IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE NOT U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT OF 1933 (THE "SECURITIES ACT") ("REGULATION S")) LOCATED OUTSIDE THE UNITED STATES IN ACCORDANCE WITH REGULATION S.

IMPORTANT: You must read the following before continuing. The following applies to the Prospectus dated 19 December 2013 following this page (the "Prospectus"), and you are therefore advised to read this carefully before reading, accessing or making any other use of the Prospectus. In accessing the Prospectus, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from the Issuer (as defined in the Prospectus) as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY THE SECURITIES OF THE ISSUER IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO.

THE SECURITIES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE SECURITIES ACT OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES OR ANY OTHER JURISDICTION AND THE SECURITIES MAY NOT BE OFFERED OR SOLD DIRECTLY OR INDIRECTLY WITHIN THE UNITED STATES OR TO OR FOR THE ACCOUNT OR BENEFIT OF U.S. PERSONS (AS DEFINED IN REGULATION S) EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THE PROSPECTUS IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

Confirmation of your representation: In order to be eligible to view the Prospectus or make an investment decision with respect to the securities, prospective investors must be located outside of the United States other than U.S. persons (as defined in Regulation S) who are purchasing the securities in an offshore transaction in reliance on Regulation S. The Prospectus is being sent to you at your request. By accepting the e-mail and accessing the Prospectus, you shall be deemed to have represented to the Issuer and the Manager that:

(1) you have understood and agree to the terms set out herein;

(2) you consent to delivery of such Prospectus by electronic transmission;

(3) you are a person who is permitted under applicable law and regulation to receive the Prospectus;

(4) you are not a "U.S. person" (as defined in Regulation S), (ii) you are transacting in an "offshore transaction" (in accordance with Regulation S) and (iii) the e-mail address that you gave us and to which this e-mail has been delivered is not located in the United States, its territories and possessions, any State of the United States or the District of Columbia;

(5) if you are a person in the United Kingdom, then you are a person who is an investment professional within the meaning of article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "FPO") or a high net worth entity falling within Article 49(2)(a) to (d) of the FPO;

(6) you will not transmit the Prospectus (or any copy of it or part thereof) or disclosure, whether orally or in writing to any other person except with the consent of the Issuer and the Manager; and

(7) you acknowledge that you will make your own assessment regarding any legal, taxation or other economic considerations with respect to your decision to subscribe for or purchase any of the securities described herein.

The materials relating to this offering (including the Prospectus) do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law.

Under no circumstances shall the Prospectus constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful.

The Prospectus has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Issuer, the Manager or any person who controls it nor any director, officer, employee nor agent of it nor affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from the Issuer or the Manager.

Prospectus dated 19 December 2013

S4B (ISSUER) PLC

(incorporated with limited liability in England and Wales under company number 08528504)

£73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 2037 unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest pursuant to financial guarantees issued by

ASSURED GUARANTY (EUROPE) LTD.

(incorporated with limited liability in England and Wales under company number 02510099)

and

ASSURED GUARANTY MUNICIPAL CORP.

(*an insurance company under the laws of the State of New York, United States of America*)

Issue Price: 100 per cent

Sole Arranger and Lead Manager

The £73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 30 September 2037 (the "**Bonds**") of S4B (Issuer) plc (the "**Issuer**") will be issued pursuant to a bond trust deed to be dated 20 December 2013 (as amended or supplemented from time to time, the "**Bond Trust Deed**") between the Issuer, Assured Guaranty (Europe) Ltd. ("**AGE**"), Assured Guaranty Municipal Corp. ("**AGM**") (and together with AGE, the "**Financial Guarantors**") and BNY Mellon Corporate Trustee Services Limited as bond trustee (the "**Bond Trustee**", which expression includes the trustee or trustees for the time being under the Bond Trust Deed). The issue price of the Bonds will be 100 per cent. The Bonds (excluding those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) will be unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest in respect of the Bonds (but excluding in each case any amounts due in respect of the Bonds: (i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason; (ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof; (iii) attributable to any default interest; (iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Bonds; or (v) in respect of which AGM or AGE has made an Accelerated Payment (as defined in the relevant Financial Guarantee) in accordance with a financial guarantee to be issued by AGE (the "**AGE Financial Guarantee**") and as set out in the section entitled "*Form of AGE Financial Guarantee*" below and a financial guarantee to be issued by AGM (the "**AGM Financial Guarantee**", and together with the AGE Financial Guarantee, the "**Financial Guarantees**" and each a "**Financial Guarantee**") and as set out in the section entitled "*Form of AGM Financial Guarantee*" below.

Interest on the Bonds will be payable semi-annually (the "**Scheduled Interest**") in arrears on 31 March and 30 September in each year (each a "**Scheduled Payment Date**"), except that the first Scheduled Interest payment will be made on 31 March 2014 in respect of the period from, and including, the Issue Date (as defined below) to, but excluding, 31 March 2014.

Unless previously redeemed or purchased and cancelled, the Bonds will mature on 30 September 2037 and will be subject to redemption in part from, and including, 30 September 2014, in accordance with the amortisation schedule set out in the section entitled "*Terms and Conditions of the Bonds - Payments and Exchange of Talons – Scheduled Payments*" below. The Bonds are also subject to redemption in whole but not in part, at the Early Redemption Price (as defined below) or at the option of the Issuer (as provided in Condition 6(b) (*Redemption at the option of the Issuer*) of the Terms and Conditions of the Bonds (the "**Conditions**")).

The Issuer is a special purpose vehicle whose principal purposes are, *inter alia*, to issue the Bonds, and to on-lend the proceeds to S4B Limited ("**ProjectCo**" or the "**Contractor**") pursuant to an issuer on-loan agreement (see the section entitled "*Financing of the Project*"). ProjectCo is a special purpose vehicle established for the principal purpose of constructing, refurbishing, financing, operating, maintaining and managing social and private accommodation for the Authority (the "**Accommodation**") and associated facilities and amenities in the Brunswick area of Manchester (the "**Site**") (the "**Project**"). Each of Mears Limited (the "**Refurbishment Contractor**" and the "**RRCMR Contractor**"), Contour Homes Limited (the "**Housing Management Contractor**"), and Galliford Try Construction Limited (the "**Construction Contractor**" and the "**Development Works Contractor**") (together the "**Sub-Contractors**") will enter into an interface agreement with the Contractor (the "**Interface Agreement**") to regulate liability between the Contractor and the Sub-Contractors. The Contractor will provide or procure the provision of certain housing management and maintenance services pursuant to two separate sub-contracts signed and to be dated the Issue Date between the Contractor and respectively the Housing Management Contractor (the "**Housing Management Contract**") and the RRCMR Contractor (the "**RRCMR Contract**"). S4B (Holdings) Limited ("**HoldCo**" and, together with the Issuer and ProjectCo, the "**Obligors**") is a special purpose vehicle established for the principal purpose of acting as the holding company of the Issuer and ProjectCo. There is no recourse to any Shareholders of HoldCo except to the extent described in this Prospectus.

The obligations of the Issuer under the Bonds will be secured in favour of BNY Mellon Corporate Trustee Services Limited as security trustee (the "**Security Trustee**") as described in the section entitled "*Financing of the Project - The Security Arrangements*" below. The Bonds are expected to be rated upon issue AA- by Standard & Poor's Credit Market Services Europe Limited ("**S&P**") and A2 by Moody's Investors Service Limited ("**Moody's**" and together with S&P, the "**Rating Agencies**" and each a "**Rating Agency**"). These ratings will be based solely upon the financial strength rating of the Financial Guarantors. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by any one or both of the Rating Agencies. A suspension, reduction or withdrawal of the rating assigned to the Bonds may adversely affect the market price of the Bonds.

Moody's and S&P are established in the EU and registered under Regulation (EC) No 1060/2009, as amended (the "**CRA Regulation**").

The Prospectus has been approved by the Central Bank of Ireland (the "**Central Bank**"), as competent authority under Directive 2003/71/EC, as amended (the "**Prospectus Directive**"). The Central Bank only approves this Prospectus as meeting the requirements imposed under Irish and EU law pursuant to the Prospectus Directive. Application has been made to the Irish Stock Exchange for the Bonds to be admitted to the official list (the "**Official List**") and trading on its regulated market (the "**Main Securities Market**"). The Main Securities Market is a regulated market for the purposes of Directive 2004/39/EC (the "**Markets in Financial Instruments Directive**"). Such approval relates only to the Bonds which are to be admitted to trading on a regulated market for the purposes of Directive 2004/39/EC and/or which are to be offered to the public in any Member State of the European Economic Area.

The Bonds will be in bearer form and in the denominations of £100,000 and integral multiples of £1,000 in excess thereof. For so long as the Bonds are represented by a Global Bond (as defined below) and the relevant clearing system(s) so permit, the Bonds will be tradable in such denominations, subject always to a minimum denomination and trading amount of £100,000. There can be no assurance, however, that the relevant clearing system(s) will enforce such minimum trading amount. The Bonds will initially be in the form of a temporary global bond (the "**Temporary Global Bond**"), without coupons or talons attached, which will be deposited on or around 20 December 2013 (the "**Issue Date**") with a common safekeeper for Euroclear S.A./N.V., as operator of the Euroclear System ("**Euroclear**") and Clearstream Banking, société anonyme, Luxembourg ("**Clearstream, Luxembourg**"). The Temporary Global Bond will be exchangeable, in whole or in part, not earlier than 40 calendar days from (but not including) the Issue Date upon certification of non-U.S. beneficial ownership, for interests in a permanent global bond (the "**Permanent Global Bond**", together with the Temporary Global Bond, the "**Global Bonds**" and each a "**Global Bond**"), without coupons or talons attached, which will also be deposited with such common safekeeper for Euroclear and Clearstream, Luxembourg. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in whole, but not in part, for Bonds in definitive form (the "**Definitive Bonds**") in the denominations of £100,000 and integral multiples of £1,000 in excess thereof, with coupons for principal and interest and talons for further coupons attached, only in the limited circumstances described in the section "*Summary of Provisions relating to the Bonds while in Global Form*" below. If Definitive Bonds are required to be issued, such Definitive Bonds (a) will only be issued to Bondholders (as defined below) holding Bonds having a nominal amount equal to or in excess of £100,000 and (b) will only be printed in denominations equal to or in excess of £100,000 and to the extent in excess of £100,000 in integral multiples of £1,000.

An investment in the Bonds involves certain risks. Prospective investors should have regard to the factors described in the section entitled "*Risk Factors*" below.

IMPORTANT NOTICE

This Prospectus (which includes the appendices) comprises a prospectus with regard to the Issuer and the Bonds for the purposes of Article 5.3 of the Prospectus Directive and has been approved by the Central Bank acting in its capacity as competent authority.

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (which has taken all reasonable care to ensure that such is the case), such information is in accordance with the facts and does not omit anything likely to affect the import of such information. The Issuer has accurately reproduced the ProjectCo Information, the HoldCo Information, the AGE Information, the AGM Information (each as defined below) and the information in the section entitled "*The Council of the City of Manchester*". As far as the Issuer is aware and is able to ascertain from information published by ProjectCo, HoldCo, the Financial Guarantors, no facts have been omitted which would render the reproduced information inaccurate or misleading.

HoldCo accepts responsibility for the information in this Prospectus under the heading "HoldCo" in the section entitled "*Description of the Issuer, ProjectCo, HoldCo and the Shareholders*" of this Prospectus and paragraphs 6 and 11 of the section entitled "*General Information*" (the "**Holdco Information**"). To the best of the knowledge of HoldCo (which has taken all reasonable care to ensure that such is the case), such information is in accordance with the facts and does not omit anything likely to affect the import of such information.

ProjectCo accepts responsibility for the information in this Prospectus under the heading "ProjectCo" in the section entitled "*Description of the Issuer, ProjectCo, HoldCo and the Shareholders*" and paragraphs 5 and 10 of the section entitled "*General Information*" (the "**ProjectCo Information**"). To the best of the knowledge of ProjectCo (which has taken all reasonable care to ensure that such is the case), such information is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Authority accepts responsibility and consents only to the scope and extent of the information contained in the section of this Prospectus entitled "*The Council of the City of Manchester*" (the "**MCC Information**"). To the best of the knowledge and belief of the Authority (which has taken all reasonable care to ensure that such is the case), the MCC Information is in accordance with the facts and does not omit anything likely to affect the import of such information. The Authority accepts no responsibility for any information (other than the MCC Information) contained in this Prospectus. Save for the MCC Information, the Authority has not separately verified the information contained herein. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Authority as to the accuracy or completeness of any information contained in this Prospectus (other than the MCC Information) or any other information supplied in connection with the Bonds or their distribution. Each person receiving this Prospectus acknowledges that such person has not relied on the Authority nor on any person affiliated with it in connection with its investigation of the accuracy of any information contained in this Prospectus (other than the MCC Information) or in making its investment decision.

AGE accepts responsibility for the information contained in this Prospectus (i) in the sections entitled: "*Risk Factors - Risks relating to the Financial Guarantors*", "*Description of the Financial Guarantors - Assured Guaranty (Europe) Ltd.*" and "*Form of AGE Financial Guarantee*"; (ii) in paragraph 2 of the section entitled "*General Information*" and (iii) in Appendix 1 and Appendix 2 to this Prospectus (together, the "**AGE Information**"). To the best of the knowledge and belief of AGE (which has taken all reasonable care to ensure that such is the case), the AGE Information is in accordance with the facts and does not omit anything likely to affect the import of such information. AGE accepts no responsibility for any other information contained in this Prospectus. Save for the AGE Information, AGE has not separately verified the information contained herein. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by AGE as to the accuracy or completeness of any information contained in this Prospectus (other than the AGE Information) or any other information supplied in connection with the Bonds or their distribution. Each person receiving this Prospectus acknowledges that such person has not relied on AGE nor on any person affiliated with it in connection with its investigation of the accuracy of any information contained in this Prospectus (other than the AGE Information) or in making its investment decision.

AGM accepts responsibility for the information contained in this Prospectus (i) in the sections entitled: *Risk Factors – Risks Relating to the Financial Guarantors*", "*Description of the Financial Guarantors - Assured Guaranty Municipal Corp.*" and "*Form of AGM Financial Guarantee*"; (ii) in paragraph 3 of the section entitled "*General Information*" and (iii) in Appendix 3 and Appendix 4 to this Prospectus (together, the "**AGM Information**"). To the best of the knowledge and belief of AGM (which has taken all reasonable care to ensure that such is the case), the AGM Information is in accordance with the facts and does not omit anything likely to affect the import of such information. AGM accepts no responsibility for any other information contained in this Prospectus. Save for the AGM Information, AGM has not separately verified the information contained herein. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by AGM as to the accuracy or completeness of any information contained in this Prospectus (other than the AGM Information) or any other information supplied in connection with the Bonds or their distribution. Each person receiving this Prospectus acknowledges that such person has not relied on AGM nor on any person affiliated with it in connection with its investigation of the accuracy of any information contained in this Prospectus (other than the AGM Information) or in making its investment decision.

The Issuer, HoldCo and ProjectCo (in relation to the ProjectCo Information only) have each confirmed to the Manager named in the section entitled "*Subscription and Sale*" (the "**Manager**") that this Prospectus contains all information regarding the Issuer, HoldCo, ProjectCo, the Project, the Finance Documents, the Project Documents and the Bonds which is material (in the context of the issue of the Bonds, offering and sale of the Bonds and which is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the Issuer, HoldCo and ProjectCo and of the rights attaching to the Bonds; the statements contained in this Prospectus are true and accurate in all material respects and are not misleading in any material respect; any opinions or intentions expressed in this Prospectus are honestly held and have been reached after considering all relevant circumstances and are based on reasonable assumptions; this Prospectus does not omit to state any fact which would make any statement misleading in any material respect; there are no other facts, the omission of which would in the context of the issue and offering of the Bonds make any statement misleading in any material respect; and all reasonable enquiries have been made to ascertain such facts and to verify the accuracy of such information or statements.

AGE has confirmed to the Manager that the AGE Information is, with respect to the AGE Information set out in this Prospectus, as of the date of this Prospectus only, in every material respect true and accurate and not misleading and does not omit to state a fact necessary to make the statements contained therein not misleading and contains, to the best of its knowledge and belief, all information which is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of AGE. To the best of the knowledge of AGE (which has taken all reasonable care to ensure such is the case), the AGE Information is, with respect to the AGE Information set out in this Prospectus, as of the date of this Prospectus only, in accordance with the facts and does not omit anything likely to affect the import of such information and accurately reflects and fairly presents the information purported to be shown herein and, insofar as such statements describe AGE, fairly and accurately describe AGE.

AGM has confirmed to the Manager that the AGM Information is, with respect to the AGM Information set out in this Prospectus, as of the date of this Prospectus only, in every material respect true and accurate and not misleading and does not omit to state a fact necessary to make the statements contained therein not misleading and contains, to the best of its knowledge and belief, all information which is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of AGM. To the best of the knowledge of AGM (which has taken all reasonable care to ensure such is the case), the AGM Information is, with respect to the AGM Information set out in this Prospectus, as of the date of this Prospectus only, in accordance with the facts and does not omit anything likely to affect the import of such information and accurately reflects and fairly presents the information purported to be shown herein and, insofar as such statements describe AGM, fairly and accurately describe AGM.

The Financial Guarantees will be issued on the Issue Date subject to certain conditions precedent being satisfied.

The Financial Guarantees have not been and will not be executed as at the date of this Prospectus. Admission of the Bonds to the Official List and to trading on the Main Securities Market of the Irish

Stock Exchange will be granted subject to the execution by the Financial Guarantors of the Financial Guarantees.

No person has been authorised to give any information or to make representations other than the information or the representations contained in this Prospectus in connection with the Obligors, the Financial Guarantors, and the Authority, or the issue or sale of the Bonds and, if given or made, such information or representations must not be relied upon as having been authorised by the Obligors, the Financial Guarantors, the Manager, the Bond Trustee, the Principal Paying Agent or the Security Trustee. Neither the delivery of this Prospectus nor the offering, sale or delivery of any Bond shall in any circumstances, create any implication that there has been no adverse change, nor any event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Obligors or the Financial Guarantors since the date hereof. Unless otherwise indicated herein, all information in this Prospectus is given as of the date of this Prospectus.

The Manager, the Principal Paying Agent, the Bond Trustee and the Security Trustee have not separately verified the information contained in this Prospectus. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Manager, the Principal Paying Agent, the Bond Trustee or the Security Trustee as to the accuracy or completeness of the information contained in this Prospectus or any other information supplied in connection with the Bonds or their distribution. The statements made in this paragraph are without prejudice to the respective responsibilities of the Obligors and the Financial Guarantors. Each person receiving this Prospectus acknowledges that such person has not relied on the Manager, the Principal Paying Agent, the Bond Trustee or the Security Trustee nor on any person affiliated with any of them in connection with its investigation of the accuracy of such information or its investment decision.

None of the Obligors, the Manager, the Financial Guarantors, the Bond Trustee, the Security Trustee, the Principal Paying Agent or any other party named in this Prospectus accepts responsibility to investors for the regulatory treatment of their investment in the Bonds in any jurisdiction or by any regulatory authority. If the regulatory treatment of an investment in the Bonds is relevant to an investor's decision whether or not to invest, the investor should make its own determination as to such treatment and for this purpose seek professional advice and consult its regulator. Prospective investors are referred to the section entitled "*Risk Factors – Risks relating to the Bonds and the Market - Changes to the risk weighted asset framework*" of this Prospectus.

This Prospectus does not constitute, and may not be used for the purposes of, an offer or solicitation by any person to subscribe or purchase any Bonds. Neither this Prospectus nor any other financial statements are intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of the Obligors, the Financial Guarantors or the Manager that any recipient of this Prospectus or any other financial statements should purchase the Bonds. Each person contemplating making an investment in the Bonds must make its own investigation and analysis of the creditworthiness of the Obligors and the Financial Guarantors and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience and any other factors which may be relevant to it in connection with such investment. A prospective investor who is in any doubt whatsoever as to the risks involved in investing in the Bonds should consult independent professional advisers. The Manager does not undertake to review the financial conditions or affairs of the Obligors or the Financial Guarantors during the life of the arrangements contemplated by this Prospectus, nor to advise any investor or potential investor in the Bonds of any information coming to the attention of the Manager.

The investment activities of certain investors are subject to legal investment laws and regulations and/or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Bonds are legal investments for it (ii) the Bonds can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of the Bonds. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of the Bonds under any applicable risk-based capital or similar rules.

The distribution of this Prospectus and the offering, sale and delivery of the Bonds in certain jurisdictions may be restricted by law. The Issuer does not represent that the Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, and does not assume any responsibility for facilitating such sale. Persons into whose possession this Prospectus comes are required by the Obligors, the Financial Guarantors and the Manager to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers and sales of the Bonds and on the distribution of this Prospectus, see the section entitled "*Subscription and Sale*" below. In particular, the Bonds and the Financial Guarantees have not been and will not be registered under the United States Securities Act of 1933 (as amended) (the "**Securities Act**") and the Bonds will be in bearer form and so are subject to U.S. tax law requirements. Subject to certain exceptions, the Bonds and the Financial Guarantees may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act and in the U.S. Internal Revenue Code of 1986, as amended, and regulations thereunder). The Bonds are being offered outside the United States in accordance with Regulation S under the Securities Act. See the section entitled "*Subscription and Sale*" below.

All references herein to "**pounds**", "**sterling**", "**Sterling**" or "**£**" are to the lawful currency of the United Kingdom, all references to "**$**", "**U.S.$**", "**U.S. dollars**" and "**dollars**" are to the lawful currency of the United States of America, and all references to "**€**", "**EUR**" or "**Euro**" are to the single currency introduced at the start of the third stage of the European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended.

In connection with the issue of the Bonds, Lloyds Bank PLC (the "Stabilising Manager") (or any person acting for the Stabilising Manager) may over-allot or effect transactions with a view to supporting the market price of the Bonds at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Bonds is made, and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue of the Bonds and 60 days after the date of the allotment of the Bonds. Any stabilising action or over-allotment shall be conducted in accordance with all applicable laws, regulations and rules.

SUPPLEMENTARY PROSPECTUS

If at any time the Issuer shall be required to prepare a supplementary prospectus pursuant to Article 16 of the Prospectus Directive, the Issuer will prepare and make available an appropriate amendment or supplement to this Prospectus or a further Prospectus which, in respect of any subsequent issue of Bonds to be listed on the Official List and admitted to trading on the Main Securities Market of the Irish Stock Exchange, shall constitute a supplementary prospectus as required by the Central Bank and Article 16 of the Prospectus Directive.

The Obligors have given an undertaking to the Manager that if at any time during the term of the Bonds there is a significant new factor, material mistake or inaccuracy relating to information contained in this Prospectus which is capable of affecting the assessment of any Bonds and whose inclusion or removal in this Prospectus is necessary, for the purpose of allowing an investor to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Obligors, the Financial Guarantors and the rights attaching to the Bonds, the Issuer shall prepare an amendment or supplement to this Prospectus or publish a replacement Prospectus for use in connection with any subsequent offering of the Bonds and shall supply to the Manager such number of copies of such supplement hereto as the Manager may reasonably request. Each supplementary prospectus that is published will incorporate by reference any supplementary prospectus previously filed with the Central Bank.

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OVERVIEW OF THE BOND ISSUE

Terms defined in "Terms and Conditions of the Bonds" have the same meaning in this section.

Introduction:	The Issuer (as defined below) is a special purpose vehicle whose principal purposes are to issue the Bonds (as defined below) and on-lend the proceeds to S4B Limited ("**ProjectCo**" or the "**Contractor**"). ProjectCo is a special purpose vehicle whose principal purposes are to design, construct, finance and operate social and private accommodation for, and to provide certain services to the Council of the City of Manchester (the "**Authority**"). ProjectCo has agreed with the Authority, inter alia, to construct, refurbish, finance, operate, maintain and manage certain properties under the Project Agreement (the "**Project**"). Each of Mears Limited (the "**Refurbishment Contractor**" and the "**RRCMR Contractor**"), Contour Homes Limited (the "**Housing Management Contractor")** and Galliford Try Construction Limited (the "**Construction Contractor**" and the "**Development Works Contractor**") (together the "**Sub-Contractors**") will enter into an interface agreement with the Contractor (the "**Interface Agreement**") to regulate liability between the Contractor and Sub-Contractors. S4B (Holdings) Limited ("**HoldCo**" and, together with the Issuer and ProjectCo, the "**Obligors**") is a special purpose vehicle established for the principal purpose of acting as the holding company of the Issuer. There is no recourse to any Shareholders of HoldCo except to the extent described in this Prospectus. Pursuant to the terms of the Collateral Deed, the Obligors will grant a joint and several guarantee in respect of each other's obligations to the Senior Creditors (as defined below) under the Senior Finance Documents. The obligations of the Issuer under the Bonds will be secured in favour of BNY Mellon Corporate Trustee Services Limited as security trustee (the "**Security Trustee**") (each as described in the section entitled "*Financing of the Project - The Security Arrangements*"). Each of the Financial Guarantors has agreed to provide a separate Financial Guarantee in relation to the Bonds. The Financial Guarantees will unconditionally and irrevocably guarantee the payment of scheduled principal and interest, (excluding any additional amounts relating to early redemption or acceleration) of the Bonds (except Bonds held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor). See "*Terms and Conditions of the Bonds*".

