (X)	**25x**	**26x**	**29x**	**32x**	**38x**
Leverage: NDSO/Claims paying resources (X)	**40x**	**40x**	**45x**	**49x**	**58x**

Source: AGM statutory statements and financial supplements

† Reflects investment in MAC and AGC surplus note since 2013; reflects investment in MAC surplus notes in 2013-2015 (fully repaid in 2Q16)

[2] KBRA does reflect the projected future performance of the AGC surplus notes in accordance with their terms in our financial model because KBRA rates AGC at AA which is consistent with the view that AGC can satisfy scheduled interest on their surplus notes.

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 September 30, 2017, net unearned premium reserves (after amounts ceded to reinsurers of $688 million) are the largest component of AGM's balance sheet liabilities at $1.2 billion. Loss reserves have trended upward through the first nine months of 2017 primarily due to Puerto Rico.

AGM Statutory Balance Sheet					
$ Thousands	**9/30/2017**	**12/31/2016**	**12/31/2015**	**12/31/2014**	**12/31/2013**
Bonds	$3,849,462	$4,074,774	$4,234,302	$4,331,217	$3,921,116
Stocks (Investments in Affiliates)	848,804	539,194	674,889	619,149	535,666
Cash & short term investments	498,768	127,000	255,392	334,483	647,084
Other invested assets and receivables	394,907	371,616	471,565	516,163	419,449
Total cash and invested assets, net admitted	**$5,591,941**	**$5,112,584**	**$5,636,148**	**$5,801,011**	**$5,523,317**
Investment income due and accrued	41,175	38,981	40,081	41,911	37,916
Deferred tax asset	64,170	156,992	91,893	93,697	64,190
Other assets	68,831	24,811	20,355	24,603	86,713
Total Assets, net admitted	**$5,766,301**	**$5,333,522**	**$5,788,476**	**$5,961,222**	**$5,712,135**
Loss and LAE Reserves	542,108	410,519	438,134	487,177	339,719
Unearned Premium Reserve	1,237,195	1,155,247	1,341,063	1,438,865	1,489,865
Contingency reserve	1,200,647	1,073,839	1,182,629	1,310,796	1,586,565
Other liabilities	463,998	372,911	385,842	457,534	562,836
Total Liabilities	**$3,443,948**	**$3,012,517**	**$3,347,667**	**$3,694,372**	**$3,978,986**
Common capital stock	15,000	15,000	15,000	15,000	15,000
Surplus Notes	-	-	-	25,000	75,000
Gross paid-in and contributed surplus	477,205	477,205	776,953	776,876	778,266
Unassigned Funds	1,830,149	1,828,800	1,648,856	1,449,974	864,883
Policyholder Surplus	**$2,322,353**	**$2,321,005**	**$2,440,809**	**$2,266,850**	**$1,733,149**
Total Liabilities and Policyholder Surplus	**$5,766,301**	**$5,333,522**	**$5,788,476**	**$5,961,222**	**$5,712,135**
Cash & short term assets/Total assets (%)	8.6%	2.4%	4.4%	5.6%	11.3%
Bonds/Total assets (%)	66.8%	76.4%	73.2%	72.7%	68.6%

Source: AGM Statutory Statements

Investments

As of September 30, 2017, AGM had total fixed income investments of $5.5 billion, including $650 million of cash and short-term investments. On a statutory basis the average pre-tax book yield is 3.41% (includes bonds held at AGM affiliate MAC). 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 fixed income portion of the portfolio.

Excluding loss mitigation bonds, AGM's investment portfolio consists of high quality, marketable securities. The largest segment of the investment portfolio is municipal bonds which consisted of 51% of the entire investment pool while corporate bonds and mortgage-backed securities represented 16% and 11% of the total portfolio, respectively.

AGM Investment Portfolio Composition (9/30/2017)				
$ Millions			---Book Yields*---	
Sector	Fair Value	% of portfolio	Pre-tax	After-tax
State and Political Subdivisions	$2,772	51%	3.62%	3.35%
Insured State and Political Subdivision	151	3%	4.76%	4.51%
U.S Treasury Securities	7	0%	3.33%	2.16%
U.S Agency Obligations	10	0%	3.74%	2.43%
Corporate Securities	851	16%	2.69%	1.75%
RMBS	379	7%	6.07%	3.95%
CMBS	239	4%	3.30%	2.15%
Asset-backed securities	122	2%	5.36%	3.48%
Foreign Governments	300	5%	1.58%	1.03%
Total Fixed Maturities	**$4,831**	**88%**	**3.68%**	**3.06%**
Short term investments and cash	650	12%	0.50%	0.33%
Grand Total†	**$5,481**	**100%**	**3.41%**	**2.83%**

Source: AGM financial supplement

** Reflects yields on consolidated AGM/MAC investment portfolio and excludes yield on cash.*

† Includes loss mitigation bonds with a par value of $857 million and a carrying value of $549 million.