The coverage provided by the Financial Guarantees is the payment of scheduled payments of principal and interest only and does not cover any amounts due in respect of the Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Bonds; or

(v) in respect of which AGM or AGE has made an Accelerated Payment (as defined in the relevant Financial Guarantee).

See "*Form of AGE Financial Guarantee*" and "*Form of AGM Financial Guarantee*".

Issuer: S4B (Issuer) plc

Issue: £73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 30 September 2037 (the "**Bonds**").

Issue Price: 100 per cent

Manager: Lloyds Bank PLC

Final Maturity: 24 years

Financial Guarantors: Assured Guaranty (Europe) Ltd. and Assured Guaranty Municipal Corp.

Interest and Redemption: Payments of interest and principal will be due on the Bonds as set out in the "*Terms and Conditions of the Bonds*" below.

Financial Guarantees: The Bonds (excluding those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) will have the benefit of the Financial Guarantees under which (i) AGE has unconditionally and irrevocably agreed to pay to the Bond Trustee 6 per cent of all sums due and payable but unpaid by the Issuer in respect of scheduled principal and interest on the Bonds and (ii) AGM has unconditionally and irrevocably agreed to pay to the Bond Trustee (x) the remaining 94 per cent of the aforementioned sums, and (y) any sums due and payable but unpaid by AGE, all as more particularly described in the Financial Guarantees.

Reimbursement and Indemnity Deed: The Obligors will be obliged to reimburse the Financial Guarantors in respect of payments made under the relevant Financial Guarantees pursuant to the Reimbursement and Indemnity Deed. In addition, the Financial Guarantors will be subrogated to the rights of the Bondholders and the Bond Trustee (as described below) in respect of any payments made by it under the relevant Financial Guarantee.

Status of Bonds: The Bonds will constitute direct and secured obligations of the Issuer which will rank *pari passu* and rateably without any preference or priority among themselves and will rank in priority to all unsecured obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Status of Financial Guarantees: The AGE Financial Guarantee will constitute a direct and unsecured obligation of AGE which will rank at least *pari passu* with all other unsecured obligations of AGE save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

The AGM Financial Guarantee will constitute a direct and unsecured obligation of AGM which will rank at least *pari passu* with all other unsecured obligations of AGM save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Financial Guarantor Downgrade Event: If at any time while the Bonds remain outstanding both (i) AGM's insurer financial strength rating by Moody's ceases to be at least "Baa3" and (ii) AGM's insurer financial strength rating by S&P ceases to be at least "BBB-" (a "**Financial Guarantor Downgrade Event**"), the Issuer shall notify the Bondholders and the Bond Trustee that a Financial Guarantor Downgrade Event has occurred and of their rights pursuant to and in accordance with the Bond Trust Deed and the Conditions.

If directed by Bondholders acting by way of an Extraordinary Resolution, the Bond Trustee shall, subject to being prefunded and/or indemnified and/or secured to its satisfaction, issue a notice (the "**Financial Guarantor Removal Notice**") to the Financial Guarantors specifying that, unless the Financial Guarantor Downgrade Event has been remedied or waived by the date that is three calendar months after the date of delivery of the Financial Guarantor Removal Notice, each of the Financial Guarantees shall be unconditionally and irrevocably terminated in whole and not in part effective on the date (the "**Financial Guarantor Removal Effective Date**") on which the Financial Guarantors have been (i) reimbursed in full for any payments made under the Financial Guarantees and (ii) paid any and all then-outstanding financial guarantee fees and other amounts owed under the Reimbursement and Indemnity Deed and the Financial

Guarantee Fee Letters. The Financial Guarantors may remedy any Financial Guarantor Downgrade Event by transferring the AGM Financial Guarantee to an affiliate of AGM that is rated at least "Baa3" by Moody's or "BBB-" by S&P at any time up to the Financial Guarantor Removal Effective Date.

Notwithstanding that the Financial Guarantees have been terminated pursuant to and in accordance with Condition 2(b) (*Financial Guarantees*) of the Bonds, the Financial Guarantors shall continue to be paid financial guarantee fees until the later of (x) the Financial Guarantor Removal Effective Date and (y) the tenth Scheduled Payment Date. Thereafter, financial guarantee fees shall cease to be paid to the Financial Guarantors and Bondholders may sanction by Extraordinary Resolution to use the amounts no longer required to be paid as such financial guarantee fees to: (i) replace the Financial Guarantors; (ii) appoint a monitoring agent; (iii) increase the interest payable on the Bonds or (iv) for such other purpose as the Bondholders may determine. See Condition 2(b) (*Financial Guarantees*) of the Bonds.

The Issuer will immediately notify the Bondholders and the Bond Trustee upon (i) any remedy or waiver of a Financial Guarantor Downgrade Event (including by way of transfer of the AGM Financial Guarantee) or (ii) termination of the Financial Guarantees pursuant to Condition 2(b) (*Financial Guarantees*) of the Bonds.

Listing and admission to trading: Application has been made for the Bonds to be admitted to the Official List and to trading on the Main Securities Market of the Irish Stock Exchange.

Ratings: The Bonds are expected to be rated, upon issue, AA- by S&P and A2 by Moody's, based on the financial strength rating of the Financial Guarantors.

A rating is not a recommendation to buy, sell or hold securities, and will depend, amongst other things, on the business and financial condition of the Financial Guarantors from time to time.

Settlement/Clearance: Euroclear and Clearstream, Luxembourg and any additional or substitute clearing system from time to time (nominated in accordance with the Bond Trust Deed).

Security Trustee: BNY Mellon Corporate Trustee Services Limited

Bond Trustee: BNY Mellon Corporate Trustee Services Limited

Principal Paying Agent: The Bank of New York Mellon, London Branch

Form and Denomination: The Bonds will be in bearer form in the denominations of £100,000 and integral multiples of £1,000 in excess thereof.

The Bonds will initially be represented by the Temporary Global Bond, without coupons or talons attached, deposited with a common safekeeper for Euroclear and Clearstream, Luxembourg. The Temporary Global Bond will be exchangeable, in whole or in part, not earlier than

40 calendar days from (but not including) the Issue Date and upon certification of non-U.S. beneficial ownership, for interests in the Permanent Global Bond, without coupons or talons attached, which will also be deposited with such common safekeeper for Euroclear and Clearstream, Luxembourg. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in whole, but not in part, for Bonds in definitive form in the denominations of £100,000 and integral multiples of £1,000 in excess thereof, with coupons for principal and interest and talons for further coupons attached in the limited circumstances described in the section entitled "*Summary of Provisions relating to the Bonds while in Global Form*" below. If Definitive Bonds are required to be issued, such Definitive Bonds (a) will only be issued to Bondholders (as defined below) holding Bonds having a nominal amount equal to or in excess of £100,000 and (b) will only be printed in denominations equal to or in excess of £100,000.

Security:

The payment obligations of the Issuer under the Bonds shall have the benefit of security interests granted by (i) the Issuer over all or substantially all of its undertaking, property and assets both present and future, all of its rights in and under the Project and the Relevant Documents to which it is a party and certain bank accounts and book debts established in connection with the Project, (ii) HoldCo over all or substantially all of its undertaking, property and assets, both present and future (including its shares in the Issuer and ProjectCo) and its interest in and rights under the Relevant Documents to which it is a party and certain bank accounts and book debts established in connection with the Project and (iii) ProjectCo over all or substantially all of its undertaking, property and assets both present and future, all of its rights in and under the Project and the Relevant Documents to which it is a party and certain bank accounts and book debts established in connection with the Project. See "*Financing of the Project — The Security Arrangements*".

Any exercise by the Security Trustee of its rights in respect of such security is subject to certain restrictions set out in the security trust and intercreditor deed dated on or about the Issue Date between the Obligors, the Financial Guarantors, the Principal Paying Agent, the Bond Trustee, the Shareholders and the Security Trustee (the "**Security Trust and Intercreditor Deed**").

Bondholder Report:

The Issuer has covenanted in the Collateral Deed that it will publish either through an electronic website or through the Principal Paying Agent via the bond clearing system semi-annually on or before the date which is 20 business days after the first day of each half of its Financial Years, a report (the "**Bondholder Report**") containing, amongst other things, the following information to the extent applicable:

- Details of compliance with the financial ratios;

- Key performance indicators;
- Summary financial results;
- Rent collection rates;
- Penalties & deductions;
- Costs incurred to date on maintenance / lifecycle and relevant changes to maintenance schedule;
- Changes to service providers;
- Material new contracts;
- Material insurance claims;
- Variations effected;
- Any material actions taken / variations effected;
- Any other material topics as relevant to the Project; and
- Any Regulatory News Service (RNS) or other market announcements made during the reporting period.

Covenants etc.: The representations, warranties, covenants (positive, negative and financial) and events of default which will apply to, *inter alia*, the Bonds will be set out in the Collateral Deed (see "*Financing of the Project — The Collateral Deed*").

Taxes: All payments of principal and interest in respect of the Bonds by the Issuer will be made free and clear of, and without withholding or deduction for taxes, unless required by law. If such taxes are imposed, the Issuer will pay principal and interest after such withholding or deduction has been made. The Issuer will not be obliged to make any additional payments to Bondholders or Couponholders (as defined below, in respect of the Bonds, in the section entitled "*Terms and Conditions of the Bonds*") in respect of any such withholding or deduction. Similarly if any withholding or deduction for taxes is required in relation to any payments by AGE or AGM under the relevant Financial Guarantees, such payments will be made by AGE or AGM, as the case may be, subject to such withholding or deduction and neither AGE or AGM will be obliged to make any additional payments to Bondholders or Couponholders in respect of such withholding or deduction.

Governing Law: The Bonds and each Financial Guarantee will be governed by English law.

Currency: The Bonds will be denominated in Pounds Sterling.

RISK FACTORS

This section summarises certain factors involved in the Project, the transaction parties and the financing arrangements which may materially affect the ability of the Issuer to make payments of interest, principal and other amounts due on the Bonds. In the case of certain risks this may lead to, among other things:

(i) *an Event of Default under the Collateral Deed (see the section entitled "Financing of the Project — The Collateral Deed" below) and hence, at the option of the Controlling Creditor, acceleration of the Bonds (see in respect of the Bonds, the section entitled "Terms and Conditions of the Bonds" below); or*

(ii) *non-payment of those amounts due on the Bonds and not guaranteed under the Financial Guarantees (see the section entitled "Overview of the Bond Issue" above), and if additionally AGE and/or AGM were to default on its obligations under the relevant Financial Guarantee, non-payment of amounts due on the Bonds that are guaranteed under such Financial Guarantee.*

Prospective Bondholders should read the detailed information appearing elsewhere in this Prospectus prior to making any investment decision. Further, any prospective Bondholders should take their own legal, financial, accounting, tax and other relevant advice as to the structure and viability of their investment.

1. Risks relating to the Issuer, ProjectCo and HoldCo

Each of the Issuer, ProjectCo and HoldCo is a newly incorporated special purpose company which have produced no financial statements since their respective dates of incorporation. The Issuer has been incorporated for the purpose of issuing the Bonds and on-lending the proceeds to ProjectCo. ProjectCo has been incorporated for the purpose of entering into the Project Agreement and undertaking the Project. The ability of ProjectCo to repay amounts it has borrowed from the Issuer and the ability of ProjectCo and the Issuer to pay dividends to HoldCo, thus enabling the Issuer to perform its obligations under the Bonds and each of ProjectCo and HoldCo to perform their obligations under the respective guarantees of the Issuer's obligations under the Bonds, is conditional upon the success of the Project. The risks relating to the Project set out below are therefore relevant to each of the Issuer, ProjectCo and HoldCo.

2. Risks relating to the Project

Introduction

The contractual arrangements for the Project are generally structured to minimise the retention by the Contractor of risks inherent in the Project. Risks under the Project Agreement are generally borne by the Contractor, unless assumed by the Authority.

To the extent borne by the Contractor under the Project Agreement, the majority of risks are passed to the Sub-Contractors under the relevant Sub-Contracts or managed through insurance. However, to the extent that the Sub-Contractors, their respective guarantors, the Authority or insurers fail to meet their obligations in respect of risks under the Project Documents which have been passed on to them by the Contractor, or claims by the Contractor exceed agreed limits on liability under the Sub-Contracts, the Contractor will continue to bear such risk to the extent defined in the Project Agreement.

Certain risks will not be passed to the Sub-Contractors but will remain with the Contractor. Where those risks sits with the Contractor they will be managed by Equitix Limited under the Management Services Agreement.

The Project Agreement follows the Local Partnerships Housing Procurement Pack standard form (as updated in October 2011) and includes certain transparency provisions from the new Standardisation of PF2 Contracts standard drafting.

Deductions

The Unitary Charge is the primary source of revenue enabling the Contractor to pay principal and interest in respect of the Bonds.

The Unitary Charge is subject to Deductions for:

(a) poor performance or non-performance of the Services ("**Performance Deductions**"); or

(b) unavailability of the properties (or part or parts of them) ("**Unavailability Deductions**"); and

(c) failures in connection with reporting requirements under the Project Agreement ("**Reporting Failure Deductions**"),

in each case as defined and measured under the Project Agreement.

Deductions from the Unitary Charge for poor performance or unavailability are passed down to the relevant Sub-Contractor carrying out the Services. As such, Deductions will in most cases either be recovered by the Contractor from the Housing Management Contractor or the RRCMR Contractor (if the Deductions result from that Sub-Contractor's default or from a risk allocated to that Sub-Contractor) or from business interruption insurance (in the event of associated physical damage). In limited cases, the Contractor may suffer Deductions from the Unitary Charge for which it will not have recourse against a Sub-Contractor or an insurer, including where:

(a) the Deductions are caused directly by acts or omissions of the Contractor; or

(b) a Sub-Contract has terminated or is insolvent and no replacement Sub-Contractor has yet been appointed.

The initial allocation of Deductions is set out in the interface agreement which is entered into between the Contractor and the Sub-Contractors (the "**Interface Agreement**").

To the extent that Deductions from the Unitary Charge exceed the relevant Sub-Contractor's liability cap or are otherwise not passed down to a Sub-Contractor, and subject to any relevant insurances and reserves, the ability of the Contractor to make payments in respect of the Bonds may be adversely affected.

To the extent that Unitary Charge uplifts are triggered late such that the net revenue received by the Contractor during the period prior to completion of all the Works is less than forecast, then the ability of the Contractor to meet its liabilities in respect of the Works may be adversely affected. The Contractor's insurances have been put in place to mitigate this risk, however the insurances may not always respond or always respond in full. Where delays are caused by the Construction Contractor or Refurbishment Contractor, these risks have been passed down to the relevant Sub-Contractors under their respective Sub-Contracts through the liquidated damages regime.

Cost Overrun, Construction Delay and Compliance with Specification

The principal risks which may arise in the construction period include:

(a) the Service Works not being completed within the agreed price in the Construction Contract and the Refurbishment Works Contract respectively;

(b) the Service Works not being completed on time which may affect the stepping-up of the Unitary Charge and may lead to a claim by the Authority pursuant to the delay indemnity in the Project Agreement; and

(c) the design and construction of the Service Works not being undertaken in compliance with the specifications and construction obligations.

Under the Construction Contract, the risks assumed by the Contractor in relation to the carrying out of the Construction Works under the Project Agreement relating to design, price overrun, technical compliance, delay, defects and resulting losses of availability are borne by the Construction Contractor subject to an agreed cap which is fifty per cent (50 per cent) of the contract sum excluding liquidated damages.

Under the Refurbishment Contract, the risks assumed by the Contractor in relation to the carrying out of the Initial Refurbishment Works under the Project Agreement relating to design, price overrun, technical compliance, delay, defects and resulting losses of availability are borne by the Refurbishment Contractor subject to an agreed cap which is sixty per cent (60 per cent) excluding any liquidated damages.

As is common in PFI contracts, there are limited exceptions to the construction risks assumed by the Contractor and not passed to the Construction Contractor and the Refurbishment Contractor respectively, such as independent breaches by the Contractor.

The obligations of the Construction Contractor under the Construction Contract are guaranteed by the Construction Contractor Guarantor pursuant to the Construction Contract Guarantee and the obligations of the Refurbishment Contractor under the Refurbishment Contract are guaranteed by the Refurbishment Contract Guarantor pursuant to the Refurbishment Contract Guarantee.

Delays in construction beyond the completion dates originally fixed in the Project Agreement may delay both the receipt of the Unitary Charge from the Authority and also reduce the period within the overall Project Term in which the Unitary Charge is due. Failure to complete the works to the agreed timetable may ultimately lead to termination of the Project Agreement save for delays caused by the Authority. In particular:

(a) if the Initial Refurbishment Works are not completed by the Longstop Date; or

(b) if an acceptance certificate for (i) 70 Low Rise Retained Units and 70 High Rise Retained Units within 25 months or (ii) 30 new Build Homes within 37 months has not been issued by the Milestone Completion Date,

the Authority becomes entitled to terminate the Project Agreement in its entirety.

For prolonged and serious failures to complete the Works that are caused by the Construction Contractor and/or Refurbishment Contractor, then events of default (entitling the Contractor to terminate the relevant Sub-Contractor) have been agreed and inserted into the relevant Sub-Contracts. Where possible these are designed to give the Contractor an ability to step in and replace the defaulting Sub-Contractor prior to termination being triggered at Project Agreement level. Where this occurs the risk of the security package being sufficient to ensure that any increased costs of the Contractor and any replacement Sub-Contractor are met lies with the Contractor.

Compensation Events, Force Majeure, Relief Events, Authority Changes and Qualifying Changes in Law occurring in the works period will not extend the Project Term. However, they will cause the affected completion dates to be adjusted to allow for any delay suffered (provided such adjustment is applied for promptly in accordance with the Project Agreement's procedures) and therefore, adjust the Longstop Date and the Milestone Completion Dates respectively.

Compensation Events trigger compensation entitlements for the Contractor which would entitle the Contractor to compensation as would place it in no better or no worse position than it would have been in had the Compensation Event not occurred.

Under the Construction Contract and the Refurbishment Contract, the Construction Contractor and the Refurbishment Contractor are required to pay liquidated damages to the Contractor (other than in specified circumstances) for failure to complete, on time, construction or refurbishment of such of the properties as triggers increases to the Unitary Charge. The level of the liquidated damages has been calculated to reflect the loss of uplift to the Unitary Charge and any delay in receiving the Authority Capital Contribution (see paragraph entitled "*Authority Capital Contribution*" below for further detail). The Contractor will benefit from advance loss of profit insurance and business interruption cover in specified circumstances where insured loss causes delays to completion. It is however possible that the liquidated damages regime may not always respond in full for example if the damages are set at too low a level to meet the funding shortfall or if the relevant Sub-Contract provisions are held to be unenforceable, in which case any residual risk lies with the Contractor.

Termination and replacement of the "Services Contractors"

As is usual in PFI contracts, should any of the Services Contractors consistently or seriously fail in performing its services, or should become insolvent, the Contractor may terminate that Services Contractor's Sub-Contract.

In limited circumstances, for example a public safety incident, the Authority may require that the Contractor terminates an individual service provider.

Market Testing of certain Services

Certain Services are subject to market testing on the date five years from the Service Commencement Date 6 January 2014 and thereafter at five yearly intervals. The Unitary Charge is adjusted for the results of the market testing, such that any increase or decrease in real terms from the Contractor's underlying cost of providing these services increases or reduces the Service Payment on a pound for pound basis.

Service Performance and Availability

Each of the Services will be monitored against agreed measures. Deficient performance can progressively reduce the Unitary Charge payable in respect of such Services.

A certain level of deficient performance may lead to unavailability or consequential unavailability of Properties. The payment arising from continuing availability is the primary source of revenue enabling the Contractor to pay principal and interest in connection with the Bonds. Unavailability may result in a lower than forecast Unitary Charge, for which recourse will generally be available against the relevant Services Contractor subject to caps on liability. Deductions for unavailability may also be the subject of business interruption cover.

Ultimately, at higher levels of default, the Authority will be able to terminate the Project Agreement for poor service performance.

The termination triggers at Project Agreement level for poor performance have been dropped down to the RRCMR Contractor and the Housing Management Contractor under their subcontracts with a buffer so as to enable the Contractor to step in and replace the poor performing Sub-Contractor prior to termination being triggered at Project Agreement level. The residual risk of the termination regime at Sub-Contract level not operating as it is designed to do lies with the Contractor.

Site Conditions and Title

The Contractor is responsible for the condition of the Sites including dealing with any contamination. Unusually this includes responsibility in certain circumstances for dealing with contamination under existing buildings which by its nature is difficult to measure. This risk has been passed down to the Refurbishment Sub-Contractor and the Construction Sub-Contractor who have sought to mitigate their exposure through carrying out various surveys across the project site as well as through their contract sum analysis.

The Authority agrees to grant licences to the Contractor over relevant parts of the Sites to enable the Contractor to carry out the Works and provide the Services. The licences are subject to the statutory rights of the Authority or any third party, the Authority's rights of access to the properties, rights granted under any tenancy agreement and rights, covenants and encumbrances contained in the titles to the properties.

The Authority bears the risk in the title to the Sites subject to certain disclosed adverse rights which have been identified and are scheduled in the Project Agreement. In the event that a non-disclosed adverse right is identified that impacts on the carrying out of the Works or Services, this is an Authority risk and dealt with through the Compensation Event regime.

Defects

The Contractor takes the risk in latent defects and defects in the retained dwellings and defects in the new build properties. Unusually the Contractor takes the risk of defects in existing properties though in relation to the high rise tower block this risk is subject to an aggregate cap of £175,000 (following which it becomes an Authority risk).

This risk has been flowed down to the Refurbishment Contractor who has carried out survey work and sought to include any identified issues in their refurbishment programme.

The Contractor also takes the risk of defects in any new build and infrastructure works and the retained dwellings from year 12 following issue of the relevant practical completion certificate for each phase of the Works. Prior to the 12 year defects period this risk has been flowed down to the Construction Contractor for the new build and infrastructure works and to the Refurbishment Contractor for the Refurbishment Works.

Housing specific risks

Service Works or Services Denial Event – as is usual in social housing PFIs, the acts of tenants that impact on the ability to carry out Works or Services are dealt with as a Relief Event. These risks include an access refusal by the tenant, a rehousing refusal and a tenant waiver of works event. Whilst these risks are not regular occurrences on social housing PFI schemes, the risk of them occurring has been passed down to the relevant Sub-Contractors. The Project Agreement provides that the occurrence of these risks will not prevent the Contractor from obtaining an acceptance certificate (and uplift in Unitary Charge) by the end of the Works period.

Welfare Reform and Rent Collection – various legislative changes have been made pursuant to the Welfare Reform Act 2012 including the introduction of the universal credit and direct payment of benefits to tenants that risk impacting on meeting the rent collection targets (and hence trigger deductions). The Contractor takes the risk on rent collection over an annual measurement period. In the event that rent collection levels fall below target, then the related deductions are passed down to the Housing Management Contractor subject to a risk sharing mechanism with the Housing Management Contractor up to the first market testing date whereby the Housing Management Contractor takes the risk of deductions below an agreed floor. The Contractor has reserved against this risk in full until the first market testing date at which point there is an ability to reprice this risk in full. There are also certain provisions at Project Agreement level intended to take account of the impact of Welfare Reform (direct payment). The Authority remains responsible for processing Housing Benefits for applicable tenants both pre and post introduction of Direct Payments.

Tenant and Third Party Damage – the Contractor bears the risk of Tenant and Third Party Damage to a dwelling which then necessitates remedial work. This risk has been flowed down to the RRCMR Contractor who currently operates in the PFI area and based on its experience considers this risk to be limited. It has however agreed to reserve a fixed sum per annum of £40,000 to mitigate this risk further.

Termination of the Project Agreement

As is usual in PFI projects the Project Agreement incorporates termination rights for the Authority and the Contractor and provides for compensation from the Authority in the case of termination for any reason of the Project Agreement, with the amount received varying depending on the reason for termination and other circumstances.

The amount of compensation payable by the Authority if termination of the Project is due to:

(a) voluntary termination by the Authority;

(b) the Authority exercising a right to terminate at one of the Authority break points (in years 10, 15 and 20 of the contract period);

(c) Authority Default;

(d) Force Majeure Event;

(e) Corrupt Gifts and Fraud;

(f) wilful breach of the Refinancing provisions;

(g) occurrence of an Uninsurable risk;

(h) termination for want of statutory orders (CPO and Highways); and

(i) termination at the request of the Regulator (as defined in the Project Agreement) under clauses 34.4.10 and 34.4.13 of the Project Agreement,

have been generally structured so as to enable the Contractor to meet its obligations under the Bonds. However, payment by the Authority of such compensation may not be sufficient or sufficiently timely to enable the Contractor to meet its obligations under the Bonds as they fall due.

For termination by reason of default of the Contractor (other than Corrupt Gifts or wilful breach of the Refinancing provisions) the amount of compensation will depend on the Project's value as assessed either by bidders in the market or by expert valuation. In any event, there is no prescribed minimum valuation and the compensation may well not be sufficient to enable the Contractor to meet its obligations under the Bonds.

In relation to certain events of default by the Contractor, there is a remedy period under the Project Agreement designed in part to enable the Security Trustee to step-in and rescue the project in accordance with the Funder Direct Agreement by replacing the Contractor (and relevant Sub-Contractors) prior to Project Agreement termination.

In the event of termination of the Project Agreement, the Contractor will transfer to the Authority (at the Authority's request) those assets and contracts acquired or entered into by the Contractor that it requires in order to either continue to carry out the Works or provide the Services.

Default Interest

The amounts payable by the Authority following a delay in payment to the Contractor may not always be sufficient or sufficiently timely to enable the Contractor to meet its obligations to pay default interest under the Bonds.

Lifecycle

The Contractor takes the risk on the adequacy of the Lifecycle funds with the risk of carrying out the relevant lifecycle works being passed down to the RRCMR Contractor. The Contractor has sought to mitigate this risk through its contract pricing. Any excess amounts in the Maintenance Reserve Account in years 15, 20 and on expiry of the Project Agreement are, subject to Lenders' Technical Adviser approval, shared between the Contractor and the RRCMR Contractor on a 50/50 basis.

Indemnities

Under the Project Agreement, the Contractor is required in a number of circumstances to indemnify the Authority in respect of:

(a) claims for death or personal injury;

(b) damage or loss to Authority Property;

(c) third party actions and claims;

(d) certain third party claims in relation to the condition of the Properties; and

(e) breach of statutory duty,

up to certain monetary caps.

The risk of these indemnities being triggered is passed down to the Sub-Contractors where their activities have given rise to the claim (which sit outside their limits of liability). In addition, the project insurances are designed to cover the majority of events that might trigger an indemnity claim.

As is usual in PFI projects, the Project Agreement also includes certain other indemnities in relation to, for example, intellectual property and TUPE. The risk of these being triggered has been flowed down to the relevant Sub-Contractors in full.

Planning and Consents

Full planning permission in connection with the Project was obtained on 30 May 2013 and the Judicial Review period has now expired.

The Contractor is also responsible for obtaining any other relevant consents required to carry out the Works and provide the Services and this risk has been passed down to the relevant Sub-Contractors or, where relevant, retained by the Authority.

Change in Law

In general, the Authority takes the risk on the cost of changes in law including capital expenditure. The exception to this is in connection with general changes in law which require capital expenditure and which were foreseeable at the date of the Project Agreement or which occur in the two year period following the date of the Project Agreement, the risk for which sits with the Contractor.

Authority Capital Contribution

The Authority Capital Contribution is £24,000,000. This will be paid to the Contractor in instalments on completion of Phases (at the issue of the relevant Acceptance Certificate). This contribution has reduced the overall debt requirement for the project.

Statutory Orders

The Authority is obliged to obtain a Compulsory Purchase Order in respect of the Sites to ensure that any adverse property interests can be extinguished effectively. The Authority is also obliged to obtain a Highways Order to stop up any relevant footpaths and roads at the Sites.

The risk of obtaining both these orders rests with the Authority and failure to obtain them on time will result in a Compensation Event and, ultimately, could lead to termination of the Project.

The risk of identifying those interests that are required to be extinguished and/or stopped up by the Authority as outlined above lies with the Contractor and this responsibility has been passed down in full to the Construction Contractor and where relevant the RRCMR Contractor.

Development Works

(a) As is common in this type of social housing PFI, some of the dwellings that are to be built are for outright sale (i.e. not social housing) and are therefore not funded through PFI credits.

(b) All Development Works risks are passed down in full to the Development Contractor. In addition, the Development Works are ring-fenced from the rest of the Project. Clause 25.7 (*Completion of the Development Works and Termination of the Development Works Licence*) and clause 47.5 (*Rectification of Contractor Fault*) of the Project Agreement are designed to minimise any potential impact on the PFI arising from the Development Works. There is also provision for payment to the Contractor of development fees and upside profits from the sale of the Development Works Properties (as defined in the Project Agreement) which is passed down to the Development Contractor (as defined in the section entitled "*Overview of the Project*").

3. **Risks relating to the Financial Guarantors**

Ratings of Bonds affected by the Financial Guarantors

The ratings of the Bonds are based primarily on the Financial Guarantees issued by the Financial Guarantors with respect to the Bonds. The financial strength ratings assigned by S&P and Moody's to the Financial Guarantors provide the rating agencies' opinions of each Financial Guarantor's financial strength and ability to meet ongoing obligations to policyholders and cedants in accordance with the terms of the financial guarantees it has issued or the reinsurance agreements it has executed. The ratings also reflect qualitative factors, such as the rating agencies' opinion of a financial guarantor's business strategy and franchise value, the anticipated future demand for its product, the composition of its portfolio, and its capital adequacy, profitability and financial flexibility. A downgrade by a rating agency of the financial strength ratings of either of the Financial Guarantors could impair the Financial Guarantors' financial condition, results of operation, liquidity, business prospects or other aspects of the Financial Guarantors' business.

The ratings assigned by S&P and Moody's to the Financial Guarantors are subject to frequent review and may be lowered by a rating agency at any time and without notice to the Financial Guarantors as a result of a number of factors over which the Financial Guarantors have no control, including, but not limited to, the rating agency's revised stress loss estimates for a Financial Guarantor's portfolio, adverse developments in a Financial Guarantor's financial condition or results of operations because of underwriting or investment losses or other factors, changes in the rating agency's outlook for the financial guarantee industry or in the markets in which the Financial Guarantors operate, or a revision in the rating agency's capital model or ratings methodology.

A downgrade may have a negative impact on a Financial Guarantor in respect of transactions that it has insured or reinsurance that it has assumed. For example, a downgrade of one of the Financial Guarantors may result in increased claims under certain financial guarantees issued by such Financial Guarantor, including with respect to AGM: (i) termination of certain interest rate swaps guaranteed by AGM which in turn may result in claims to AGM if the obligor owed a termination payment as a result and AGM guaranteed such termination payment; (ii) early termination of all leases under leveraged lease transactions insured by AGM which in turn may result in claims to AGM to the extent the early termination payment owing to the lessor within such a transaction is not paid by the municipal lessee (this is mitigated by a liquidity facility with Dexia Crédit Local S.A.); and (iii) certain GICs issued by AGM's former affiliates that are guaranteed by AGM may come due or may come due if the GIC issuers do not post collateral.

In addition, the rating agencies may change their requirements for the Financial Guarantors' respective capital adequacy. Changes in the rating agencies' capital models or ratings methodology could require additional capital to be raised to maintain the Financial Guarantors' current ratings levels, even if there are no adverse developments with respect to any specific investment or insured risk. The amount of such capital required may be substantial, and may not be available to the Financial Guarantors on favourable terms and conditions or at all. Accordingly, the Financial Guarantors cannot ensure that they will seek to, or be able to, complete a required capital raising. The failure to raise additional required capital could result in a downgrade of the Financial Guarantors' ratings or the Financial Guarantors being unable to write new business.

Financial guarantees issued by the Financial Guarantors insure the credit performance of guaranteed obligations over an extended period of time, in some cases 30 years or more, and in most circumstances, the Financial Guarantors have no right to cancel such financial guarantees. As a result, each Financial Guarantor's estimate of ultimate losses on a financial guarantee is subject to significant uncertainty over the life of the guaranteed transaction because of the potential for significant variability in credit performance as a result of changing economic, fiscal and financial market variability over the long duration of most contracts. If a Financial Guarantor's actual losses exceed its current estimates, this may result in adverse effects on the relevant Financial Guarantor's financial condition, results of operations, liquidity, business prospects, financial strength ratings and ability to raise additional capital.

Rating agencies and insurance regulatory authorities impose capital requirements on the Financial Guarantors. These capital requirements, which include leverage ratios and surplus requirements, limit the amount of financial guarantees that the Financial Guarantors may write. The Financial Guarantors have several alternatives available to control their leverage ratios, including obtaining capital contributions from Assured Guaranty Ltd., purchasing reinsurance or entering into other loss mitigation agreements, or reducing the amount of new business written. However, a material reduction in the capital and surplus of a Financial Guarantor, whether resulting from underwriting or investment losses, a change in regulatory capital requirements or otherwise, or a disproportionate increase in the amount of risk in force, could increase such Financial Guarantor's leverage ratio. This in turn could require that Financial Guarantor to obtain reinsurance for existing business (which may not be available, or may only be available on terms that such Financial Guarantor considers unfavourable), or add to its capital base to maintain its financial strength ratings. Failure to maintain regulatory capital levels could limit a Financial Guarantor's ability to write new business.

Reliance on the Financial Guarantors

Pursuant to the Financial Guarantees, the Financial Guarantors guarantee scheduled payments of principal and interest under the Bonds. The payment of the guaranteed amounts (as defined in the Financial Guarantees) ("**Guaranteed Amounts**") will depend upon each of the Financial Guarantors performing its obligations under its respective Financial Guarantee. The likelihood of payment of the Guaranteed Amounts will depend upon the creditworthiness of each of the Financial Guarantors. Consequently, investors are relying not only on the creditworthiness of the Issuer, but also on the creditworthiness of each of the Financial Guarantors to perform its obligations under the relevant Financial Guarantee. The insolvency of either of the Financial Guarantors or a default by it under its respective Financial Guarantee may adversely affect the likelihood of investors receiving scheduled payments of principal and interest and could result in a withdrawal or downgrade of the ratings of the Bonds.

The Financial Guarantees only guarantee scheduled principal and scheduled interest payments by the Issuer on the date(s) when such amounts are initially scheduled to become due and payable (subject to and in accordance with each Financial Guarantee), and do not guarantee the market price, or liquidity of any securities, nor do they guarantee that the ratings on such securities will not be revised or withdrawn.

Reliance by AGE on AGM

The financial strength ratings of AGE are based primarily on the ratings of and the capital support and reinsurance provided by AGM to AGE pursuant to certain intercompany support agreements (the "**Support Agreements**"). Any downgrade of the ratings of AGM would very likely result in a downgrade of the ratings of AGE. The Support Agreements are not, and should not be regarded as, conferring any recourse against AGM or any other person under the Support Agreements. See "*Description of the Financial Guarantors*" below for further details on the Support Agreements.

Regulation

AGE is authorised by the UK Prudential Regulation Authority (the "**PRA**") to carry out and effect "credit", "suretyship" and "miscellaneous financial loss" insurance business in the United Kingdom and, pursuant to the EC third non-life insurance directive (No. 92/49/EEC), various European countries (such authorisation being the "**Insurance Business Authorisation**") and is regulated by the PRA and the UK Financial Conduct Authority.

The Insurance Business Authorisation may be revoked, withdrawn or restrictively modified by the PRA. Such revocation, withdrawal or restrictive modification could have a material adverse impact on AGE, including its ability to generate new business or increased costs of regulatory compliance.

AGM is licensed to write financial guaranty insurance and reinsurance (which is classified in some states as surety or another line of insurance) in the 50 states of the United States of America, the District of Columbia and Puerto Rico. The New York Department of Financial Services (NY DFS) is the regulatory authority of the State of New York, U.S.A., which is AGM's state of organisation and domicile.

State insurance authorities have broad regulatory powers with respect to various aspects of the business of U.S. insurance companies, including licensing these companies to transact business, accreditation of reinsurers, admittance of assets to statutory surplus, regulating unfair trade and claims practices, establishing reserve requirements and solvency standards, regulating investments and dividends and, in certain instances, approving policy forms and related materials and approving premium rates. If AGM fails to comply with applicable insurance laws and regulations it could be exposed to fines, the loss of insurance licenses, limitations on its right to originate new business and restrictions on its ability to pay dividends, all of which could have an adverse impact on its business results and prospects.

Concentration of business

Each of the Financial Guarantors is engaged exclusively in the business of writing financial guarantees, and, in the case of AGM, related lines of insurance and reinsurance.

Although it is the Financial Guarantors' policy to diversify and manage exposure to single obligors and to particular business sectors, it may have individual large exposures to single obligors or particular business sectors; if a material adverse event or series of events occurs with respect to one or more of these concentrations that is more severe than the assumptions used by the Financial Guarantors, such event or series of events could result in losses to the Financial Guarantors and could harm the Financial Guarantors' business.

As one example, AGM guarantees the obligations of state and local governments in the U.S.. The economic crisis caused many state and local governments that issue some of the obligations that AGM guarantees to experience significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations. If the issuers of the obligations in AGM's public finance portfolio do not have sufficient funds to cover their expenses and are unable or unwilling to raise taxes, decrease spending or receive federal assistance, AGM may experience increased levels of losses or impairments on its public finance obligations.

AGM's risk of loss on and capital charges for municipal credits could also be exacerbated by rating agency downgrades of municipal credit ratings. A downgraded municipal issuer may be unable to refinance maturing obligations or issue new debt, which could exacerbate the municipality's inability to service its debt. In addition, obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, may be adversely affected by revenue declines resulting from reduced demand, changing demographics or other factors associated with an economy in which unemployment remains high, housing prices have not yet stabilised and growth is slow.

Impact of Market Conditions

The Financial Guarantors' loss reserves, profitability, financial position, insured portfolio, investment portfolio, cash flow and statutory capital could be materially affected by the global markets. Upheavals in the financial markets can affect the Financial Guarantors' business through their effects on general levels of economic activity and employment. The global recession and disruption of the financial markets has led to concerns over capital markets access and the solvency of certain European Union member states, including Greece, Portugal, Ireland, Italy and Spain, and of financial institutions that have significant direct or indirect exposure to debt issued by these countries. In the U.S., the unemployment rate remains high and housing prices have only recently shown signs of stabilisation. The Financial Guarantors and their financial position will continue to be subject to risk of the global financial and economic conditions that could materially and negatively affect the demand for their products, the amount of losses incurred on transactions they guarantee and the value of their investment portfolios.

The issuers or borrowers whose obligations the Financial Guarantors guarantee or hold may default on their obligations because of bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting structured finance obligations that the Financial Guarantors have guaranteed may deteriorate, causing these obligations to incur losses. These losses could be significantly more than the Financial Guarantors expect and could materially adversely impact their financial strength, ratings and prospects for future business.

Since mid-2007 there have been several adverse developments in the credit and financial guarantee markets that have affected AGM's business, financial condition, results of operation and future business prospects. In particular, U.S. residential mortgages and residential mortgage backed securities transactions ("**RMBS**") that were issued in the 2005-2007 period have generated losses far higher than originally expected and higher than experienced in the last several decades. This poor performance led to price declines for RMBS securities and the rating agencies downgrading thousands of such transactions. In addition, the material amount of the losses that have been incurred by insurers of these mortgages, such as Fannie Mae or private mortgage insurers, by guarantors of RMBS securities or of securities that contain significant amounts of RMBS, and by purchasers of RMBS securities have resulted in the insolvency or significant financial impairment of many of these companies.

In addition, AGM has been affected by a negative perception of financial guarantors arising from the financial distress suffered by other companies in the industry during the financial crisis, some of which entered into rehabilitation proceedings or were required by their regulators to suspend claim payments. The demand for AGM's financial guarantees has also been negatively affected by its credit spread, which is a reflection of the risk that investors perceive in AGM, among other factors; the higher AGM's credit spread, the lower the benefit of AGM's financial guarantee to certain investors. If investors view AGM as being only marginally less risky, or perhaps even as risky, as the uninsured security, the coupon on a security guaranteed by AGM may not be much lower than, or may be the same as, an uninsured security offered by the same issuer. If the guarantee does not lower the cost of issuance in a material respect, issuers may be unwilling to pay AGM a fee for such guarantee. The decreased demand for AGM's financial guarantees may be exacerbated in a low interest rate environment, where the credit spread between high quality or insured obligations versus lower rated or uninsured obligations is narrow and, as a result, financial guarantees typically provide lower interest cost savings to issuers than they would during periods of relatively wider credit spreads. These factors may result in decreased demand for AGM's financial guarantees, which may have a negative impact on AGM's long-term financial prospects.

Control by the Financial Guarantors

While the Financial Guarantees mitigate the credit risks to which potential investors in the Bonds would otherwise be exposed, the involvement of the Financial Guarantors has certain consequences. For example, for so long as they are the Controlling Creditor, the Financial Guarantors will have the right to exercise many of the discretions which would otherwise rest in the Bond Trustee and the Security Trustee (including the discretion as to whether to declare events of default or enforcement events or to accelerate payments of principal and interest, and in respect of which the Bond Trustee might otherwise have sought the directions of the Bondholders). In addition, in the event that the Financial Guarantors are required to make a payment under the Financial Guarantees, the Issuer will be required to reimburse the Financial Guarantors and to pay various fees, costs and expenses to the Financial Guarantors.

Acceleration of Bonds

The terms of each Financial Guarantee provide that amounts of principal on any Bonds which have become immediately due and payable (whether by virtue of acceleration, prepayment or otherwise) will not be treated as Guaranteed Amounts which are due for payment unless the relevant Financial Guarantor in its sole discretion elects so to do by notice in writing to the Bond Trustee. If no such election is made, that Financial Guarantor will continue to be liable to make payments of Guaranteed Amounts in respect of the Bonds pursuant to the relevant Financial Guarantee on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

Withholding Tax

If any withholding tax is imposed on payments under the Bonds or the Financial Guarantees, the Financial Guarantors are not required to "gross up" payments to the Bondholders. In such circumstances, Bondholders will receive payments from the Financial Guarantors net of such withholding tax.

4. **Risks relating to the Bonds and the Market**

Interest Rate Risks

Since the Bonds bear interest at a fixed rate, investment in the Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Bonds.

Modification, Waivers and Substitution

The conditions of the Bonds contain provisions for calling meetings of Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Bondholders including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.

If it is then the Controlling Creditor, subject to clause 5 (*Consent of Controlling Creditor and Entrenched Rights and Reserved Matters of Senior Creditors*) of the Security Trust and Intercreditor Deed, the Bond Trustee may, without the consent of the Bondholders or Couponholders concur with the Issuer, the Financial Guarantors or any other relevant parties in making:

(a) any modification to the Conditions of the Bonds, the Bond Trust Deed, the Financial Guarantees, the Security Documents, the Collateral Deed and the Finance Documents which is in the opinion of the Bond Trustee of a formal, minor or technical nature or is made to correct a manifest error or an error which is, in the opinion of the Bond Trustee, proven; and

(b) any other modification of any such document which is in the opinion of the Bond Trustee not materially prejudicial to the interests of Bondholders.

For the avoidance of doubt, and notwithstanding the foregoing, the Bond Trustee shall have the unfettered right to seek the consent of Bondholders to the making of any such modification.

If the Bond Trustee is then the Controlling Creditor, subject to clause 5 (*Consent of Controlling Creditor and Entrenched Rights and Reserved Matters of Senior Creditors*) of the Security Trust and Intercreditor Deed, the Bond Trustee may also, without the consent of any of the Bondholders or Couponholders, waive or authorise any Event of Default, any Potential Event of Default, any Financial Guarantor Default or any Financial Guarantor Downgrade Event or any other breach or proposed breach of the Bond Trust Deed, the Bonds, the Financial Guarantees, the Security Trust and Intercreditor Deed or any other Relevant Document to which it is a party, or determine that any Financial Guarantor Default or any Financial Guarantor Downgrade or any Event of Default or any Potential Event of Default shall not, or shall not subject to specified conditions, be treated as such or, in the case of a Financial Guarantor Default or Financial Guarantor Downgrade Event, has been cured to its satisfaction, if the Bond Trustee is of the opinion that so to do will not be materially prejudicial to the interests of the Bondholders.

For the avoidance of doubt, the Bond Trustee, if it is then the Controlling Creditor, shall have the unfettered right to seek the consent of Bondholders to any such authorisation or waiver.

The secondary market generally

The Bonds may have no established trading market when issued and one may never develop. If a market does develop, it may not be very liquid. Therefore, investors may not be able to sell the Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a materially adverse effect on the market value of the Bonds.

An active trading market for the Bonds may not develop

There can be no assurance that an active trading market for the Bonds will develop, or, if one does develop, that it will be maintained. If an active trading market for the Bonds does not develop or is not maintained, the market or trading price and liquidity of the Bonds may be adversely affected. The Issuer or its Affiliates (as defined below) are entitled to issue further Bonds. Such transactions may favourably or adversely affect the price development of the Bonds. If additional and competing products are introduced in the markets, this may adversely affect the value of the Bonds.

Scope of cover under the Financial Guarantees

Save as set out below, the coverage provided by the Financial Guarantees is the payment of scheduled payments of principal and interest only, and does not cover any amounts due in respect of the Bonds:

(a) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(b) attributable to any present or future taxes, withholding, deduction, assessment or other charge imposed by the laws of any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority thereof, (including interest and penalties in respect of such taxes, withholding, deduction, assessment or other charge) with respect to any payment by the Issuer due under the Bonds or any gross-up or make whole payment payable by the Issuer in respect of any such taxes, withholding, deduction, assessment or other charge;

(c) attributable to any default interest;

(d) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Bonds; or

(e) in respect of which AGM or AGE has made an Accelerated Payment (as defined in the relevant Financial Guarantee).

Withholding tax

Under EC Council Directive 2003/48/EC (the "**Directive**") on the taxation of savings income each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income payments ("**Savings Income**") made by a person within its jurisdiction to or collected by such a person for an individual or to certain non-corporate entities, resident in that other Member State (interest payments on the Bonds will for these purposes be Savings Income). However, for a transitional period, Austria and Luxembourg are instead applying a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments. However, Luxembourg has announced that it will cease to withhold from 1 January 2015 and instead provide the required information.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted and implemented similar measures (either provision of information or transitional withholding) in relation to payments of Savings Income made by a person within its jurisdiction to an individual, or to certain non-corporate entities, resident in a Member State.

In addition, Member States have entered into reciprocal arrangements with certain of those non-EU countries and dependent or associated territories of certain Member States in relation to payments of Savings Income made by a person in a Member State to an individual, or to certain non-corporate entities, resident in certain dependent or associated territories or non-EU countries.

Where an individual Bondholder receives a payment of Savings Income from any Member State or dependent or associated territory employing the withholding arrangement, the individual Bondholder may be able to elect not to have tax withheld. The formal requirements may vary slightly from jurisdiction to jurisdiction. They generally require the individual Bondholder to produce certain information (such as his tax number) and consent to details of payments and other information being transmitted to the tax authorities in his home state. Provided that the other tax authority receives all of the necessary information the payment will not suffer a withholding under the Directive or the relevant law conforming with the Directive in a dependent or associated territory.

The Directive is currently the subject of a review which may lead to it being amended to overcome its perceived shortcomings. Any changes could apply to bonds (including the Bonds) that have already been issued at the date of the amendment of the Directive.

If a payment of Savings Income were to be made or collected through a Member State, non-EU country or dependent or associated territory which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent (as hereinafter defined) nor any other person would be obliged to pay additional amounts to Bondholders or to otherwise compensate Bondholders for the reduction in the amounts that they will receive as a result of the imposition of such withholding tax. The Issuer is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Directive.