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 three quarters of 2017, net income trended upward relative to prior periods, bolstered by refunding activity and the impact of reassuming exposures previously ceded to two external reinsurers. On an annualized basis, return on surplus was nearly 18% for the nine months ending September 30, 2017, although excluding the impact of the reassumption transaction, the company reported an underwriting loss due to increased loss reserves for Puerto Rico

Because of continued challenges in the new business environment, AGM's low gross premium written has kept the company's reported expense ratio somewhat above historical benchmarks. While KBRA does not view AGM's expense ratio as a significant issue in the near term and also acknowledges the inherent lag between expense recognition and revenue generation, we will continue to monitor the company's efforts to manage its revenue/cost profile since KBRA views a high expense ratio as unsustainable in the long-term.

Select AGM Statutory Income Data					
$ Thousands	9/30/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013
Gross Premiums Written (GPW)	$259,805	$219,959	$198,604	$245,042	$262,322
Net Premiums Written	214,656	143,477	141,842	173,887	(191,293)
Net premiums Earned (NPE)	150,758	295,799	222,958	203,133	296,018
Loss & loss adjustment expenses (L&LAE)	202,143	103,022	132,941	(120,663)	(56,914)
Other underwriting expenses	88,074	84,226	74,201	86,508	101,830
Total losses & operating expenses	290,217	187,248	207,142	(34,154)	44,916
Net underwriting gain (loss)	(139,459)	108,551	15,816	237,287	251,102
Net investment gain	145,296	155,488	199,410	159,261	230,009
Other income, net gain (loss)	295,526	29,055	55,330	9,243	(19,366)
Earnings Before Taxes	301,364	293,095	270,556	405,791	461,744
Net Income	$332,651	$190,726	$216,695	$303,884	$339,635
Dividends Paid	$142,000	$246,600	$214,800	$160,000	$163,000
Expense ratio (Underwriting exp. / GPW)	33.9%	38.3%	37.4%	35.3%	38.8%
Loss ratio (L&LAE / NPE)	134.1%	34.8%	59.6%	NM	NM
Combined ratio	168.0%	73.1%	97.0%	NM	NM
Return on Surplus (ROS) Pre-tax basis *	17.3%	12.3%	11.5%	20.3%	53.3%
Return on Surplus (ROS) After-tax basis *	19.1%	8.0%	9.2%	15.2%	39.2%

Source: AGM statutory statements

** Return on Surplus was annualized for the 3Q 2017*

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 lessor of 10% of its surplus and 100% of its adjusted net investment income for such 12-month period. Further, management has stated that they will not take any capital management actions, including the payment of ordinary or extraordinary dividends, that do not maintain or improve AGM's ratings or trading value.

Over the past three years AGM has up-streamed dividends at or near the maximum amount allowed. In 2016, AGM paid dividends of $246.6 million; during the first nine months of 2017, the company has paid dividends of $142 million. As of 3Q2017, the total amount of dividends available for AGM to distribute in 2017 without regulatory approval is estimated by the company to be approximately $196 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. Management has stated that they expect periodically to request the authority to repurchase additional shares of common stock from Assured Guaranty Municipal Holdings Inc., perhaps as frequently as annually.

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.

Reinsurance

AGM, jointly with MAC and AGC, benefits from an aggregate excess of loss reinsurance facility with a number of third party reinsurers rated no lower than AA- (publicly available ratings) or who have posted collateral. The current facility attaches when the group's combined net losses exceeds $1.25 billion in aggregate. The reinsurers cover $360 million of the next $400 million of losses in excess of the attachment point with AGM, MAC, and AGC jointly retaining the remaining $40 million. The reinsurance agreement terminated on January 1, 2018 and KBRA expects Assured Guaranty to have extended it in either its current or modified form. 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.

In addition, AGM cedes approximately 25% of its exposures to affiliate company, AG Re, a Bermuda-based reinsurer. KBRA reviewed AG Re's claims paying ability and risk profile as part of its rating analysis of AGM.

Sutton Capital Trusts

In June 2003, AGM established four Custodial Trusts ("Trusts") which issued an aggregate of $200 million of preferred trust securities. The proceeds of the issuance were invested in highly rated commercial paper. AGM entered into an agreement with the Trusts whereby it is entitled in its sole discretion to deliver Preferred Stock to the Trusts in exchange for cash up to the $200 million held in the Trusts.

A number of other financial guarantors successfully utilized similar capital support facilities during the credit crisis to augment their claims paying resources. In light of the very liquid investments in the Trusts and the associated robust funding mechanism, KBRA includes $200 million of capital support from the Trusts in its financial model analysis of AGM.

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.