Should the Issuer or the Financial Guarantors be required by law at any time to make any withholding or deduction for or on account of taxes or similar charges from payments made in respect of the Bonds or under the Financial Guarantees respectively, no additional or "grossing-up" payments will be made.

See the sections entitled "*Terms and Conditions of the Bonds – Taxation*", "*Form of AGE Financial Guarantee*" and "*Form of AGM Financial Guarantee*" below.

Rating of the Bonds

The ratings anticipated to be assigned to the Bonds are based on the financial strength rating of the Financial Guarantors and reflect only the views of the Rating Agencies.

A rating is not a recommendation to buy, sell or hold securities and will depend, amongst other things, on certain underlying characteristics of the business and financial condition of the Financial Guarantors from time to time.

There is no assurance that any such ratings will continue for any period of time or that they will not be reviewed, revised, suspended or withdrawn entirely by the Rating Agencies as a result of changes in, or unavailability of, information or if, in the Rating Agencies' judgment, circumstances so warrant. If any rating assigned to the Bonds is lowered or withdrawn, the market price of the Bonds is likely to be reduced and no person or entity will be obliged to provide any additional credit enhancement in respect of the Bonds.

The Financial Guarantors have not covenanted to maintain any ratings by the Rating Agencies during the life of the Bonds.

Priority of Claims

The Security Trust and Intercreditor Deed provides for an order of priority of payment under which the proceeds of enforcement of the security and the joint and several guarantees granted by the Obligors are to be applied following enforcement of such security. This is relevant to Bondholders to the extent that an amount due to be paid to the Bondholders is not covered by, or paid under, the Financial Guarantees (see the sections entitled "*Form of AGE Financial Guarantee*" and "*Form of AGM Financial Guarantee*" below).

Certain claims of the other Senior Creditors will, in accordance with such order of priority, be paid in priority to payment of certain amounts due to the Bondholders (see the section entitled "*Financing of the Project – The Security Arrangements – Security Trust and Intercreditor Deed*" below).

Changes to the risk weighted asset framework

In Europe, the U.S. and elsewhere there is increased political and regulatory scrutiny of the asset-backed securities industry. This has resulted in numerous measures for increased regulation which are currently at various stages of implementation and which may have an adverse impact on the regulatory capital charge to certain investors and/or the incentives for certain investors to invest in securities issued under such structures, and may thereby affect the price and liquidity of such securities. The exact scope of this increased regulation is often unclear and it is possible that it could be argued that the Bonds were subject to some or all of it.

Investors in the Bonds are responsible for analysing their own regulatory position and the Issuer does not accept responsibility for the regulatory treatment of their investment in the Bonds. Investors should consult their own advisers as to the regulatory capital requirements in respect of the Bonds and as to the consequences and effect on them of any pending or future regulatory changes. No predictions can be made as to the precise effects of such matters on any investor or otherwise.

Limitations on Mandatory Redemption of the Bonds following a Spens Acceleration Event

The mandatory redemption of the Bonds under Condition 6(d) (*Mandatory Redemption – Below Par Redemption*) is dependent on there being sufficient funds available for the Security Trustee to pay the claims of all the Senior Creditors and the Security Trustee thus enabling the Security Trustee to issue the Sufficiency Certificate, which is a pre-condition to such mandatory redemption. Therefore, if the Authority were to pay compensation to the Issuer in an amount that was intended to enable the Issuer to pay the Default Amount to the Bondholders, such mandatory redemption may, however, not occur since there may be other claims not covered by the compensation payments from the Authority or other monies available to the Security Trustee. In such circumstances, the Financial Guarantors (so long as they are Controlling Creditor) will retain the discretion to direct the Bond Trustee to declare the Bonds immediately due and payable by the Issuer (see in respect of the Bonds, the section entitled "*Terms and Conditions of the Bonds*" below).

European Monetary Union

Prior to the maturity of the Bonds, the United Kingdom may become a participating member state in the Economic and Monetary Union and the euro may become the lawful currency of the United Kingdom. Adoption of the euro by the United Kingdom may have the following consequences: (i) all amounts payable in respect of the sterling denominated Bonds may become payable in euro; and (ii) the Issuer may redenominate the Bonds into euro and take additional measures in respect of the Bonds (see Condition 16 (*Redenomination*) in respect of the Bonds). It cannot be said with certainty what effect, if any, adoption of the euro by the United Kingdom will have on investors in the Bonds.

Liability of the Bond Trustee and the Security Trustee

Neither the Bond Trustee nor the Security Trustee will be responsible for (a) monitoring or supervising the performance by the Issuer or any other party to the transaction documents of their respective functions and obligations under the transaction documents or the operation of any account opened pursuant to the transaction documents and each of the Bond Trustee and the Security Trustee will be entitled to assume, until it has written notice to the contrary, that all such persons are properly performing their duties, or (b) considering the basis on which approvals or consents are granted by the Issuer, the Controlling Creditor or any other party to the transaction documents under the transaction documents. Neither the Bond Trustee nor the Security Trustee will be liable to any Bondholder or other Secured Creditor for any failure to make or to cause to be made on its behalf the searches, investigations and enquiries which would normally be made by a prudent chargee in relation to the secured assets and has no responsibility in relation to the legality, validity, value, sufficiency and enforceability of the transaction security and the Relevant Documents.

Unless the Security Trustee is satisfied that it will not incur any liability (whether environmental or otherwise) arising from it enforcing the security, or that it is prefunded and/or indemnified and/or secured to its satisfaction in respect of any such liability, it will not be obliged to enforce the security when required to do so by the Controlling Creditor.

OVERVIEW OF THE PROJECT

The following is an overview of the Project and should be read in conjunction with the rest of this Prospectus. The summaries of the documents do not purport to be complete and are subject to the detailed provisions of such documents.

Overview

S4B Limited (the "**Contractor**") has signed a project agreement (the "**Project Agreement**") with The Council of the City of Manchester (the "**Authority"**) to be dated on or before the Issue Date. Pursuant to the Project Agreement, the Contractor has agreed to provide and refurbish certain properties in the Brunswick area of Manchester and to manage and maintain them (the "**Project**") including:

(a) the demolition of 228 housing revenue account ("**HRA**") properties and 45 leasehold/private properties;

(b) the design and construction of 199 HRA properties and 318 leasehold/private properties;

(c) the refurbishment of 573 HRA properties and 139 leasehold/private properties;

(d) the reversal of 88 HRA properties and 35 leasehold/private properties; and

(e) the provision of services including Tenancy and Estate Management Services and Full Property Management Standards.

The term of the Project is 25 years from the Issue Date (the "**Project Term**") unless terminated early. The Project is part of the private finance initiative (the "**PFI**") and approval for the Project was given by the Department of Communities and Local Government on behalf of the Secretary of State for Communities and Local Government in England and Wales on 11 December 2013.

The Project Agreement will become effective upon the issue of the Bonds (the "**Effective Date**"). The issue of the Bonds is conditional upon the Project Agreement becoming effective (subject only to the issue of the Bonds).

It is a condition precedent to the issue of the Bonds that the Authority be given approval by the Secretary of State for Communities and Local Government pursuant to Section 27 of the Housing Act 1985 to enter into the Project. Each of the Project Documents is dated on or prior to the Issue Date and is subject to the laws of England and Wales and the jurisdiction of the English courts.

Construction Contract

The Contractor has signed a sub-contract (the "**Construction Contract**") to be dated the Issue Date with Galliford Try Construction Limited (the "**Construction Contractor**" and the "**Development Works Contractor**") under which the Construction Contractor will carry out the design and construction of the Infrastructure and Communal Works and the New Build Houses (the "**Construction Works**") and will perform all other associated works and the other obligations set out in the Construction Contract. The obligations of the Construction Contractor under the Construction Contract are guaranteed by Galliford Try plc (the "**Construction Contractor Guarantor**"). The following additional performance security is provided:

(a) a retention equal to 5 per cent of the contract sum which shall be reduced to 2.5 per cent on a phase by phase basis on certification of completion by the independent certifier and further reduced to 0 per cent on expiry of the relevant defects liability period; and

(b) a performance bond in an amount equal to 10 per cent of the contract sum under the Construction Contract (which steps down at six monthly intervals against expiry of the relevant defects liability period for the relevant works undertaken and completed at that point) from an appropriately rated entity acceptable to the Contractor and the Senior Creditors.

Refurbishment Contract

The Contractor has signed a sub-contract (the "**Refurbishment Contract**") to be dated the Issue Date with Mears Limited (the "**Refurbishment Contractor**") under which the Refurbishment Contractor will carry out refurbishment works in relation to the Retained Dwellings and will perform all other associated works and the other obligations set out in the Refurbishment Contract (the "**Refurbishment Works**"). The obligations of the Refurbishment Contractor under the Refurbishment Contract are guaranteed by Mears Group plc (the "**Refurbishment Contractor Guarantor**"). The following additional performance security is provided:

(a) a retention equal to 2.5 per cent of the contract sum which is then released on completion of the making good of any defects on a phase by phase basis; and

(b) a performance bond in an amount equal to 15 per cent of the contract sum under the Refurbishment Contract (which steps down at six monthly intervals against expiry of the relevant defects liability period for the relevant works undertaken and completed at that point) from an appropriately rated entity acceptable to the Contractor and the Senior Creditors.

Development Works Contract

The Contractor has signed a sub-contract (the "**Development Works Contract**") to be dated the Issue Date with Galliford Try Construction Limited (the "**Development Works Contractor**") under which the Development Works Contractor will carry out the design and construction of the new build for sale properties and will perform all other associated works and the other obligations set out in the Development Works Contract (the "**Development Works**"). The Development Works are effectively ring-fenced in the Project Agreement so that failure to deliver the Development Works cannot lead to termination of the Project Agreement, rather the Authority's only remedies are pursuant to the indemnities and an entitlement to terminate the relevant Development Works Licence the subject of the failure. Under the Development Works Contract, the Development Works Contractor will pay the Contractor a £1,987,000 development fee in four instalments. The first instalment of £687,000 is due on the Issue Date, the second instalment of £700,000 is due on the later of (a) 31 April 2014 and (b) the date on which the Remedial Works have been completed, and the third and fourth instalments of £300,000 are due on 30 November 2014 and 31 October 2015, respectively. The Contractor will be entitled to set-off the development fee against amounts due under the Construction Contract. The payments are made automatically and are not subject to any performance conditions. The obligations of the Development Contractor under the Development Contract are guaranteed by Galliford Try plc (the "**Development Contractor Guarantor**").

The Construction Works and the Refurbishment Works together are referred to as the Service Works. The Service Works and the Development Works together are referred to as the Works.

Housing Management and Maintenance

The Authority will remain responsible for providing certain elements of the housing management services required at the Properties including: rent or service charge setting policies (except as expressly provided for under the Project Agreement); allocation of tenants to dwellings; amendment of the policies and protocols of the Authority and variations to the tenancy agreements or the leases. However, the Contractor will provide or procure the provision of certain housing management and maintenance services pursuant to two separate sub-contracts signed and to be dated the Issue Date between the Contractor and respectively:

(a) Contour Homes Limited (the "**Housing Management Contractor**") (the "**Housing Management Contract**"); and

(b) Mears Limited (the "**RRCMR Contractor**") (the "**RRCMR Contract**").

Under the Housing Management Contract, the Housing Management Contractor will provide housing management services (the "**Housing Management Services**"). There is no parent company guarantee requirement for the Housing Management Contractor as it is a significant asset owning entity. The Housing Management Contractor's parent company, Symphony Housing Group, is non-asset holding and therefore the Contractor does not require a parent company guarantee to be given.

Under the RRCMR Contract, the RRCMR Contractor will provide responsive repairs, cyclical maintenance and renewal services (the "**RRCMR Services**"). The obligations of the RRCMR Contractor under the RRCMR Contract are guaranteed by Mears Group plc.

Services

The Housing Management Services and the RRCMR Services are together the "**Services**". The Housing Management Contractor and the RRCMR Contractor are together the "**Services Contractors**".

The Authority undertakes in the Project Agreement to grant to the Contractor a licence over the relevant areas to carry out the Service Works and the Services and a development works licence to carry out the Development Works.

The Construction Contract, the Refurbishment Contract, the Development Works Contract, the Housing Management Contract and the RRCMR Contract (together the "**Sub-Contracts**" and each a "**Sub-Contract**") shall mean any one of them will become effective at the same time as the Project Agreement becomes effective.

The Authority, the Security Trustee and the Contractor have entered into a direct agreement (the "**Funders Direct Agreement**") to be dated the Issue Date relating to rights of step-in and step-out in default situations which might otherwise cause termination of the Project Agreement. Similarly, the Contractor, the Security Trustee and each of the Sub-Contractors and the relevant guarantors have entered into direct agreements (the "**Senior Creditor's (Sub-Contractor) Direct Agreements**") to be dated the Issue Date regulating their relationship with the funders in relation to the Sub-Contracts.

The Contractor will provide:

(a) Interim Services to the Authority from the period from and including the Service Commencement Date to the Full Services Commencement Date (for the avoidance of doubt, there are no housing management interim services);

(b) Full Services to the Authority from the Full Services Commencement Date until the termination of the Project Agreement or the expiry of the Project Term;

(c) Housing Management Services from the Service Commencement Date until the termination of the Project Agreement or the expiry of the Project Term; and

(d) The Authority will be obliged to make payments to the Contractor in respect of the Services (the "**Unitary Charge**") in accordance with the payment mechanism.

The Unitary Charge is subject to a detailed performance measurement regime and may be subject to Deductions for poor performance, in accordance with the Payment Mechanism. The Unitary Charge will continue (subject to availability and Performance Deductions, Relief Events, Force Majeure and Uninsurable risk) until the termination of the Project Agreement or the expiry of the Project Term.

SOCIAL HOUSING SECTOR: OVERVIEW

Origins of Social Housing and History of its Development to Date

Social housing in Britain started with Almshouses which were established from the 10th century, to provide a place of residence for "poor, old and distressed folk". Social housing is housing that is let at lower than market rent, mainly on a secure basis to people in housing need. It is generally provided by councils and non-profit organisations such as Registered Providers.

Local authority social housing expanded greatly after World War I, two million houses were built before 1939, initially for general needs but later to ease slum clearance. After World War II, replacement of the housing stock, particularly through clearances, became council social housing's main role via mass building programmes.

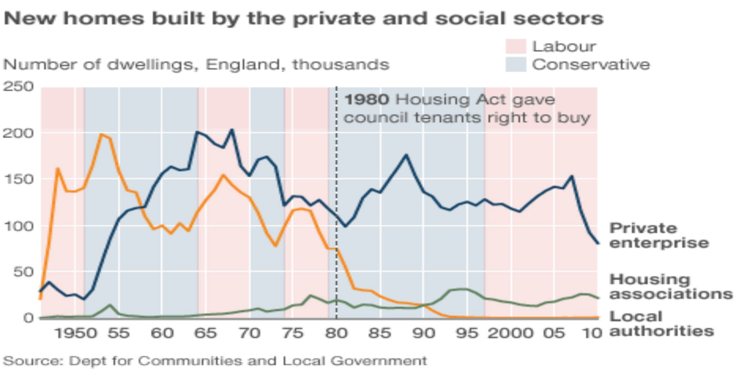
During the 1950s and 1960s, the number of high-rise social dwellings rose significantly. The argument was advanced that more generously sized dwellings could be provided this way, that communities could be re-housed close to existing employment opportunities and suit consumption and leisure patterns. In the early 1950s just 23 per cent of public-sector approvals were for flats, with only 3 per cent high-rise, but by 1966 high-rise housing accounted for 26 per cent of all homes started. Government provided subsidies for local authorities to build such housing. Many such dwellings have since suffered problems, especially poor protection from damp and weather ingress, as well as other design defects and poor management.

After 1970 council social housing acquired a more residual role, more concerned with welfare issues and special needs. Housing Benefit replaced General subsidies for many tenants. Since 1979, the sector of social housing has changed through the introduction of Right to Buy legislation and emphasis on the development of new social housing by housing associations (now known as Registered Providers). Although some are much older, the modern non-profit housing associations emerged in the 1960s, 70s and 80s – there was a quantitative growth in the number and percentage of units owned and managed by housing associations through large scale Voluntary transfers and other methods. Approximately 40 per cent of the country's social housing stock is owned by local authorities, 15 per cent is managed by arm's length management organisations and 45 per cent by housing associations.

Sweeping policy changes and spending cuts are having a severe impact, altering the financial models that have operated since the 1980s. The government's drive to cut the £21 billion housing benefit bill (and, as the Coalition sees it, welfare dependency) while reducing development grant has cut budgets and shapes future strategies.

Current Market

Although the recent falls in affordable housing starts have been nothing like as severe as for private house building, the housing market today remains depressed. There has not been the growth in social housing that was hoped for despite strong increases in demand. As at 31 March 2012, there were an estimated 23.1 million dwellings in England. In 2011 there were 19.0 million private dwellings (owner occupied plus private rented tenures) and 4.0 million social rented dwellings (Private Registered Providers plus local authority tenures). Between March 2011 and March 2012 the social rented stock increased by 12,000 dwellings and the private stock increased by 113,000 dwellings.



2011-12 NEW SUPPLY OF AFFORDABLE HOUSING

57,950 gross additional affordable homes were supplied in England in 2011-12. 37,540 new affordable homes were provided for social rent in 2011-12. A further 930 new affordable homes were provided for affordable rent in 2011-12 (the first year for which this scheme has run).

52,880 new build affordable homes were provided in 2011-12, representing 91 per cent of all affordable homes provided in 2011-12 compared to 88 per cent of total supply in 2010-11. This was the highest percentage reported since before 1991-92.

In 2011-12, 88 per cent of affordable homes were in receipt of funding through the Homes and Communities Agency (excluding homes delivered under Section 106 without grant), a reduction from 92 per cent in 2010-11. Around 92 per cent of these were new build homes.

There are approximately 1.8 million households on waiting lists for social housing.

The market of the social housing offer is becoming more diverse. Registered Providers are now offering tenancies at 'affordable' rents as well as 'social' rents to general needs applicants, not just to defined groups of 'moderate income' households. Registered Providers and local authorities both have powers under the Localism Act to offer fixed-term tenancies. The impact of these changes will vary from area to area and depend to some extent on local housing market pressures, but also on the policies of local councils and social landlords.

A revitalised private rented sector is now firmly established in the UK, and with more households remaining in the sector for prolonged periods. As social sector fixed-term tenancies are more widely used, there will be less difference between the offer of a social and private sector tenancy, especially where the social tenancy is at an 'affordable' rent. In time these policy developments could also reduce the differences in the way households make use of the two sectors, with the average length of time in social sector tenancies shortening.

Government Initiatives

The government's policy is aiming to improve the quality and quantity of properties for rent, both in the private and social sector. Their main initiatives include:

- Providing more affordable housing, including through a new model of affordable rent that allows registered providers to charge no more than 80 per cent of local market rent;
- Supporting innovation and new ways of delivering affordable homes;
- Allowing local flexibility on waiting lists, the types of tenancies and social tenants' and landlords' rights and responsibilities;
- Helping social landlords stop tenancy fraud and anti-social behaviour;
- changing the housing revenue account ("**HRA**") subsidy system to a new, fair, locally controlled system where local authorities are responsible and accountable for their housing services funding local authorities to refurbish their housing stock;
- re-invigorating Right to Buy;
- supporting tenants to play a bigger role in managing their accommodation through the tenant empowerment programme; and
- Encouraging more investment in the private rented sector through schemes like new loan guarantees and the Build to Rent Fund.

Affordable Rent represents a major shift in the approach to delivering affordable housing. Government is monitoring its success and its ability to attract future private investment. The key principles of the Affordable Rent model are flexibility, innovation and efficient use of existing assets. In addition, the Localism Act is designed to strengthen the economic regulation role of the social housing regulator and includes the aims of promoting new supply and supporting value for money from public investment.

"Laying the foundations" (2011) is the national housing strategy for England and establishes the Government's actions to address the housing shortage, boost the economy, create jobs, and give people the opportunity to get on the housing ladder. This states social housing can improve people's life chances and it sets out the goal to implement a radical programme of reform to make better use of social housing to support those who need it most.

The Homes and Communities Agency ("**HCA**") is the national housing and regeneration agency for England (other than in London) and works closely with the Government on social and affordable housing. It was established as a non-departmental government body on 1 December 2008 to:

- work with partners to create homes, economic growth and jobs;
- provide and manage investment, including the Affordable Homes Programme; and
- economic regulate of housing associations, safeguarding £43 billion of taxpayer investment in the sector and helping to secure more private investment for affordable housing.

Future Developments and Challenges

In 2013, with large scale reductions in capital subsidy, sweeping welfare reforms and shifts in national housing policy away from the provision of traditional low-rent social housing, there are major challenges being faced by the sector. The social and affordable housing sector is debating its purposes and objectives. Many providers (particularly Registered Providers) are reviewing their strategies and business plans in order to ensure a workable balance between their social and commercial aspirations. All social landlords aspire to improve customer satisfaction and performance, but they have tough decisions to make in order to ensure value for money and on rent levels and arrears.

Some of the key challenges include:

Prolonged austerity and House building remains fragile – the Office for Budget Responsibility forecasts that the UK economy will grow slowly over the next few years, with greater concentrations of unemployment, under–employment and in-work poverty in deprived areas. At a time when the government is set to cut public spending still further, this places more demands on scarce resources, not least housing benefit and housing welfare and an overall pressure to reduce revenue subsidy for housing.

Localism and flexibility - the Localism Act 2011 contained wide-ranging changes that will affect the way social housing operates for some time to come. These include new powers to grant fixed-term tenancies, more control over local waiting lists, reform of homelessness duties to allow councils to discharge homeless people into the private rented sector, and reform of the housing revenue account system. Other relevant changes include the granting of new freedoms to enable Registered Providers to dispose of their stock and changes to planning law.

Private rented sector and pressure on tenants - there will be increased difficulty for tenants in meeting rental payments caused not only by the reduction of welfare support but also by falling real wages and the growth of under-employment. At the same time, social housing is likely to be in even greater demand, especially if rents in the private sector continue to rise. Savills estimates that by 2016 one in five households in England will be in the private rented sector.

Welfare reforms - reducing the nation's benefits bill, particularly in relation to housing benefit, simplifying the benefits system as a whole and "making work pay". The Government's assessment is that the average household will lose £83 per week:

- phased introduction (2013-17) of Universal Credit - a single benefit to replace most of the current working-age benefits;
- an underoccupation "Bedroom tax" and a limit on the amount that households and individuals can claim in social security – a benefit cap of £350 per week for a single person and £500 for a family; and
- many social landlords say that paying housing benefit direct to tenants rather than to landlords will have the biggest impact, with more than 80 per cent saying this will affect them

significantly. 22 per cent said the changes will make it harder for them to meet their loan covenants, with 10 per cent of those involved in the affordable homes programme saying that direct payment will make it harder for them to deliver their house-building commitments (Smith Institute Survey 2013).

Development grant post-2015 – many are planning for a low- or no-grant future. Developing social housing organisations are expected to benefit directly and indirectly from other schemes to boost housing supply, such as the Get Britain Building fund, the Build Now, Pay Later scheme, the New Homes Bonus and the Growing Places fund, although there is some expectation that a future government might revert to a form of grant model, albeit on a much smaller scale. A further round of grant funding based on the affordable rent model is a possibility.

Borrow to build - especially by Registered Providers but there are mixed views on the scope for higher gearing. Registered Providers alone have £27 billion of unutilised security to cover future borrowing. It is hoped the latest plans to underwrite the debt of housing associations will boost borrowing (through the recent Affordable Homes Guarantee Scheme). Some investors in social housing bonds are reported to have warned the Government that a guarantee scheme could in fact be counterproductive as it could drive down yields, thus making the bonds less attractive.

Uncertainty of the next Spending Review - Government may seek further savings on the housing benefit bill. It may seek to replicate the changes made in other welfare benefits (tax credits, state benefits and public-sector pensions in 2011) by shifting rent increase inflation linkage from the Retail Price Index to the Consumer Price Index. There is concern in the sector that such a change in the rent settlement could adversely affect business planning and loan agreements.

Council Building - The self-financing of council housing under the recently reformed housing revenue account (HRA) system is widely considered to be a positive development by most. There could be new investment in affordable housing where Local Authorities take a commercial approach. Some Local Authorities (especially those that are major landlords) could borrow to build, provided they have sufficient borrowing headroom and land. This could make more collaboration between Local Authorities and Registered Providers the next logical step to deliver a refreshed council building programme.

FINANCING OF THE PROJECT

The following is an overview of the financing of the Project and should be read in conjunction with the rest of this Prospectus. The summaries of the documents do not purport to be complete and are subject to the detailed provisions of the relevant documents.

1. General

The Project will be financed by:

(a) the proceeds of the issue of the Bonds by the Issuer (see the section entitled "*Overview of the Bond Issue*" above) which proceeds will be on-lent by the Issuer to ProjectCo pursuant to an Issuer On-Loan Agreement between the Issuer and ProjectCo dated on or about the Issue Date. The Issuer will be liable for certain costs so that ProjectCo will only receive an amount equal to the net proceeds of the Bonds after deduction of such costs;

(b) subordinated debt provided by the Shareholders to HoldCo and provided by HoldCo to ProjectCo as set out in the section entitled "*Subscription Agreement*" below;

(c) the £50,000 paid up share capital of ProjectCo;

(d) interest accrued on the accounts with the Account Bank in accordance with the Accounts Agreement (each as defined in the section entitled "*Accounts Agreement*" below);

(e) income earned from authorised investments made in accordance with the Accounts Agreement;

(f) investment return earned on the Guaranteed Investment Contract (as defined in the section entitled "*Guaranteed Investment Contract*" below);

(g) ground rents received for the private for sale properties; and

(h) the Authority Capital Contribution (as described in the section entitled "*Risk Factors*").

The Bonds will be initially subscribed by Lloyds Bank PLC in its capacity as Manager.

The proceeds of the Bonds (net of Issue Expenses) and the proceeds of the paid up share capital of the Issuer will be deposited into an escrow account (the "**Escrow Account**") in the name of ProjectCo and/or invested in the Guaranteed Investment Contract).

Amounts deposited into the Escrow Account may be applied by ProjectCo only for the purposes set out in the Collateral Deed (as defined below in the section entitled "*The Collateral Deed*") and the Accounts Agreement (as defined below in the section entitled "*Accounts Agreement*").

The Bonds (excluding those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) will have the benefit of the Financial Guarantees. Under each of the Financial Guarantees, AGE or AGM, as the case may be, unconditionally and irrevocably guarantees in favour of the Bond Trustee amounts unpaid by the Issuer in respect of scheduled payments of principal and interest (excluding in each case any amounts due in respect of the Bonds (i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason; (ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof; (iii) attributable to any default interest; (iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Bonds; or (v) in respect of which AGM or AGE has made an Accelerated Payment (as defined in the relevant Financial Guarantee).

Under a Reimbursement and Indemnity Deed to be entered into between the Issuer, ProjectCo, HoldCo and the Financial Guarantors (the "**Reimbursement and Indemnity Deed**") on or before the Issue Date, the Issuer, HoldCo and ProjectCo agree to reimburse the Financial Guarantors for any payments made by them under the Financial Guarantees. In addition the Financial Guarantors will be subrogated to the rights of the Bondholders and the Bond Trustee in respect of any payments made by the Financial Guarantors under the relevant Financial Guarantee. The rights to reimbursement of the Financial Guarantors in respect of the relevant Financial Guarantees will have the benefit of the security granted by the Issuer, HoldCo and ProjectCo to the Security Trustee. Under the terms of the Collateral Deed, the Issuer, HoldCo and ProjectCo will grant a joint and several guarantee of their obligations to make, inter alia, reimbursements to the Financial Guarantors under the Reimbursement and Indemnity Deed.

Payments in respect of the Bonds will be made pursuant to the paying agency agreement (the "**Paying Agency Agreement**", which expression includes any modification or supplement thereto) to be entered into on or before the Issue Date between the Issuer, the Financial Guarantors, the Bond Trustee and The Bank of New York Mellon, London Branch as principal paying agent (the "**Principal Paying Agent**" which expression shall include any additional or successor paying agent ("**Paying Agent**") appointed in accordance with the Paying Agency Agreement). Under the Collateral Deed, the Issuer agrees to ensure that it will maintain a Paying Agent with a specified office in London.

The Issuer will pay or procure to be paid to:

(a) the Financial Guarantors that portion of the financial guarantee fee which is payable in accordance with the Financial Guarantee Fee Letters in consideration for the issuance of the Financial Guarantees;

(b) the Bond Trustee for its services as Bond Trustee remuneration on the issue of the Bonds and on each anniversary of the issue of the Bonds and upon such terms as agreed with the Issuer;

(c) the Security Trustee, for its services as Security Trustee, fees and remuneration and upon such terms as may from time to time be agreed between the relevant Obligor and/or AGE and/or AGM and the Security Trustee under the relevant Finance Documents;

(d) the Principal Paying Agent for its services as Principal Paying Agent under the Paying Agency Agreement, fees in such amounts and upon such terms as agreed by the Issuer;

(e) the Manager, a combined management and underwriting commission on the Issue Date; and

(f) the Manager, all fees, costs and expenses payable in connection with the listing and structuring of the Bonds on the Issue Date upon such terms as agreed by the Issuer.

The Issuer will also pay to each of the Bond Trustee, Security Trustee, the Paying Agents, the Manager and the Financial Guarantors their fees, costs, charges, liabilities and expenses in connection with the issue of the Bonds, upon such terms as agreed by the Issuer. Other amounts (including indemnity amounts) are also payable to each of the Bond Trustee, the Security Trustee and the Principal Paying Agent under the Finance Documents.

2. The Collateral Deed

The following is an overview of certain of the provisions of the Collateral Deed. It is not exhaustive and is subject to the Collateral Deed's detailed provisions. Capitalised terms used in this section entitled "Collateral Deed" have the meanings given to them in the Collateral Deed unless otherwise defined. Copies of the Collateral Deed are available for inspection by Bondholders during normal business hours at the principal office of the Bond Trustee and at the Specified Office (as set out below) of the Paying Agent.

On or before the Issue Date, the Obligors, the Security Trustee, the Bond Trustee and the Financial Guarantors will enter into the collateral deed (the "**Collateral Deed**") in which the Obligors will give certain representations and covenants to, inter alios, the Financial Guarantors, the Bond Trustee and the Security Trustee.

Definitions

"**Acceptable Letter of Credit**" means a letter of credit in the agreed form or such other form as is satisfactory to the Controlling Creditor, securing compliance by the Shareholders with their respective commitments to subscribe and pay for HoldCo Loan Stock in accordance with the Subscription Agreement which:

(a) is issued in favour of ProjectCo and the Security Trustee or the Security Trustee only (as the case may be) and either the issuing bank or the paying bank is at all times an Appropriately Rated Qualifying Bank;

(b) has a residual maturity of not less than 30 days; and

(c) is in full force and effect;

"**Appropriately Rated**" means in respect of the following parties, having (as applicable) the minimum ratings set out in (a) to (f) below unless otherwise agreed in writing by the Controlling Creditor:

(a) any Qualifying Bank (other than The Royal Bank of Scotland Plc or National Westminster Bank Plc), a short term debt rating of at least A-1 by S&P and at least P-1 by Moody's and a long term debt rating of at least A by S&P and at least A2 by Moody's, and in respect of The Royal Bank of Scotland Plc or National Westminster Bank Plc a long term debt rating of at least A- by S&P and at least A3 by Moody's;

(b) any GIC Provider or GIC Guarantor, a short term debt rating of at least A-1 by S&P and at least P-1 by Moody's and a long term debt rating of at least A by S&P and at least A2 by Moody's;

(c) any Insurer, a financial strength rating of at least A by S&P or at least A2 by Moody's;

(d) any Performance Bond Provider, a long term debt rating of at least A+ by S&P or at least A1 by Moody's;

(e) any Account Bank, a short term debt rating of at least A-1 by S&P and at least P-1 by Moody's and a long term debt rating of at least A by S&P and at least A2 by Moody's; and

(f) any Collateral Account Bank, a short term debt rating of at least A-1 by S&P and at least P-1 by Moody's and a long term debt rating of at least A by S&P and at least A2 by Moody's.

"**Authority**" means the Council of the City of Manchester.

"**Bond Documents**" means the Bonds, the Bond Trust Deed, the Paying Agency Agreement, the Bond Subscription Agreement, the Issuer ICSD Agreement and the Effectuation Authorisation Agreement.

"**Controlling Creditor**" means at any time, the Financial Guarantors unless and until such time:

(a) as both of the Financial Guarantees have been terminated in accordance with Condition 2(b) (*Financial Guarantees*); or

(b) as the Security Trustee has received notice from the Bond Trustee that a Financial Guarantor Default has occurred,

in which case it shall be the Bond Trustee acting on the instructions of the Majority Bondholders, unless:

(i) a new financial guarantor or monitoring advisor has been appointed by the Bondholders under Condition 2(b) (*Financial Guarantees*), in which case it shall be the new financial guarantor or monitoring advisor; or

(ii) such Financial Guarantor Default has been cured or waived, in which case it shall be the Financial Guarantors.

"**Direct Agreements**" means:

(a) the Funders' Direct Agreement;

(b) the New Build Direct Agreement;

(c) the Refurbishment Direct Agreement;

(d) the Development Direct Agreement;

(e) the Hard FM Direct Agreement; and

(f) the HM Direct Agreement.

"**Finance Documents**" means the Senior Finance Documents and the Junior Finance Documents.

"**Guarantees**" means:

(a) the New Build Guarantee;

(b) the Refurbishment Guarantee;

(c) the Development Guarantee; and

(d) the Hard FM Guarantee.

"**HoldCo Loan Stock**" means the junior loan stock issued or to be issued by HoldCo and subscribed or to be subscribed by the Shareholders pursuant to the Subscription Agreement and the HoldCo Loan Stock Instrument.

"**HoldCo Loan Stock Instrument**" means the instrument dated on or about the Issue Date constituting the HoldCo Loan Stock.

"**HoldCo Shares**" means, at any time, fully paid, issued and allotted shares in HoldCo in existence at such time.

"**Issuer On-Loan Agreement**" means the intercompany loan agreement dated on or about the Issue Date between the Issuer (as lender) and ProjectCo (as borrower) pursuant to which the proceeds of the issue of the Bonds (net of Issue Expenses) and the proceeds of the subscription for and issue of shares in the Issuer by HoldCo are on-lent to ProjectCo.

"**Issuer Shares**" means, at any time, fully paid, issued and allotted shares in the Issuer in existence at such time.

"**Junior Finance Documents**" means the ProjectCo Loan Stock Instrument and the HoldCo Loan Stock Instrument.

"**Material Adverse Effect**" is to be construed as a reference to an event or matter which, in the opinion of the Controlling Creditor (acting reasonably), might have a material adverse effect on:

(a) the present or future financial condition, assets or revenues of any Obligor; or

(b) the present or future ability of any Material Project Party duly to perform all or any of its material obligations (including, without limitation, its payment obligations) which it is expressed to undertake under any of the Relevant Documents (but so that a breach of such an obligation will not of itself constitute a Material Adverse Effect); or

(c) the validity or enforceability of all or any material part of the Security or all or any material part of the Relevant Documents; or

(d) any right or remedy of the Senior Creditors under the Senior Finance Documents.

"**Material Project Parties**" means:

(a) the Obligors;

(b) each Shareholder (until such time as all its obligations to subscribe for HoldCo Loan Stock have been fully and finally satisfied in accordance with the Subscription Agreement) to the extent that any remaining obligation to subscribe for HoldCo Loan Stock in accordance with the Subscription Agreement is not fully supported by an Acceptable Letter of Credit;

(c) the New Build Sub-Contractor (prior to the Actual Global Completion Date);

(d) the New Build Guarantor (prior to the end of the Defects Liability Period);

(e) the Refurbishment Sub-Contractor;

(f) the Refurbishment Guarantor;

(g) the Service Providers; and

(h) the Hard FM Guarantor,

and "**Material Project Party**" means any of them.

"**ProjectCo Loan Stock**" means the junior loan stock issued or to be issued by ProjectCo and subscribed or to be subscribed by HoldCo pursuant to the Subscription Agreement and the ProjectCo Loan Stock Instrument.

"**ProjectCo Loan Stock Instrument**" means the instrument dated on or about the Issue Date constituting the ProjectCo Loan Stock.

"**ProjectCo Shares**" means, at any time, fully paid, issued and allotted shares in ProjectCo in existence at such time.

"**Project Documents**" means:

(a) the Project Agreement;

(b) the New Build Sub-Contract;

(c) the Refurbishment Sub-Contract;

(d) the Hard FM Contract;

(e) the HM Contract;

(f) the Direct Agreements;

(g) the Guarantees;

(h) the Collateral Warranties;

(i) the Interface Agreement;

(j) the Subscription Agreement;

(k) the Shareholders' Agreement;

(l) the Performance Bonds;

(m) the broker's letter of undertaking in the form set out in Part 4 of schedule 11 (*Insurances*) of the Project Agreement;

(n) any Contractor Admission Agreement to which ProjectCo is a party; and

(o) such other documents as may from time to time be agreed in writing between the Controlling Creditor and ProjectCo (each acting reasonably) to be a Project Document;

and "**Project Document**" means any one of them.

"**Qualifying Bank**" means any bank which is authorised as a bank under the Financial Services and Markets Act 2000.

"**Relevant Documents**" in relation to any person means each of the Project Documents and each of the Finance Documents to which in each case that person is expressed to be a party and a "**Relevant Document**" means any of these.

"**Secured Creditors**" means each Senior Creditor and the Paying Agents.

"**Secured Obligations**" means all present or future, actual or contingent, obligations of each of the Obligors (whether entered into solely or jointly with one or more persons and whether as principal or as surety) to any of the Secured Creditors under the Senior Finance Documents (which shall include, without limitation, any obligations of any Obligor which may from time to time arise by way of subrogation and any liability in respect of any further advances made under the Senior Finance Documents).

"**Security Documents**" means:

(a) the Debentures;

(b) the ProjectCo Security Agreement;

(c) the Security Trust and Intercreditor Deed;

(d) any other document from time to time executed in favour of the Security Trustee for the purpose of securing all or any of the Secured Obligations; and

(e) any deed of accession entered into in respect of any of the above.

"**Senior Creditors**" means each of the Financial Guarantors, the Bond Trustee, the Bondholders and the Security Trustee, and "**Senior Creditor**" means each such person.

"**Senior Finance Documents**" means:

(a) the Collateral Deed;

(b) the Bond Documents;

(c) each Financial Guarantee;

(d) the Security Documents;

(e) the Subscription Agreement;

(f) the Shareholders' Agreement;

(g) the Direct Agreements;

(h) the Accounts Agreement;

(i) the GIC;

(j) any guarantees issued pursuant to the GIC;

(k) the Issuer On-Loan Agreement;

(l) the Reimbursement and Indemnity Deed;

(m) the Joint Insurance Account Agreement;

(n) each Financial Guarantee Fee Letter;

(o) any Acceptable Security; and

(p) any other agreements or documents between any Obligor and any Senior Creditor which the Controlling Creditor may from time to time designate as a Senior Finance Document;

and "**Senior Finance Document**" means any one of them.

"**Shareholders**" means Equitix Housing 2 Limited, Galliford Try Investments Limited and Contour Homes Limited.

"**Shareholders' Agreement**" means the agreement dated on or about the Issue Date between the Issuer, HoldCo, ProjectCo and the Shareholders.

"**Subscription Agreement**" means the agreement dated on or about the Issue Date between the Issuer, HoldCo, ProjectCo, the Shareholders and the Security Trustee.

Covenants by the Obligors

The covenants contained in the Collateral Deed will, inter alia, require the Obligors (subject, in some cases, to agreed exceptions, de minimis amounts and qualifications as to materiality):

(a) to comply with the terms of the Relevant Documents;

(b) not to create or permit to subsist any encumbrance over all or any of their present or future rights, claims, revenues or assets except as permitted in the Collateral Deed;

(c) not to incur, assume or permit to exist any financial indebtedness except as permitted in the Collateral Deed;

(d) not to make any loans except as permitted in the Collateral Deed;

(e) not to dispose of assets except as permitted in the Collateral Deed; and

(f) not voluntarily to enter into liquidation, dissolution or voluntarily enter into a merger or consolidation with any other person.

Covenants by ProjectCo

The covenants contained in the Collateral Deed will, inter alia, require ProjectCo (subject, in some cases, to agreed exceptions, de minimis amounts and qualifications as to materiality):

(a) to maintain specified levels of insurance with insurers of certain acceptable rating levels;

(b) to replace any Construction Sub-Contract in accordance with the Collateral Deed;

(c) to replace any Service Contract in accordance with the Collateral Deed;

(d) to replace any Development Sub-Contract in accordance with the Collateral Deed;

(e) to carry out the Service Works and Services in accordance with, inter alia, the Project Documents;

(f) not to make any loan or provide any other form of credit or make any deposit with any person except deposits made in the accounts under the Accounts Agreement or in accordance with any of the Finance Documents or the Project Documents;

(g) save as permitted in the Project Documents, the Senior Finance Documents and the Development Sub-Contract (and including, for the avoidance of doubt, entry into the Junior Finance Documents) not to enter into any transaction with any person after the Issue Date except on the basis of an arm's length transaction;

(h) not to carry on any business or engage in any business (including any property redevelopment activities) other than the Project or as otherwise contemplated by the Relevant Documents; and

(i) not to incur expenditures or commitments for expenditures for fixed and other non-current assets or operating expenditure, except as permitted in the Collateral Deed.

Trigger Events

Following the occurrence of any of the trigger events ("**Trigger Events**") specified in the Collateral Deed, unless such Trigger Event has been waived or deemed remedied in accordance with the Collateral Deed or otherwise remedied to the satisfaction of the Controlling Creditor, the Controlling Creditor will have certain additional rights to investigate, monitor and influence certain of the activities of ProjectCo. This will include appointing experts and procuring certain reports. Until a Trigger Event has been waived or deemed remedied or otherwise remedied to the satisfaction of the Controlling Creditor, ProjectCo will not be permitted to pay any dividends or make any distributions or other similar payments to the HoldCo Distributions Account, subject to the terms of the Collateral Deed.

The Trigger Events will include, *inter alia*:

(a) the occurrence of any Potential Event of Default (as defined below) other than a Potential Event of Default in respect of the Events of Default described in clauses 18.3 (*Breach of Obligations*), 18.17 (*Senior Debt Service Reserve Account*) or 18.19 (*Debt Ratios*) of the Collateral Deed;

(b) ProjectCo being issued with a certain number of Warning Notices from the Authority within a certain time period pursuant to the Project Agreement;

(c) the Authority being entitled to reduce the Unitary Charge payable to ProjectCo by more than a certain amount within a certain period pursuant to the Project Agreement;

(d) the Actual Global Completion Date having not occurred by the date which is 7 months after the Scheduled Completion Date;

(e) any milestone date having not occurred by the relevant milestone scheduled completion date;

(f) certain specified financial coverage ratios not being met by ProjectCo on the dates they are required by the Collateral Deed to be tested;

(g) any reserve account containing less than its specified minimum balance;

(h) a Funding Shortfall continuing;

(i) any Additional Permitted Borrowing being outstanding; or

(j) ProjectCo having made a claim from the Performance Bond Provider under the Performance Bond.

Events of Default

The Collateral Deed provides that the occurrence and continuance of any of the following events of default (amongst others) will constitute an event of default ("**Event of Default**"), unless such Event of Default is no longer continuing or has been waived for the purposes of the Collateral Deed. Events of Default will include (subject, in some cases, to agreed exceptions, de minimis amounts and qualifications as to materiality):

(a) failure by any Obligor to pay any sum due from it under any of the Senior Finance Documents within any specified grace period or, if no grace period is specified (except in the case of scheduled payments of principal and interest under the Bonds or the Issuer On-Loan Agreement where no grace period shall be applicable) within three business days of the due date, in the currency and in the manner specified therein;

(b) any representation or statement made or deemed to be repeated by any Obligor in any Finance Document or in any notice or other document, certificate or statement delivered by it pursuant thereto or in connection therewith when made or deemed to be repeated pursuant to or in connection with any Finance Document is incorrect in any material respect;

(c) failure by any Obligor duly to perform or comply in any material respect with any provision of the Senior Finance Documents, subject to the specified grace period or implementation of an agreed remedial plan;

(d) insolvency, rescheduling, winding-up, dissolution, administration, reorganisation, the appointment of a liquidator, receiver, administrator, administrative receiver or similar officer or an analogous event occurs with respect to any Material Project Party which (save in the case of any Obligor) has or would reasonably be expected to have a Material Adverse Effect;

(e) by or under the authority of any government, the management as a whole of any Obligor is wholly or partially displaced and as a result the effective control of such Obligor in the conduct of its business is transferred or the authority of any Obligor in the conduct of its business is wholly curtailed or curtailed to a material extent or all or a majority of the shares of any Obligor or any Material Project Party is seized, nationalised, expropriated or compulsorily acquired;

(f) transfers of ownership of the equity share capital in any Obligor or loan stock in HoldCo or ProjectCo otherwise than as permitted in the Collateral Deed;

(g) subject to materiality, ProjectCo or certain other parties do not have certain licences, approvals or consents necessary to carry out its business;

(h) any Shareholder fails to subscribe and pay for HoldCo Loan Stock in accordance with the Subscription Agreement and upon a valid demand being made under an Acceptable Letter of Credit, there is a default in payment by the issuer of such Acceptable Letter of Credit or, upon it being called, it would not be sufficient to pay the HoldCo Loan Stock Commitment (as defined in the HoldCo Loan Stock Instrument);

(i) the occurrence of an event which, with the giving of notice, would allow either party to terminate any of the Project Documents;

(j) specified financial coverage ratios are not met by ProjectCo on the dates they are required by the Collateral Deed to be tested;

(k) ProjectCo fails to maintain the insurances required by the Collateral Deed;

(l) the Service Works have not been completed as scheduled subject to specified grace periods; or

(m) the construction of the Service Works is suspended and such suspension continues for 15 consecutive days or 45 days in aggregate in any rolling 12 month period except where such suspension is caused by a Relief Event, a Compensation Event or a Force Majeure Event.

Any event which (with the passage of time, the giving of notice, the making of any determination under the Collateral Deed or any combination thereof), if not remedied or waived, would constitute an Event of Default, is a "**Potential Event of Default**".

If an Event of Default has occurred, is continuing and has not been waived by the Controlling Creditor, the consequences include the Controlling Creditor: (a) stopping releases of funds from the Escrow Account; (b) requiring the exercising of any remedies or rights in respect of Trigger Events; (c) directing the Security Trustee to exercise any rights available to the Security Trustee under the Direct Agreements and/or the Joint Insurance Account Agreement; (d) directing ProjectCo to: (i) terminate any existing contract or agreement or procure the termination of any Construction Sub-Contract or any Service Contract (in each case only if such contract, agreement, Construction Sub-Contract or Service Contract is capable of termination at such time in accordance with its terms and those of the Project Documents); (ii) make specified changes to management, systems or advisers or other operational changes; (iii) tender for such new contracts as the Controlling Creditor may specify on a basis approved by the Controlling Creditor and in any event on reasonable commercial terms; and (iv) make, compromise, settle or discontinue any claim which the Issuer may have or purport to have against any other person; (e) requiring the Obligors to pay immediately to the Senior Debt Service Account an amount equal to all outstanding amounts of principal, interest and default interest and other amounts due or owing under or relating to the Bonds and the Reimbursement and Indemnity Deed; (f) instructing the Security Trustee or the Issuer to take all steps necessary to enforce the security granted by any of the Obligors to the Security Trustee or the Issuer (as applicable) and/or to exercise all or any other rights granted to the Security Trustee pursuant to the Finance Documents or to the Issuer pursuant to the Issuer On-Loan Agreement and which the Security Trustee or the Issuer is entitled to exercise on the occurrence and continuance of an Event of Default, in each case in accordance with the terms of the Security Trust and Intercreditor Deed (as defined in "*Security Trust and Intercreditor Deed*" below); (g) directing the Issuer to declare that any amounts outstanding under the Issuer On-Loan Agreement is immediately due and payable in accordance with its terms; (h) directing the Bond Trustee to declare that each Bond is immediately due and payable (see the section entitled "*Terms and Conditions of the Bonds*" below); (i) instructing the Security Trustee to notify the relevant underwriters or insurers that an Event of Default has occurred (provided that the Controlling Creditor shall instruct the Security Trustee to notify the relevant underwriters or insurers as soon as reasonably practicable upon the waiver or remedy of such an Event of Default); (j) directing the Shareholders to subscribe for their respective outstanding HoldCo Loan Stock in accordance with the Subscription Agreement; (k) directing the Security Trustee to notify the Account Bank that an Enforcement has occurred; and/or (l) exercising any other rights expressed to arise under any Relevant Document upon an Event of Default. No action shall be taken by either the Bond Trustee or the Security Trustee unless it has been prefunded, indemnified and/or secured to its satisfaction.

3. The Security Arrangements

The Bonds will also have the benefit of the security arrangements summarised below. Attention is drawn to "Security Trust and Intercreditor Deed" below. Capitalised terms used in this section entitled "The Security Arrangements" have the meanings given to them in the Security Trust and Intercreditor Deed unless otherwise defined. The ability of the Bond Trustee to exercise rights in respect of such security arrangements will be restricted by the Security Trust and Intercreditor Deed and Bondholders will have no independent entitlement to exercise such rights.

Security from the Issuer

Pursuant to an English law debenture to be granted by the Issuer in favour of the Security Trustee on or before the Issue Date (the "**Issuer Debenture**"), the obligations of the Obligors under the Senior Finance Documents will be secured by charges in favour of the Security Trustee over all the undertaking and assets of the Issuer in England and Wales, which will include, inter alia fixed charges over its credit balances, book debts, insurances and certain specified contracts.

Security from ProjectCo

Pursuant to an English law debenture to be granted by ProjectCo in favour of the Security Trustee on or before the Issue Date (the "**ProjectCo Debenture**"), the obligations of the Obligors under the Senior Finance Documents will be secured by charges in favour of the Security Trustee over all the undertaking and assets of ProjectCo in England and Wales, which will include, inter alia, fixed charges over its credit balances, book debts, insurances and certain specified contracts.

Pursuant to an English law security agreement to be granted by ProjectCo in favour of the Issuer on or before the Issue Date (the "**ProjectCo Security Agreement**") the obligations of ProjectCo under the Issuer On-Loan Agreement will be secured by charges in favour of the Issuer over all the undertaking and assets of ProjectCo in England and Wales, which will include, inter alia, fixed charges over its credit balances, book debts, insurances and certain specified contracts.

Security from HoldCo

Pursuant to an English law debenture to be granted by HoldCo in favour of the Security Trustee on or before the Issue Date (the "**HoldCo Debenture**"), the obligations of the Obligors under the Senior Finance Documents will be secured by charges in favour of the Security Trustee over all the undertaking and assets of HoldCo in England and Wales, which will include, inter alia, fixed charges over its credit balances, book debts, insurances, shares held by it in ProjectCo and the Issuer and certain specified contracts.

Security Trust and Intercreditor Deed

The Obligors, the Security Trustee, the Bond Trustee, the Financial Guarantors and the Shareholders have entered into a security trust and intercreditor deed (the "**Security Trust and Intercreditor**

Deed") on or before the Issue Date which will set out the relationship of various Senior Creditors and Junior Creditors. The Security Trust and Intercreditor Deed will regulate, inter alia, the ranking of debt and security and the rights of parties in the case of default on certain obligations and will provide that, inter alia, the Junior Creditors will be subordinated to the Senior Creditors.

Each of the Secured Creditors, will appoint the Security Trustee to act as trustee in connection with the security and the Security Trust and Intercreditor Deed. In such capacity, the Security Trustee will agree in the Security Trust and Intercreditor Deed that it will, subject to being secured, prefunded or indemnified to its satisfaction, exercise any right which it may have in respect of the Financing Rights (subject to the operation of certain entrenched rights and reserved matters, i.e. rights which cannot be exercised without the consent of the person having such entrenched rights and reserved matters and subject to the other provisions of the Security Trust and Intercreditor Deed) only as directed by the Controlling Creditor.

When exercising the Financing Rights in accordance with the instructions of the Controlling Creditor, the Security Trustee is not required to have regard to the interests of any Senior Creditor or other persons in relation to the exercise of such rights and has no liability to any such Senior Creditor or other person as a consequence of so exercising such rights.

The provisions of the Security Trust and Intercreditor Deed and the Security Documents will allow the Controlling Creditor (and no other person) to instruct the Security Trustee or the Issuer (in respect of the Issuer On-Loan Agreement only) to enforce the security under the Security Documents (as applicable) in accordance with the terms thereof and the terms of the Security Trust and Intercreditor Deed (an "**Enforcement**").

Following an Enforcement, any proceeds of such Enforcement or other monies paid to or collected by the Security Trustee under the Security Trust and Intercreditor Deed or under any of the Security Documents or otherwise held by the Security Trustee on account of the Obligors as part of the Security shall be held by the Security Trustee on trust and (after taking into account any payments that have been made to the Paying Agent that are due to be distributed by the Paying Agent to Bondholders in accordance with the Paying Agency Agreement) applied in the following order:

(a) in payment, to the Security Trustee or any receiver of any unpaid remuneration payable under the Security Trust and Intercreditor Deed or the other Relevant Documents (including that agreed pursuant to clauses 11.17 (*Indemnity of the Controlling Creditor*), 11.18 (*Remuneration of Security Trustee*), 11.19 (*Additional Remuneration*) and 11.20 (*Increase in Remuneration*) of the Security Trust and Intercreditor Deed) and all costs, charges, expenses, liabilities, indemnity payments, legal fees and disbursements, other fees and disbursements or other amounts expended or incurred by or other amounts due to the Security Trustee or any receiver or Appointee in connection with the trusts of the Security Trust and Intercreditor Deed or in enforcing the rights and remedies of the Security Trustee under any of the Relevant Documents;

(b) in payment to the Bond Trustee of all unpaid remuneration, and all costs, charges, expenses, liabilities, indemnity payments, legal fees and disbursements, accountants' and other Appointees fees and disbursements expended or incurred by or other amounts due to the Bond Trustee in connection with the trusts of the Security Trust and Intercreditor Deed and the Bond Trust Deed or in enforcing the rights and remedies of the Bond Trustee under the Relevant Documents;

(c) in payment to the Principal Paying Agent and any other Paying Agent, of all unpaid remuneration, and all costs, charges, expenses, liabilities, indemnity payments, legal fees and disbursements, accountants' and other Appointees fees and disbursements expended or incurred by or other amounts due to the Principal Paying Agent and any other Paying Agent in connection with the trusts of the Security Trust and Intercreditor Deed and the Paying Agency Agreement or in enforcing the rights and remedies of the Principal Paying Agent and any other Paying Agent under the Relevant Documents;

(d) in payment to the Step-In Creditor until it has received any and all unpaid costs and expenses incurred by the Step-In Creditor;

(e) in payment, to the Financial Guarantors (and pro rata between each Financial Guarantor) until they have received any and all costs, fees or expenses due and payable under the Reimbursement and Indemnity Deed (other than pursuant to clauses 3.2.4, 3.3.1 or 3.9 of the Reimbursement and Indemnity Deed);

(f) only if and for so long as the Financial Guarantors are not the Controlling Creditor, to the Senior Creditors until they have received any and all costs and expenses due and payable pursuant to clauses 22.1 (*Transaction Expenses*) and 22.3 (*Costs*) of the Collateral Deed;

(g) in payment, pro rata, to the Financial Guarantors until they have received any and all amounts due and payable under clause 3.2.4 of the Reimbursement and Indemnity Deed and the Financial Guarantee Fee Letters (as such term is defined in the Reimbursement and Indemnity Deed);

(h) in payment, pro rata to the Bond Trustee on behalf of Bondholders of any and all scheduled interest due and payable on the Bonds; provided that, the amount payable pursuant to this paragraph (h) on any date shall be limited to the Scheduled Interest Liability as at that date. For this purpose, "**Scheduled Interest Liability**" means the amount in respect of interest on the Bonds which the Financial Guarantors have become actually and presently liable to pay on or prior to that date pursuant to the Financial Guarantees or would be or become so liable subject only to a claim being made in accordance with the Financial Guarantees;

(i) in payment, pro rata, to the Financial Guarantors until they have received any and all amounts due and payable under clauses 3.3.1 and 3.9 of the Reimbursement and Indemnity Deed with respect to interest on the Bonds (including pursuant to any right of subrogation the Financial Guarantors have acquired in respect of any payments made by the Financial Guarantors under the Financial Guarantees with respect to interest on the Bonds);

(j) in payment, pro rata, to the Bond Trustee on behalf of Bondholders of any and all principal due and payable on the Bonds; provided that, the amount payable pursuant to this paragraph (j) on any date shall be limited to the Scheduled Principal Liability as at that date. For this purpose, "**Scheduled Principal Liability**" means the amount in respect of principal of the Bonds which the Financial Guarantors have become actually and presently liable to pay on or prior to that date pursuant to the Financial Guarantees or would be or become so liable subject only to a claim being made in accordance with the Financial Guarantees;

(k) in payment, pro rata, to the Financial Guarantors until they have received any and all amounts due and payable under clauses 3.3.1 and 3.9 of the Reimbursement and Indemnity Deed with respect to principal on the Bonds (including pursuant to any right of subrogation the Financial Guarantors have acquired in respect of any payments made by the Financial Guarantors with respect to principal on the Bonds);

(l) in payment to the Bond Trustee on behalf of Bondholders of any and all partial redemption amounts due and payable pursuant to Condition 6 (*Redemption and Purchase*) of the Bonds;

(m) if the Bonds have been accelerated in accordance with Condition 9 (*Events of Default*) of the Bonds, in payment, pro rata, to the Bond Trustee on behalf of Bondholders of any and all outstanding principal due and payable on the Bonds;

(n) if the Authority elects to pay the Force Majeure Termination Sum or the Authority Voluntary Termination Sum in instalments (the "**Instalment Option**") pursuant to clause 60.2 (*Instalments*) of the Project Agreement, in payment on each Instalment Date to the relevant Obligor (or if the relevant Obligor so directs to the Junior Creditors) a percentage of that part of the Force Majeure Termination Sum or the Authority Voluntary Termination Sum representing the Equity Pay Out Amount;

(o) if the Bonds have not been accelerated pursuant to Condition 9 (*Events of Default*) of the Bonds, any and all amounts remaining after application of paragraphs (a) - (n) above shall be held in trust by the Security Trustee on behalf of the Senior Creditors and invested in Authorised Investments as instructed by the Controlling Creditor and, unless otherwise instructed by the Controlling Creditor, applied by the Security Trustee in payment of amounts becoming due and payable under paragraphs (a) - (n) as and when such amounts become so due and payable;

(p) following discharge in full of all Financial Guarantor Liabilities and payment in full of all outstanding principal due and payable on the Bonds, if any other Senior Liabilities remain outstanding, towards payment, pro rata, of all remaining sums or liabilities due or owed to the Senior Creditors in respect of such Senior Liabilities; and

(q) following discharge in full of all Liabilities, all remaining amounts in payment to the Issuer.

Payments pursuant to paragraph (n) above shall cease if:

(a) the Controlling Creditor has informed the Security Trustee that the Authority has failed to pay all or any portion of the Force Majeure Termination Sum or the Authority Voluntary Termination Sum (as applicable) or interest thereon which is then due and payable; or

(b) the Controlling Creditor has informed the Security Trustee that an Authority Default (as defined in the Project Agreement) has occurred; or

(c) the Controlling Creditor reasonably believes that the Authority's financial standing, the financial resources available to the Authority to perform its obligations under the Relevant Documents or the Authority's capacity to perform its obligations under the Relevant Documents have been materially and adversely affected.

Definitions

"**Bond Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by (a) any Obligor to any of the Bond Trustee and the Bondholders under and in respect of the Bonds, the Bond Trust Deed or the Collateral Deed or (b) ProjectCo to the Issuer pursuant to the Issuer On-Loan Agreement.

"**Controlling Creditor**" means at any time, the Financial Guarantors unless and until such time:

(a) as both of the Financial Guarantees have been terminated in accordance with Condition 2(b) (*Financial Guarantees*); or

(b) as the Security Trustee has received notice from the Bond Trustee that a Financial Guarantor Default has occurred,

in which case it shall be the Bond Trustee acting on the instructions of the Majority Bondholders, unless:

(i) a new financial guarantor or monitoring advisor has been appointed by the Bondholders under Condition 2(b) (*Financial Guarantees*), in which case it shall be the new financial guarantor or monitoring advisor; or

(ii) such Financial Guarantor Default has been cured or waived, in which case it shall be the Financial Guarantors.

"**Financial Guarantor Default**" means any of the following events:

(a) any Guaranteed Amount which is due for payment by AGM in accordance with the terms of the AGM Financial Guarantee and is not paid by AGM on the date stipulated in the AGM Financial Guarantee;

(b) AGM disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the AGM Financial Guarantee or seeks to do so (in each case, in writing);

(c) AGM (i) files a petition or commences a case or proceeding under any provision or chapter of the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation, or (ii) makes a general assignment for the benefit of its creditors, or (iii) has a final and nonappealable order for relief entered against it under the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation; or

(d) a court of competent jurisdiction, the New York Department of Insurance or other competent regulatory authority enters a final and nonappealable order, judgment or decree (i) appointing a custodian, trustee, agent or receiver for AGM or for all or any material portion of its property or (ii) authorising the taking of possession by a custodian, trustee, agent or receiver of AGM or of all or any material portion of its property.

"**Financial Guarantor Downgrade Event**" has the meaning given to it in Condition 2(b) (*Financial Guarantees*) of the Bonds.

"**Financial Guarantor Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by (a) any Obligor to either Financial Guarantor (by way of subrogation or otherwise) in respect of the Bonds, the Bond Trust Deed, the Financial Guarantees, the Financial Guarantee Fee Letters, the Accounts Agreement, the Collateral Deed or under the Reimbursement and Indemnity Deed or (b) ProjectCo to the Issuer in connection with the Net Bond Proceeds Advance pursuant to the terms of the Issuer On-Loan Agreement.

"**Financing Rights**" means, in respect of the Security Trustee or any other Senior Creditor, all rights which it has the benefit of pursuant to any Finance Document or any Project Document (other than any Reserved Matter or any right to amend the provisions of the Security Trust and Intercreditor Deed) including:

(a) the right, or the right to direct the Security Trustee or another Senior Creditor, to consent to any amendment, waiver, modification and/or extension of any provision of any Finance Document;

(b) the right, or the right to direct the Security Trustee or another Senior Creditor, to exercise any right, power and discretion of or under any of the provisions of the Finance Documents (including, without limitation, the right to refuse to advance sums upon non-satisfaction of, or to waive, any conditions precedent contained in any Finance Document);

(c) the right, or the right to direct the Security Trustee or another Senior Creditor, to bring any litigation, arbitration, administrative or other proceedings arising from or in connection with the Finance Documents; and

(d) the exercise of any right expressed to be in favour of the Controlling Creditor under the Collateral Deed.

"**Junior Creditors**" means:

(a) the Shareholders (in their capacity as holder of HoldCo Shares and HoldCo Loan Stock (as applicable));

(b) HoldCo (in its capacity as holder of ProjectCo Shares, Issuer Shares and ProjectCo Loan Stock);

(c) the Issuer (in its capacity as lender of the Issuer Equity Proceeds Advance in the Issuer On-Loan Agreement); and

(d) any other junior creditor who has become a party to the Security Trust and Intercreditor Deed under the terms of clause 17 (*Assignments and Transfers*) of the Security Trust and Intercreditor Deed.

"**Junior Liabilities**" means any indebtedness of any Obligor and any amounts owing to:

(a) each and every Junior Creditor; and

(b) any other Obligor,

under the Junior Finance Documents, the Subscription Agreement and/or constitutional documents of each Junior Creditor.

"**Liabilities**" means the Senior Liabilities and the Junior Liabilities or any of them.

"**Security Trustee Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by the Obligors or any of them to the Security Trustee for its own account under or in respect of the Senior Finance Documents and the Project Documents.

"**Senior Liabilities**" means the Paying Agent Liabilities, the Financial Guarantor Liabilities, the Bond Liabilities and the Security Trustee Liabilities (each as defined in the Security Trust and Intercreditor Deed).

4. **Subscription Agreement**

ProjectCo, HoldCo, the Issuer, the Shareholders and the Security Trustee have entered into a Subscription Agreement in relation to the deferred subscription (in pre-agreed instalments per annum from 30 September 2017 to 31 March 2020) of the HoldCo Loan Stock and the ProjectCo Loan Stock by the Shareholders and HoldCo respectively and the provision of an Acceptable Letter of Credit by each Shareholder to cover the respective HoldCo Loan Note commitment of each Shareholder during the deferred period.

5. **Shareholders' Agreement**

ProjectCo, HoldCo, the Issuer and the Shareholders have entered into a shareholders' agreement to regulate and govern the respective rights and obligations of the Shareholders in HoldCo and to ensure that the Businesses of HoldCo, ProjectCo and the Issuer shall be conducted in accordance with the provisions of the Shareholders' Agreement.

6. **HoldCo Loan Stock**

Pursuant to the HoldCo Loan Stock Instrument, HoldCo will issue and the Shareholders will subscribe for loan stock pursuant to the Subscription Agreement.

7. **ProjectCo Loan Stock**

Pursuant to the ProjectCo Loan Stock Instrument, ProjectCo will issue and HoldCo will subscribe for such loan stock on the same day and in the same manner as HoldCo issues and receives proceeds from the issue of HoldCo Loan Stock pursuant to the Subscription Agreement.

8. **Funders' Direct Agreement**

The Authority, the Security Trustee and ProjectCo have entered into the Funders' Direct Agreement in connection with the Project pursuant to which the Authority, following an event of default under the Project Agreement, agrees not to terminate the Project Agreement for a limited period. The Security Trustee is entitled during such limited period to propose, in accordance with instructions from the Controlling Creditor under the Security Trust and Intercreditor Deed, a representative to step in and undertake ProjectCo's obligations under the Project Agreement. For the avoidance of doubt, such representative will not be the Security Trustee.

The Bond Trustee will not, at any time whilst the Financial Guarantors are the Controlling Creditor, be able to control the exercise of step-in rights under the Funders' Direct Agreement. For the ranking of step-in expenses, see the section entitled "*Security Trust and Intercreditor Deed*" above.

9. **Guarantee**

Pursuant to the terms of the Collateral Deed, each of the Issuer, ProjectCo and HoldCo have entered into a guarantee in which each of them, jointly and severally, irrevocably and unconditionally, guarantees to each Senior Creditor the performance of all the terms, conditions and covenants on the part of each of the Issuer, ProjectCo and HoldCo contained in the Senior Finance Documents, which includes the obligations of the Issuer in respect of the Bonds.

10. **Accounts Agreement**

The Issuer has entered into an accounts agreement with ProjectCo, HoldCo, the Security Trustee, the Bond Trustee, the Financial Guarantors and Barclays Bank PLC, as account bank (the "**Account Bank**") (the "**Accounts Agreement**") on or before the Issue Date, which will regulate payments into and out of each of the accounts intended, inter alia, to ensure the paying up of the relevant debt service accounts and the prevention of certain prohibited payments.

Amounts will be drawn from the Escrow Account to meet expenditure related to the Project subject to the satisfaction of certain conditions, including there being no Event of Default, as more fully set out in the Collateral Deed.

11. **Guaranteed Investment Contract**

ProjectCo will, on or before the Issue Date, enter into a guaranteed investment contract (the "**Guaranteed Investment Contract**") with Lloyds Bank PLC (the "**GIC Provider**"). Certain on-lent bond proceeds will on the Issue Date be deposited by ProjectCo with the GIC Provider. The amount and timing of payments from the GIC Provider to ProjectCo will be regulated under the Guaranteed Investment Contract and the withdrawal amounts are, subject to certain provisions of the Guaranteed Investment Contract allowing acceleration, on a fixed profile.

TERMS AND CONDITIONS OF THE BONDS

The following is the text, subject to completion and minor amendment and save for the text in italics, (other than headings) of the terms and conditions which will be endorsed on each Bond in definitive form. Bonds in definitive form will only be issued in certain limited circumstances. For a summary of the provisions of the Bonds in global form, see the section "Summary of Provisions relating to the Bonds while in Global Form".

The issue of the £73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 30 September 2037 (the "**Bonds**", which expression includes any further bonds issued pursuant to Condition 19 (*Further Issues*) and forming a single series therewith) was authorised by a resolution of the Board of Directors of S4B (Issuer) plc (the "**Issuer**") passed on 16 December 2013. The Bonds are subject to, and have the benefit of, a bond trust deed dated the Issue Date (as defined in Condition 4 (*Interest*) below) (as amended or supplemented from time to time, the "**Bond Trust Deed**") between the Issuer, Assured Guaranty (Europe) Ltd. ("**AGE**"), Assured Guaranty Municipal Corp. ("**AGM**" and, together with AGE, the "**Financial Guarantors**") and BNY Mellon Corporate Trustee Services Limited as Bond Trustee (the "**Bond Trustee**", which expression includes all persons for the time being acting as bond trustee or bond trustees appointed under the Bond Trust Deed). These terms and conditions include summaries of and are subject to the detailed provisions of the Bond Trust Deed which includes the form of the Bonds and the Coupons (as defined below) relating to them and the security trust and intercreditor deed dated on or before the Issue Date (as amended, supplemented or replaced from time to time, the "**Security Trust and Intercreditor Deed**") between the Issuer, S4B Limited ("**ProjectCo**") and S4B (Holdings) Limited ("**HoldCo**" and, together with the Issuer and ProjectCo, the "**Obligors**"), Equitix Housing 2 Limited, Galliford Try Investments Limited and Contour Homes Limited (the "**Shareholders**"), BNY Mellon Corporate Trustee Services Limited as security trustee (the "**Security Trustee**", which expression includes all persons for the time being acting as security trustee or security trustees appointed under the Security Trust and Intercreditor Deed), the Bond Trustee (for itself and on behalf of the Bondholders) and the Financial Guarantors.

The Bonds (excluding those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) are unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest (but excluding any amounts due in respect of the Bonds (i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason; (ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof; (iii) attributable to any default interest; (iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Bonds; or (v) in respect of which AGM or AGE has made an Accelerated Payment (as defined in the relevant Financial Guarantee) in respect of the Bonds, pursuant to a financial guarantee to be dated the Issue Date issued by AGE (the "**AGE Financial Guarantee**") and a financial guarantee dated the Issue Date issued by AGM (the "**AGM Financial Guarantee**", and together with the AGE Financial Guarantee, the "**Financial Guarantees**").

Payments in respect of the Bonds will be made pursuant to a paying agency agreement dated the Issue Date (as amended or supplemented from time to time, the "**Paying Agency Agreement**") between the Issuer, the Financial Guarantors, the Bond Trustee and The Bank of New York Mellon, London Branch as principal paying agent (the "**Principal Paying Agent**", which expression includes any successor principal paying agent appointed under the Paying Agency Agreement and together with any additional or successor paying agents appointed under the Paying Agency Agreement, the "**Paying Agents**").

The holders of the Bonds (the "**Bondholders**") and the holders of the related principal and interest coupons (the "**Couponholders**" and the "**Coupons**", respectively) will be entitled to the benefit of, will be bound by and are deemed to have notice of, all the provisions of the Bond Trust Deed, the Financial Guarantees, the Collateral Deed (as defined in Condition 2(f) (*Collateral Deed*)), the Security Documents (as defined in Condition 2(e) (*Security*)) and the Paying Agency Agreement applicable to them.

Copies of the Bond Trust Deed, the Financial Guarantees, the Collateral Deed, the Security Documents and the Paying Agency Agreement are available for inspection by Bondholders during normal business hours at the registered office for the time being of the Bond Trustee presently at One Canada Square, London E14 5AL and at the specified offices of each of the Paying Agents.

Capitalised terms used in these conditions have the meaning given to them in the Relevant Documents.

1. **Form, Denomination and Title**

(a) *Form and Denomination*

The Bonds are in bearer form, serially numbered, in denominations of £100,000 and integral multiples of £1,000 in excess thereof with Coupons for principal and interest and talons (each a "**Talon**") for further Coupons attached at the time of issue. Bonds of one denomination will not be exchangeable for Bonds of any other denomination.

(b) *Title*

Title to the Bonds, the Coupons and the Talons will pass by delivery. The holder of any Bond, Coupon or Talon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no person shall be liable for so treating such holder.

2. **Status, Financial Guarantees and Security**

(a) *Status of the Bonds*

The Bonds constitute direct, secured obligations of the Issuer which rank *pari passu* and rateably without any preference or priority among themselves and will rank in priority to all unsecured obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

(b) *Financial Guarantees*

The Bonds (excluding those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) will have the benefit of the Financial Guarantees under which (i) AGE has unconditionally and irrevocably agreed to pay to the Bond Trustee 6 per cent of all sums due and payable but unpaid by the Issuer in respect of scheduled principal and interest on the Bonds and (ii) AGM has unconditionally and irrevocably agreed to pay to the Bond Trustee (x) the remaining 94 per cent of the aforementioned sums, and (y) any sums due and payable but unpaid by AGE, all as more particularly described in the Financial Guarantees.

If at any time while the Bonds remain outstanding both (i) AGM's insurer financial strength rating by Moody's ceases to be at least "Baa3" and (ii) AGM's insurer financial strength rating by S&P ceases to be at least "BBB-" (a "**Financial Guarantor Downgrade Event**"), the Issuer shall notify the Bondholders in accordance with Condition 15 (*Notices*) and the Bond Trustee that a Financial Guarantor Downgrade Event has occurred and of their rights pursuant to and in accordance with the Bond Trust Deed and the Conditions.

If directed by Bondholders (as defined in Condition 6(e) (*Definitions*)) acting by way of an Extraordinary Resolution, the Bond Trustee, subject to being prefunded, and/or indemnified and/or secured to its satisfaction, shall issue a notice (the "**Financial Guarantor Removal Notice**") to AGM and AGE specifying that, unless the Financial Guarantor Downgrade Event has been remedied or waived by the date that is three calendar months after the date of delivery of the Financial Guarantor Removal Notice, each of the Financial Guarantees shall be unconditionally and irrevocably terminated in whole and not in part effective on the date (such date the "**Financial Guarantor Removal Effective Date**") on which the Financial Guarantors have been (i) reimbursed in full for any payments made under the Financial Guarantees and (ii) paid any and all then-outstanding financial guarantee fees and other amounts owed under the Reimbursement and Indemnity Deed and the Financial Guarantee Fee Letters. The

Financial Guarantors may remedy any Financial Guarantor Downgrade Event by transferring the AGM Financial Guarantee to an affiliate of AGM that is rated at least "Baa3" by Moody's or "BBB-" by S&P at any time up to the Financial Guarantor Removal Effective Date. Notwithstanding that the Financial Guarantees have been terminated pursuant to and in accordance with this Condition 2(b), the Financial Guarantors shall continue to be paid financial guarantee fees until the later of (x) the Financial Guarantor Removal Effective Date and (y) the tenth Scheduled Payment Date. Thereafter, financial guarantee fees shall cease to be paid to the Financial Guarantors and the Bondholders may sanction by Extraordinary Resolution to use the amounts no longer required to be paid as such financial guarantee fees:

(i) to pay a replacement financial guarantor (if available) to act as Controlling Creditor;

(ii) to pay a monitoring adviser (if available) to act as Controlling Creditor;

(iii) to increase the amount of interest payable on the Bonds by the amount of such financial guarantee fees; or

(iv) for such other purpose as the Bondholders may determine.

The Issuer will immediately notify the Bondholders and the Bond Trustee in accordance with Condition 15 (*Notices*) (i) upon any remedy or waiver of a Financial Guarantor Downgrade Event (including by way of transfer of the AGM Financial Guarantee) or (ii) termination of the Financial Guarantees pursuant to this Condition 2(b).

(c) *Status of Financial Guarantees*

The AGE Financial Guarantee provided by AGE constitutes a direct, unsecured obligation of AGE which will rank at least *pari passu* with all other unsecured obligations of AGE, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

The AGM Financial Guarantee provided by AGM constitutes a direct, unsecured obligation of AGM which will rank at least *pari passu* with all other unsecured obligations of AGM, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

(d) *Subrogation of the Financial Guarantors*

The Bond Trust Deed and the Financial Guarantees each provide that the Financial Guarantors shall be subrogated to the rights of the Bond Trustee and each Bondholder and Couponholder in respect of amounts due under the Bonds which have been paid under the AGE Financial Guarantee and the AGM Financial Guarantee.

(e) *Security*

The obligations of the Issuer under the Bonds have the benefit of the security constituted by:

(i) a fixed and floating charge English law debenture dated on or before the Issue Date (as defined below) granted by the Issuer in favour of the Security Trustee (the "**Issuer Debenture**");

(ii) a fixed and floating charge English law debenture dated on or before the Issue Date (as defined below) granted by ProjectCo in favour of the Security Trustee (the "**ProjectCo Debenture**"); and

(iii) a fixed and floating charge English law debenture dated on or before the Issue Date (as defined below) granted by HoldCo in favour of the Security Trustee (the "**HoldCo Debenture**"),

(together, with the Security Trust and Intercreditor Deed, any other document from time to time executed in favour of the Security Trustee for the purpose of securing all or any of the

Secured Obligations and any deed of accession entered into in respect of any of the above, the "**Security Documents**").

(f) *Collateral Deed*

The Bond Trustee on behalf of the Bondholders has the benefit of certain representations and covenants set out in a collateral deed (the "**Collateral Deed**"), dated on or about the Issue Date between, *inter alios*, the Obligors, the Financial Guarantors and the Bond Trustee. The Collateral Deed also contains a guarantee of the Issuer's obligations under the Bonds from the other Obligors.

(g) *Security Trust and Intercreditor Deed*

The Bonds are subject to the Security Trust and Intercreditor Deed pursuant to which the exercise by the Bond Trustee of rights under the Bond Trust Deed and under the Bonds may in certain circumstances be directed by, and is in most circumstances subject to the prior consent of, other parties to the Security Trust and Intercreditor Deed. Bondholders and Couponholders are bound by, and deemed to have notice of, all the provisions of the Security Trust and Intercreditor Deed.

The Controlling Creditor has the exclusive right, power and authority to direct, or to refrain from directing, the Senior Creditors and the Security Trustee in the exercise of the Financing Rights subject to Reserved Matters or Entrenched Rights (as defined in the Security Trust and Intercreditor Deed) in each case without regard to the interests of any other person and the Controlling Creditor will not owe fiduciary duties to any person.

When exercising the Financing Rights in accordance with the instructions of the Controlling Creditor, the Security Trustee is not required to have regard to the interests of the Bondholders in relation to the exercise of such rights and has no liability to the Bondholders as a consequence of so acting.

"**Creditors**" means the Issuer, in its capacity as lender under the Issuer On Loan Agreement, each of the Senior Creditors and each of the Junior Creditors and "**Creditor**" means any of them.

"**Controlling Creditor**" means at any time, the Financial Guarantors unless and until such time:

(a) as both of the Financial Guarantees have been terminated in accordance with Condition 2(b) (*Financial Guarantees*); or

(b) as the Security Trustee has received notice from the Bond Trustee that a Financial Guarantor Default has occurred,

in which case it shall be the Bond Trustee acting on the instructions of the Majority Bondholders, unless:

(i) a new financial guarantor or monitoring advisor has been appointed by the Bondholders under Condition 2(b) (*Financial Guarantees*), in which case it shall be the new financial guarantor or monitoring advisor; or

(ii) such Financial Guarantor Default has been cured or waived, in which case it shall be the Financial Guarantors.

"**Financial Guarantor Default**" means any of the following events:

(a) any Guaranteed Amount which is due for payment by AGM in accordance with the terms of the AGM Financial Guarantee and is not paid by AGM on the date stipulated in the AGM Financial Guarantee;

(b) AGM disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the AGM Financial Guarantee or seeks to do so (in each case in writing);

(c) AGM (i) files a petition or commences a case or proceeding under any provision or chapter of the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation, or (ii) makes a general assignment for the benefit of its creditors, or (iii) has a final and nonappealable order for relief entered against it under the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation; or

(d) a court of competent jurisdiction, the New York Department of Insurance or other competent regulatory authority enters a final and nonappealable order, judgment or decree (i) appointing a custodian, trustee, agent or receiver for AGM or for all or any material portion of its property or (ii) authorising the taking of possession by a custodian, trustee, agent or receiver of AGM or of all or any material portion of its property.

"**Financing Rights**" means, in respect of the Security Trustee or any other Senior Creditor, all rights of which it has the benefit of pursuant to any Finance Document or any Project Document (other than any Reserved Matter (as defined in the Security Trust and Intercreditor Deed) or any right to amend the provisions of the Security Trust and Intercreditor Deed) including:

(a) the right, or the right to direct the Security Trustee or another Senior Creditor, to consent to any amendment, waiver, modification and/or extension of any provision of any Finance Document;

(b) the right, or the right to direct the Security Trustee or another Senior Creditor, to exercise any right, power and discretion of or under any of the provisions of the Finance Documents (including, without limitation, the right to refuse to advance sums upon non-satisfaction of, or to waive, any conditions precedent contained in any Finance Document);

(c) the right, or the right to direct the Security Trustee or another Senior Creditor, to bring any litigation, arbitration, administrative or other proceedings arising from or in connection with the Finance Documents; and

(d) the exercise of any right expressed to be in favour of the Controlling Creditor under the Collateral Deed.

"**Junior Creditors**" means:

(a) the Shareholders (in their capacity as holder of HoldCo Shares and HoldCo Loan Stock (as applicable));

(b) HoldCo (in its capacity as holder of ProjectCo Shares, Issuer Shares and ProjectCo Loan Stock);

(c) the Issuer (in its capacity as lender of the Issuer Equity Proceeds Advance in the Issuer On-Loan Agreement); and

(d) any other junior creditor who has become a party to the Security Trust and Intercreditor Deed under the terms of clause 17 (*Assignments and Transfers*) of the Security Trust and Intercreditor Deed.

"**Senior Creditors**" means each of the Financial Guarantors, the Bond Trustee, the Bondholders and the Security Trustee and "**Senior Creditor**" means each such person.

"**Shareholders**" means Equitix Housing 2 Limited, Galliford Try Investments Limited and Contour Homes Limited.

(h) *Effect on Bondholders and Couponholders*

The Bondholders and the Couponholders have the benefit of and are deemed to have notice of all the provisions of the Security Documents, the Collateral Deed, the Security Trust and Intercreditor Deed, the Financial Guarantees, the Bond Trust Deed, the Paying Agency Agreement and the other Finance Documents to which the Bond Trustee or the Security Trustee are party.

3. **Covenants of the Issuer**

The Issuer shall perform all its obligations and exercise all its rights under and in accordance with the Finance Documents and the documents relating to the Project to which it is party. In particular, the Issuer has undertaken to:

(a) provide a report (a form of which is set-out in schedule 6 to the Collateral Deed) to Bondholders, the Financial Guarantors, the Bond Trustee, the Security Trustee (either through an electronic website or through the Principal Paying Agent via the bond clearing system) semi-annually on or before the date which is 20 business days after the first day of each half of its Financial Years;

(b) procure the admission of the Bonds to the Official List of the Irish Stock Exchange and to trading on its regulated market and to maintain the same or, if it is unable to do so having used all reasonable endeavours or if it is impracticable or unduly burdensome to maintain such listing, trading and/or quotation, use its reasonable endeavours to obtain and maintain a listing, trading and/or quotation of the Bonds on such other stock exchange(s), listing authority and/or quotation system, which shall be in any case a "recognised stock exchange" for the purposes of section 1005 of the Income Tax Act 2007, as it may, with the prior written approval of the Bond Trustee and the Financial Guarantors decide;

(c) use all reasonable endeavours to, and the Issuer shall also use all reasonable endeavours to procure that there will at all times be furnished to any stock exchange, listing authority and/or quotation system on which the Bonds are for the time being listed, traded or quoted such information as such stock exchange, listing authority and/or quotation system may require to be furnished in accordance with its normal requirements or in accordance with any arrangements for the time being made with any such stock exchange, listing authority and/or quotation system; and

(d) maintain a rating of the Bonds and a shadow rating by at least two rating agencies.

4. **Interest**

The Bonds bear interest on their Outstanding Principal Amount (as defined in Condition 7(a) (*Scheduled Payments*) below) ("**Scheduled Interest**") from 20 December 2013 (the "**Issue Date**") at the rate of 4.926 per cent per annum (the "**Rate of Interest**"). Scheduled Interest will be payable semi-annually in arrear on each scheduled payment date listed in Condition 7(a) (*Scheduled Payments*) (each, a "**Scheduled Payment Date**"), subject as provided in Condition 7 (*Payments and Exchange of Talons*). Each period beginning on (and including) the Issue Date or any Scheduled Payment Date and ending on (but excluding) the next Scheduled Payment Date is herein called an "**Interest Period**". The first Scheduled Payment Date will be on 31 March 2014 in respect of the Interest Period from, and including the Issue Date to, but excluding, 31 March 2014. The amount of interest payable in respect of each Bond for any Interest Period shall be calculated by the Principal Paying Agent by applying the Rate of Interest to the Outstanding Principal Amount of such Bond, dividing the product by two except that the amount of interest payable in respect of each Bond for the Interest Period ending on 31 March 2014 will amount to £1,366.83 in respect of each Bond of £100,000 denomination and £13.67 in respect of each £1,000 in aggregate principal amount of the funds in excess of £100,000.

If interest is required to be calculated in respect of a Bond for a period which is not an Interest Period, it shall be calculated by applying the Rate of Interest to the Outstanding Principal Amount of such Bond, multiplying the product by the relevant Day Count Fraction, where:

"**Day Count Fraction**" means:

(a) if the Calculation Period is equal to or shorter than the Regular Period (as defined below) during which it falls, the number of days in the Calculation Period divided by the product of (1) the number of days in such Regular Period and (2) two; and

(b) if the Calculation Period is longer than one Regular Period, the sum of:

(i) the number of days in such Calculation Period falling in the Regular Period in which it begins divided by the product of (1) the number of days in such Regular Period and (2) two; and

(ii) the number of days in such Calculation Period falling in the next Regular Period divided by the product of (1) the number of days in such Regular Period and (2) two;

"**Calculation Period**" means the relevant period for which interest is to be calculated from (and including) the first day in such period to (but excluding) the last day in such period;

"**Outstanding Principal Amount**" means the aggregate principal amount of the Bonds (or, as the context may require, the relevant number thereof or an individual Bond) outstanding for the time being as reduced by payments of Scheduled Principal or other amounts in respect of principal in accordance with Condition 6 (*Redemption and Purchase*); and

"**Regular Period**" means each period from (and including) 31 March or 30 September in any year to (but excluding) the next 31 March or 30 September.

5. **Default Interest**

(a) *Default Interest*

The Outstanding Principal Amount of each Bond will cease to bear interest from the Scheduled Payment Date for the payment of such principal amount (or part thereof) unless, upon due presentation, payment is improperly withheld or refused, in which case the unpaid amount will bear default interest ("**Default Interest**") at the Rate of Interest (after as well as before judgment) until whichever is the earlier of:

(i) the day on which all principal sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder; and

(ii) the day which is seven days after the Principal Paying Agent or the Bond Trustee has notified the Bondholders that it has received all principal sums due in respect of the Bonds up to such seventh day (except to the extent that there is any subsequent default in payment in which case interest shall continue to accrue on any principal amount until such principal amounts are received by or on behalf of the relevant Bondholders).

(b) *Default Interest Payment*

Accrued Default Interest shall be payable prior to the final Scheduled Payment Date on each date (each a "**Default Interest Payment Date**") on which any amount of Scheduled Principal (as defined in Condition 6(a) (*Scheduled Redemption*)) remains unpaid and which is an integral multiple of six months after the due date for payment of such Scheduled Principal. Any amounts of Default Interest arising after the final Scheduled Payment Date shall be immediately due and payable. Each period beginning on (and including) the date on which the relevant payment is improperly withheld or refused or any Default Interest Payment Date and ending on (but excluding) the next Default Interest Payment Date is herein called a "**Default Interest Period**".

(c) *Default Interest Calculation*

The amount of Default Interest payable in respect of each Bond for any Default Interest Period shall be calculated by the Principal Paying Agent on the basis of the Day Count Fraction.

Default Interest does not accrue on Scheduled Interest or Default Interest. The payment of Default Interest is not guaranteed by the Financial Guarantors under the Financial Guarantees.

6. **Redemption and Purchase**

(a) *Scheduled Redemption*

Unless previously redeemed, or purchased and cancelled, the Issuer will redeem the Bonds in instalments by the payment on each Scheduled Payment Date of the scheduled principal (which, in respect of each £1,000 of Bonds will be the relevant amount set out in Condition 7(a) (*Scheduled Payments*) under "**Scheduled Principal**" (the "**Scheduled Principal**")). The first instalment will be payable on the Scheduled Payment Date falling in September 2014. The final Scheduled Payment Date is the Scheduled Payment Date falling in September 2037. For the avoidance of doubt, the Outstanding Principal Amount of each Bond will be reduced for each payment of principal on the Scheduled Payment Dates as provided in Condition 7 (*Payments and Exchange of Talons*) and such payment will not result in a reduction of the number of Bonds in issue.

(b) *Redemption at the option of the Issuer*

The Issuer may at any time, with the approval of the Financial Guarantors if they are the Controlling Creditor, having given not less than 30 nor more than 60 days' notice of redemption to the Bondholders in accordance with Condition 15 (*Notices*) (which notice shall be irrevocable and shall oblige the Issuer to redeem the Bonds), redeem each of the Bonds in whole, but not in part, at an amount (the "**Early Redemption Price**") equal to the higher of:

(i) the Outstanding Principal Amount of that Bond together with (a) any payment of principal and interest due but unpaid on or prior to the Redemption Option Reference Date and (b) any interest (other than under (a)) accrued up to and including the date of redemption; and

(ii) the Outstanding Principal Amount of the relevant Bond multiplied by the price (as reported to the Bond Trustee and the Issuer by a leading broker and/or primary dealer operating in the gilt edged market selected by the Bond Trustee, expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield (as defined in Condition 6(e) (*Definitions*)) of the Bonds (if the Bonds were to remain outstanding to their original maturity) on the Redemption Option Reference Date (as defined below) would be equal to the Gross Redemption Yield (determined by the middle-market price) at 3.00 p.m. (London time) on the Redemption Option Reference Date of the Reference Gilt (as defined in Condition 6(e) (*Definitions*)).

On the date specified for redemption in the notice given by the Issuer, the Issuer shall redeem each of the Bonds at the Early Redemption Price.

For the purposes of this Condition 6(b), "**Redemption Option Reference Date**" means the date which is two business days prior to the despatch of the notice of redemption under this Condition 6(b) (for the purposes of this Condition 6(b), in the notice given by the Issuer).

To the extent that the amount described under Condition 6(b)(ii) exceeds the amount described under Condition 6(b)(i), payment of the excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

(c) *Mandatory Redemption –Above Par Redemption*

If, (i) an Election Notice has been served (ii) an Authority Instalment Default has occurred or (iii) the Project Agreement has terminated and the Authority has not chosen, or is not entitled to exercise, the Instalment Option, and the amount paid by the Authority (the "**Compensation on Termination**") into an account designated by ProjectCo which is secured in favour of the Security Trustee under the ProjectCo Debenture is greater than or equal to the Outstanding Principal Amount of the Bonds together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed) and any accrued interest thereon then:

(i) if the Compensation on Termination is sufficient to pay the Default Amount of the Bonds and the Bond Trustee has received a Sufficiency Certificate (as defined in the Security Trust and Intercreditor Deed), then each Bond will, subject to the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed, be redeemed at the Default Amount for the Bonds on the date falling ten days after deposit of the Compensation on Termination by the Authority into such account; and

(ii) if the Compensation on Termination is not sufficient to pay the Default Amount for the Bonds but is greater than or equal to the Outstanding Principal Amount together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed) and any accrued interest thereon, then, unless an AP Non Redemption Instruction is in effect, each Bond will, subject to the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed, be redeemed at its Outstanding Principal Amount plus its pro rata share of the difference between the Compensation on Termination and the Outstanding Principal Amount of the Bonds (the "**Above Par Redemption Amount**") on the date that is ten days after (x) if no AP Non Redemption Instruction is in effect, the date of deposit of the Compensation on Termination by the Authority into such account or (y) if an AP Non Redemption Instruction is in effect, the date (if any) on which such AP Non Redemption Instruction is no longer in effect.

(d) *Mandatory Redemption - Below Par Redemption*

If, (i) an Election Notice has been served (ii) an Authority Instalment Default has occurred or (iii) the Project Agreement has terminated and the Authority has not chosen, or is not entitled to exercise, the Instalment Option, and the Compensation on Termination is less than the Outstanding Principal Amount of the Bonds together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed) and any accrued interest thereon then, unless a BP Non Redemption Instruction is in effect, each Bond will, subject to the priority of payments set out in clause 13 (*Application*) of the Security Trust and Intercreditor Deed, be redeemed to the extent of its Below Par Redemption Amount on the date (the "**BP Redemption Date**") that is ten days after (x) if no BP Non Redemption Instruction is in effect, the date of deposit of the Compensation on Termination by the Authority into such account or (y) if a BP Non Redemption Instruction is in effect, the date (if any) on which such BP Non Redemption Instruction is no longer in effect.

For the purposes of this Condition 6 the amounts payable pursuant to Condition 6(c) (*Mandatory Redemption – Above Par Redemption*) and this Condition 6(d) shall be without prejudice to the Default Amount payable pursuant to Condition 9 (*Events of Default*).

Neither AGE nor AGM shall be liable to pay any amount in excess of the Outstanding Principal Amount of the Bonds.

Payment of the Below Par Redemption Amount on the BP Redemption Date does not accelerate AGE and/or AGM's payment obligation under the Financial Guarantees. AGE and/or AGM shall only be liable to make payments in respect of the Bonds (pursuant to the Financial Guarantees) in the amounts and on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

(e) *Definitions*

For the purposes of this Condition 6:

"**AP Non Redemption Instruction**" means that the holders of at least 25 per cent of the Outstanding Principal Amount of the Bonds have, by written notice to the Bond Trustee or the holders have by Extraordinary Resolution, instructed the Bond Trustee that each Bond shall not be redeemed at its Above Par Redemption Amount, subject to the Bond Trustee being indemnified and/or secured and/or prefunded to its satisfaction, provided that no such instruction may be given if the Bonds have already been accelerated and provided further that any such instruction shall be deemed to be immediately revoked if the Bonds are subsequently accelerated.

"**Authority Event of Default**" means either (i) an event of default in relation to the Authority leading to termination of the Project Agreement pursuant to clause 47.3 (*Termination on Authority Default*) of the Project Agreement or (ii) a termination of the Project Agreement pursuant to clause 50 (*Termination for Want of Statutory Order*) of the Project Agreement.

"**Authority Instalment Default**" means a default by the Authority on its instalment payments leading to deemed termination of the Instalment Option.

"**Authority Voluntary Termination**" means (i) the Authority choosing to terminate the Project Agreement in accordance with clause 47.1 (*Voluntary Termination by the Authority*) or clause 47.2 (*Termination on Authority Break Point Date*) of the Project Agreement or (ii) a termination of the Project Agreement pursuant to clause 96.3 (*Failure to Issue a Certificate*) of the Project Agreement.

"**BP Non Redemption Instruction**" means that the holders of at least 25 per cent of the Outstanding Principal Amount of the Bonds have, by written notice to the Bond Trustee or the holders have by Extraordinary Resolution, instructed the Bond Trustee that each Bond shall not be redeemed to the extent of its Below Par Redemption Amount, subject to the Bond Trustee being indemnified and/or secured and/or prefunded to its satisfaction, provided that no such instruction may be given if the Bonds have already been accelerated and provided further that any such instruction shall be deemed to be immediately revoked if the Bonds are subsequently accelerated.

"**Below Par Redemption Amount**" means, in respect of each Bond, its pro rata share of the Compensation on Termination which pro rata share will be applied on the BP Redemption Date to reduce the Outstanding Principal Amount of each Bond pro rata and the payments of Scheduled Principal due on the Bonds set forth in column B of Condition 7(a) (*Scheduled Payments*) shall be adjusted to reflect such reduction by applying such reduction to the payments of Scheduled Principal due on the Bonds sequentially, commencing with the Scheduled Payment Date occurring immediately after the BP Redemption Date, until the Below Par Redemption Amount is applied in full.

"**Default Amount**" means:

(i) in the case of an acceleration of the Bonds pursuant to Condition 9 (*Events of Default*) following a Spens Acceleration Event, the higher of (i) the Outstanding Principal Amount of the relevant Bond multiplied by the price (as reported to the Bond Trustee and the Issuer by a leading broker and/or primary dealer operating in the gilt-edged market selected by the Bond Trustee) expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield (as defined below) of such Bonds (if the Bonds were to remain outstanding to their original maturity) on the Reference Date (as defined below) would be equal to the Gross Redemption Yield (determined by the middle-market price) at 3:00 p.m. on the Reference Date of the Reference Gilt (or in the case of a Modified Spens Acceleration Event, the Reference Gilt plus 25 basis points) and (ii) the Outstanding Principal Amount;

(ii) in all other circumstances, the Outstanding Principal Amount,

plus, in all circumstances, any accrued interest.

To the extent that the Default Amount exceeds the Outstanding Principal Amount of the Bonds, such excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

On the termination of the Project Agreement, the Authority will pay compensation in an amount and at times which will vary according to the circumstances of termination and

which may not be sufficient or sufficiently timely to enable the Issuer to pay the Default Amount. In particular, if the Authority terminates the Project Agreement as a result of ProjectCo Default it may not be obliged to pay an amount to ProjectCo equivalent to the Outstanding Principal Amount of the Bonds and will not be obliged to pay the Default Amount.

"**Election Notice**" means a notice served by the Authority pursuant to the Project Agreement whereby the Authority elects to accelerate the payment of any termination sum due under the Project Agreement in lieu of continuing to pay under the Instalment Option.

"**Full Spens Acceleration Event**" means

(i) termination of the Project Agreement as a result of an Authority Event of Default; or

(ii) the occurrence of an Authority Instalment Default (other than following a ProjectCo Default).

"**Gross Redemption Yield**" means a yield calculated in accordance with principles consistent with those used in the United Kingdom Debt Management Office notice "Formulae for Calculating Gilt Prices from Yields" page 4, Section One: Price/Yield Formulae "Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date" published on 8 June 1998 and updated on 15 January 2002 (and as further updated, supplemented, amended or replaced from time to time);

"**Instalment Option**" means the provision of the Project Agreement whereby the Authority may elect to pay the termination sum payable upon termination of the Project Agreement in instalments.

"**Modified Spens Acceleration Event**" means

(i) termination of the Project Agreement as a result of an Authority Voluntary Termination; or

(ii) the Authority serving an Election Notice (other than following a ProjectCo Default).

"**ProjectCo Default**" means the occurrence of a Contractor Default (as defined in the Project Agreement) leading to termination of the Project Agreement pursuant to clause 47.4 (*Termination on Contractor Default*) of the Project Agreement.

"**Project Agreement**" means the project agreement dated on or about the date of the Collateral Deed between ProjectCo and the Authority in relation to the Project.

"**Reference Date**" means the Calculation Date (as defined in the Project Agreement, being 20 business days after the date of termination of the Project Agreement) other than (i) in the case of the Authority serving an Election Notice, the date of such Election Notice or (ii) in the case of an Authority Instalment Default, the date that the Contractor serves notice on the Authority of such instalment default.

"**Reference Gilt**" means the fixed rate sterling obligation of the United Kingdom Government listed on the Official List of the Financial Conduct Authority (in its capacity as competent authority under the Financial Services and Markets Act 2000, as amended) and traded on the London Stock Exchange whose duration most closely matches that of the Bonds on the Reference Date as the Issuer may (with the advice of three persons operating in the gilt edged market selected by the Issuer and approved by the Bond Trustee) determine to be appropriate.

"**Spens Acceleration Event**" means a Full Spens Acceleration Event or a Modified Spens Acceleration Event.

(f) *No other Redemption*

Without prejudice to Condition 9 (*Events of Default*), the Issuer, any Affiliate of the Issuer or any Shareholder shall not be entitled to redeem, purchase or cancel the Bonds (other than those held by or on behalf of any Obligor or any Affiliate of an Obligor or Shareholder of an Obligor) in whole or in part otherwise than as provided in Conditions 6(a) (*Scheduled Redemption*), 6(b) (*Redemption at the option of the Issuer*), 6(c) (*Mandatory Redemption – Above Par Redemption*), 6(d) (*Mandatory Redemption – Below Par Redemption*), 6(g) (*Purchase*) and 6(h) (*Cancellation*).

(g) *Purchase*

The Issuer or any Affiliate of the Issuer may at any time purchase Bonds in the open market or otherwise and at any price, provided that all unmatured Coupons and unexchanged Talons appertaining thereto are purchased therewith. Any purchase by tender by the Issuer shall be made available to all Bondholders alike. Any Bonds so purchased (by tender or otherwise) shall be surrendered and cancelled.

(h) *Cancellation*

All Bonds so redeemed or purchased and surrendered for cancellation by the Issuer and any unmatured Coupons or unexchanged Talons attached to or surrendered with them shall be cancelled and may not be reissued or resold.

7. **Payments and Exchange of Talons**

(a) *Scheduled Payments*

The Issuer will in respect of each £1,000 in original principal amount of Bonds then outstanding on each Scheduled Payment Date make a total payment, comprising the relevant payment of Scheduled Interest and, if applicable, the relevant payment of Scheduled Principal on each Scheduled Payment Date:

A. Scheduled Payment Date	**B. Scheduled Principal per £1,000**	**C. Scheduled Interest per £1,000**	**D. Total Payment per £1,000**	**E. Outstanding Principal Amount per 1,000**
		(£)		
31 March 2014	-	13.67	13.67	1,000.00
30 September 2014	35.47	24.63	60.10	964.53
31 March 2015	28.58	23.76	52.33	935.95
30 September 2015	45.35	23.05	68.40	890.60
31 March 2016	35.99	21.94	57.92	854.62
30 September 2016	23.57	21.05	44.62	831.04
31 March 2017	29.41	20.47	49.88	801.64
30 September 2017	18.18	19.74	37.93	783.45
31 March 2018	22.45	19.30	41.75	761.00
30 September 2018	41.31	18.74	60.05	719.69
31 March 2019	-	17.73	17.73	719.69
30 September 2019	-	17.73	17.73	719.69
31 March 2020	20.54	17.73	38.27	699.15
30 September 2020	34.24	17.22	51.46	664.92
31 March 2021	14.60	16.38	30.97	650.32
30 September 2021	15.58	16.02	31.60	634.74
31 March 2022	15.72	15.63	31.35	619.02
30 September 2022	15.58	15.25	30.83	603.44
31 March 2023	15.95	14.86	30.81	587.48
30 September 2023	15.21	14.47	29.68	572.27
31 March 2024	15.41	14.10	29.50	556.87
30 September 2024	14.38	13.72	28.10	542.48
31 March 2025	14.59	13.36	27.96	527.89
30 September 2025	13.23	13.00	26.23	514.66

A. Scheduled Payment Date	**B. Scheduled Principal per £1,000**	**C. Scheduled Interest per £1,000**	**D. Total Payment per £1,000**	**E. Outstanding Principal Amount per 1,000**
31 March 2026	13.80	12.68	26.47	500.86
30 September 2026	11.25	12.34	23.59	489.61
31 March 2027	11.63	12.06	23.69	477.98
30 September 2027	11.43	11.77	23.20	466.55
31 March 2028	11.70	11.49	23.19	454.85
30 September 2028	14.58	11.20	25.79	440.27
31 March 2029	15.17	10.84	26.01	425.10
30 September 2029	17.93	10.47	28.40	407.17
31 March 2030	18.64	10.03	28.67	388.53
30 September 2030	20.81	9.57	30.38	367.71
31 March 2031	20.69	9.06	29.74	347.03
30 September 2031	21.55	8.55	30.10	325.47
31 March 2032	21.55	8.02	29.57	303.92
30 September 2032	22.48	7.49	29.96	281.45
31 March 2033	22.83	6.93	29.76	258.62
30 September 2033	22.32	6.37	28.69	236.30
31 March 2034	22.67	5.82	28.49	213.63
30 September 2034	23.96	5.26	29.22	189.66
31 March 2035	26.53	4.67	31.20	163.13
30 September 2035	28.23	4.02	32.24	134.91
31 March 2036	31.05	3.32	34.37	103.86
30 September 2036	33.43	2.56	35.98	70.43
31 March 2037	36.45	1.73	38.19	33.98
30 September 2037	33.98	0.84	34.82	-

Following any payment of the Below Par Redemption Amount in accordance with Condition 6(d) (*Mandatory Redemption – Below Par Redemption*), the amounts listed in Columns B to E above will be adjusted to reflect such payment from the Scheduled Payment Date following such payment.

For the avoidance of doubt, the number of Bonds in issue will not be reduced by the scheduled payments of Scheduled Principal in Column B and payment pursuant to Condition 6(c) (*Mandatory Redemption – Above Par Redemption*) or 6(d) (*Mandatory Redemption – Below Par Redemption*). Payments of Scheduled Principal will reduce the Outstanding Principal Amount of each Bond pro rata.

(b) *Method of Payment*

Payments in respect of the Bonds by the Issuer will be made only against:

(i) presentation and surrender of the appropriate Coupons; and

(ii) in the case of final redemption (provided that payment is made in full) surrender of the relevant Bonds,

at the specified office of any Paying Agent outside the United States by sterling cheque drawn on, or by transfer to a sterling account maintained by the payee with, a bank in London.

(c) *Payments subject to Fiscal Laws*

All payments in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8 (*Taxation*). No commissions or expenses shall be charged to the Bondholders or Couponholders in respect of such payments.

(d) *Unmatured Coupons Void*

On the early redemption in full of any Bond pursuant to Conditions 6(b) (*Redemption at the option of the Issuer*), 6(c) (*Mandatory Redemption - Above Par Redemption*), 6(d) (*Mandatory Redemption - Below Par Redemption*), 6(h) (*Cancellation*) or 9 (*Events of Default*), all unmatured Coupons relating thereto (whether or not still attached) shall become void and no payment will be made in respect thereof.

(e) *Payments on Business Days*

If the due date for payment of any amount in respect of any Bond or Coupon is not a business day in the place of presentation (and in the case of any payment by transfer to a sterling account in London), the holder shall not be entitled to payment in such place of the amount due until the next following business day in such place and shall not be entitled to any further interest or other payment in respect of any such delay. In this paragraph, "business day" means, in respect of any place of presentation, any day on which banks are open for business in such place of presentation and, in the case of payment by transfer to a sterling account as referred to above, on which dealings in foreign currencies may be carried on both in London and New York and in such place of presentation.

(f) *Payments otherwise than against the Surrender of Coupons*

If a Paying Agent makes a payment in respect of any Bond in circumstances where no Coupon is surrendered, such Paying Agent will endorse on such Bond a statement indicating the amount and date of such payment.

(g) *Fractions*

In respect of any payments to Bondholders any fractions of one pound will be rounded in accordance with Condition 18 (*Rounding*).

(h) *Exchange of Talons*

On or after the maturity date of the final Coupon which is (or was at the time of issue) part of a coupon sheet relating to the Bonds (each a "**Coupon Sheet**"), the Talon forming part of such Coupon Sheet may be exchanged at the specified office of the Principal Paying Agent for a further Coupon Sheet excluding any Coupons in respect of which claims have already become void pursuant to Condition 10 (*Prescription*). Upon the due date for redemption of any Bond, any unexchanged Talon relating to such Bond shall become void and no Coupon will be delivered in respect of such Talon.

8. Taxation

All payments of principal and interest in respect of the Bonds by the Issuer shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature unless such withholding or deduction is required by law.

In that event, the Issuer shall account to the relevant authorities for the amount to be withheld or deducted and shall make such payment of principal or interest, as the case may be, after such withholding or deduction has been made.

The Issuer shall notify the Bond Trustee of any such withholding or deduction and shall take reasonable measures available to it to avoid such obligation including the replacement of the Principal Paying Agent, the addition, replacement or removal of a Paying Agent or changing the specified office of any Paying Agent. Should the Issuer still be obliged to make the withholding or deduction, it will, on written request from any Bondholder, provide to the Bondholder copies of any documentation or correspondence with the tax authority regarding the deduction or withholding as the Bondholder may reasonably require to assist it to reclaim such deduction or withholding.

The Issuer will not be obliged to make any additional payments to Bondholders or Couponholders in respect of any such withholding or deduction.

To the extent that the Issuer is obliged to make any such deduction or withholding, there is no obligation on the Financial Guarantors to make good any such amount so deducted or withheld under the Financial Guarantees.

9. **Events of Default**

After any event of default pursuant to the terms of the Collateral Deed (an "**Event of Default**") occurs and is continuing, then:

(a) if and for so long as the Financial Guarantors are the Controlling Creditor, the Bond Trustee shall, upon being (a) so directed by the Financial Guarantors in accordance with the Security Trust and Intercreditor Deed; and (b) prefunded and/or indemnified and/or secured to its satisfaction, declare by written notice to the Issuer that the Bonds are immediately due and payable; or

(b) if and for so long as the Financial Guarantors are not the Controlling Creditor, the Bond Trustee may at any time and shall, upon being (a) so requested in writing by the holders of at least 25 per cent in Outstanding Principal Amount of the then outstanding Bonds (as defined in the Bond Trust Deed) or so directed by a resolution passed at any meeting of the Bondholders by a majority of not less than three quarters of the votes cast (an "**Extraordinary Resolution**"); and (b) prefunded and/or indemnified and/or secured to its satisfaction, declare by written notice to the Issuer that the Bonds are immediately due and payable,

whereupon without further action or formality each Bond shall become due and payable at the Default Amount for the Bonds (as defined above) together with accrued interest up to and including the date of redemption.

For a summary description of the Events of Default, see the section entitled "Financing of the Project — The Collateral Deed".

Such an acceleration of sums due on the Bonds does not accelerate AGE and/or AGM's payment obligation under the Financial Guarantees. AGE and/or AGM shall only be liable to make payments in respect of the Bonds (pursuant to the Financial Guarantees) on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

While the Financial Guarantors are the Controlling Creditor, save in the circumstances set out in Condition 6(c) (Mandatory Redemption - Above Par Redemption) and 6(d) (Mandatory Redemption – Below Par Redemption) and as described below, neither the Bondholders nor the Bond Trustee will have any rights to call for repayment of the Bonds following the occurrence of an Event of Default or for any enforcement of the security for the Bonds unless instructed or directed by the Financial Guarantors.

10. **Prescription**

Claims for principal and interest shall become void unless the relevant Coupons and/or the relevant Bonds (as the case may be) are presented for payment within five years (in the case of interest) and ten years (in the case of principal) of the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in London by the Principal Paying Agent or the Bond Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

11. **Replacement of Bonds, Coupons and Talons**

If any Bond, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying Agent, subject to all applicable laws and stock exchange (or other relevant authority) requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Bonds, Coupons or Talons must be surrendered before replacements will be issued.

12. **Bond Trustee, Security Trustee and Paying Agents**

(a) Under the Bond Trust Deed, the Bond Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and monies received by the Bond Trustee will be applied to pay its liabilities, costs and expenses and other amounts due to it in priority to the claims of the Bondholders. In addition, the Bond Trustee is entitled to enter into business transactions with the Obligors, the Financial Guarantors, the Bondholders, the Couponholders and any entity related to the Obligors, the Financial Guarantors or any other party to the Relevant Documents without accounting for any profit.

(b) In the exercise of its powers, trusts, authorities and discretions under these Conditions, the Financial Guarantees and the Bond Trust Deed, the Bond Trustee will have regard to the interests of the Bondholders as a class and will not have regard to the consequences of such exercise for individual Bondholders or Couponholders (whatever their number) whether resulting from their being resident or domiciled in any particular jurisdiction or otherwise and the Bond Trustee shall not be entitled to require from the Obligors, the Financial Guarantors or the Security Trustee, nor shall any Bondholder or Couponholder be entitled to claim from the Obligors, the Financial Guarantors, the Bond Trustee or the Security Trustee, any indemnification or other payment in respect of any consequence (including, without limitation, any tax consequence) for individual Bondholders or Couponholders of any such exercise.

(c) Under the Security Trust and Intercreditor Deed, the Security Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and to be paid its liabilities, costs and expenses and other amounts due to it in priority to the claims of the Bondholders. In addition the Security Trustee is entitled to enter into business transactions with the Obligors, the Financial Guarantors, the Bondholders, the Couponholders and any entity related to the Obligors, the Financial Guarantors or any other party to the Relevant Documents without accounting for any profit.

(d) Neither the Bond Trustee nor the Security Trustee has investigated nor are either of them responsible or liable for any loss arising as a result of any failure to investigate the legality, validity, value, sufficiency or enforceability of the security created by the Security Documents or the validity or enforceability of any contracts over which such security is created or of the Financial Guarantees and both the Bond Trustee and the Security Trustee shall accept without investigation, requisition or objection and without any responsibility or liability for doing so such right and title as the Obligors have to the property assets and rights over which security is created pursuant to the Security Documents.

The Security Trustee has no responsibility for the validity or enforceability of any obligation of any other party under any Relevant Documents.

The Bond Trustee has no responsibility for the validity or enforceability of the AGE Financial Guarantee against AGE or any permitted assignee of AGE under the AGE Financial Guarantee or the AGM Financial Guarantee against AGM or any permitted assignee of AGM under the AGM Financial Guarantee.

The Bond Trustee will not be liable to Bondholders for any loss they may suffer as a result of any termination of the AGE Financial Guarantee or the AGM Financial Guarantee resulting from any act or omission on the part of the Bond Trustee unless the consequences of such act or omission were notified in writing to the Bond Trustee in accordance with the Bond Trust Deed prior to such act or omission occurring and the Bond Trustee so acted or omitted to do so negligently or in wilful default.

Neither the Bond Trustee nor the Security Trustee will be responsible for or liable for loss which results should any deficiency arise between the amount realised in respect of the assets and rights over which security is given by the Security Documents and sums due in respect of the Bonds because the Security Trustee or the Bond Trustee is liable to tax in respect of the property assets and rights over which such security is created.

None of the Security Trustee, the Bond Trustee and the Principal Paying Agent shall be responsible for monitoring the obligations of any person to the Issuer and each of them shall, until they have received notice in writing to the contrary, assume that all persons are duly performing the same.

Neither the Security Trustee nor the Bond Trustee will be obliged to take any action under the Bond Trust Deed or the Security Trust and Intercreditor Deed unless either or each is prefunded and/or indemnified and/or secured to its satisfaction in respect of any liability, loss, cost or expense which it may in its opinion incur. Protection and realisation of the security may be prevented or delayed as a result.

(e) None of the Bond Trustee, the Security Trustee and the Principal Paying Agent shall be responsible for monitoring compliance by the Issuer or any other person with any matter set out in the Collateral Deed including whether an Event of Default or Potential Event of Default has occurred and, if the Bond Trustee is the Controlling Creditor, and is for whatever reason required to make any determination of material adverse change, or like matter, pursuant to the terms of the Collateral Deed, it may, in its absolute discretion, seek directions from the Bondholders or seek advice from an expert, both in accordance with the Bond Trust Deed and the Bond Trustee will not be responsible for the consequences of any delay involved in so doing.

(f) In acting under the Paying Agency Agreement and in connection with the Bonds and the Coupons, the Paying Agents act solely as agents of the Issuer and (to the extent provided therein) the Bond Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Bondholders or Couponholders.

(g) The initial Paying Agents and their initial specified offices are listed below. The Issuer reserves the right (with the prior approval of the Bond Trustee) at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor principal paying agent and additional or successor paying agents; provided, however, that the Issuer shall at all times maintain (i) a Principal Paying Agent (ii) so long as the Bonds are admitted to listing on the Official List and to trading on the Irish Stock Exchange's market for listed securities, at least one Paying Agent with a specified office in the European Union (iii) if so required by the Controlling Creditor, at least one Paying Agent with a specified office outside the European Union and (iv) a Paying Agent in a member state of the European Union that will not be obliged to withhold or deduct tax pursuant to any law implementing the European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000. Notice of any change in any of the Paying Agents or in their specified offices shall promptly be given by the Issuer to the Bondholders in accordance with Condition 15 (*Notices*).

(h) The Issuer has covenanted in the Bond Trust Deed to make available its annual report at the specified offices of the Paying Agents.

(i) The Bond Trustee shall be entitled to rely on certificates and reports of the auditors of the Issuer notwithstanding that such auditors' liability in respect thereof may be limited (by reference to a monetary cap or otherwise) and shall be entitled to enter into letters engaging the auditors to provide any certificate or report.

In acting as Bond Trustee under the Relevant Documents, the Bond Trustee shall, subject to clause 7.4 (*Interests of the Bondholders*) of the Bond Trust Deed, have regard solely to the interests of the Bondholders and not to any other Creditor or Beneficiary.

13. Meetings of Bondholders: Modification and Waiver

(a) *Meetings of Bondholders*

(i) Subject to Condition 13(b) (*Modification and Waiver*), the Bond Trust Deed contains provisions for convening single meetings of Bondholders to consider matters affecting their interests, including the modification of these Conditions, the Bond Trust Deed, the Financial Guarantees and any other Finance Documents, the Security Documents and the Collateral Deed. Any such modification may, subject to the prior written consent of the Financial Guarantors if they are the Controlling Creditor, be made if sanctioned by an Extraordinary Resolution (as defined in the Bond Trust Deed). A meeting of

Bondholders will also have the power (exercisable by Extraordinary Resolution) to advise or instruct the Bond Trustee in connection with the exercise by the Bond Trustee, subject to Condition 14(a) (*Exercise and Enforcement*), of any of its rights, powers, trusts, authorities and discretions under the Finance Documents, to remove or approve the appointment of a new Bond Trustee and to appoint any persons (whether Bondholders or not) as a committee to represent the interests of the Bondholders and to confer upon such committee any powers which the Bondholders could themselves exercise by Extraordinary Resolution.

(ii) The quorum for all business other than an Extraordinary Resolution will be one or more persons present in person holding or representing 10 per cent in aggregate outstanding principal amount of the Bonds, or at any meeting adjourned for want of a quorum, one or more persons being actually present at such meeting in person representing Bondholders whatever the principal amount of Bonds held or represented.

(iii) The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more persons present in person holding or representing 25 per cent in outstanding principal amount of the Bonds or, at any adjourned meeting, one or more persons being actually present at such meeting in person representing Bondholders whatever the principal amount of the Bonds held or represented; provided, however, that certain proposals including any proposal:

(A) to change any date fixed for payment of principal, premium (if any) or interest in respect of the Bonds, to reduce the amount of principal, premium, (if any) or interest payable on any date in respect of the Bonds to alter the method of calculating the amount of any payment in respect of the Bonds or the date for any such payment;

(B) to effect any exchange of the Bonds for, or the conversion of the Bonds into shares, bonds or other obligations of the Issuer, either Financial Guarantor or any other person or to approve the substitution of any person for the Issuer as principal obligor under the Bonds or the substitution of any person for AGE and/or AGM as guarantors under the Financial Guarantees;

(C) to change the currency of payments under the Bonds other than any change made pursuant to Condition 16 (*Redenomination*);

(D) to modify any provisions of the Financial Guarantees;

(E) to change the quorum required at any meeting of the Bondholders or the majority required to pass an Extraordinary Resolution;

(F) to release all or part of the Security other than in accordance with the Security Documents;

(G) to waive or amend any of the covenants described in Condition 3(a) to (c) (*Covenants of the Issuer*);

(H) to alter the rights of priority set out in clause 13 (*Application*) under the Security Trust and Intercreditor Deed;

(I) to exercise the rights under Condition 2(b) (*Financial Guarantees*) or make any amendments to such Condition;

(J) to remove any Bond Trustee or approve the appointment of a new Bond Trustee;

(K) to direct the Bond Trustee to give a Financial Guarantor Removal Notice;

(L) to approve any proposal by the Issuer or the Financial Guarantors for any modification of any provision of any Relevant Document or any arrangement in respect of the obligations of the Issuer under or in respect of the Bonds or the obligations of the Financial Guarantors under the Financial Guarantees relating to the Bonds;

(M) to waive any breach or authorise any proposed breach by any Obligor, the Financial Guarantors or any other party of its obligations under any Relevant Document or any act or omission which might otherwise constitute a Financial Guarantor Default, or, as the case may be, an Event of Default; or

(N) to amend any of the above reserved matters,

(together the "**Reserved Matters**") may only be sanctioned by an Extraordinary Resolution passed at a meeting of Bondholders at which one or more persons present in person holding or representing not less than three-quarters or, at any meeting adjourned for want of a quorum, at least 25 per cent in aggregate outstanding principal amount of the Bonds form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Bondholders and Couponholders whether present or not.

The majority required for an Extraordinary Resolution is at least 75 per cent of the votes cast. In addition, a resolution in writing signed by or on behalf of all Bondholders who for the time being are entitled to receive notice of a meeting of Bondholders under the Bond Trust Deed will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Bondholders.

(b) *Modification and Waiver*

If it is then the Controlling Creditor, subject to clause 5 (*Consent of Controlling Creditor and Entrenched Rights and Reserved Matters of Senior Creditors*) of the Security Trust and Intercreditor Deed, the Bond Trustee may, without the consent or sanction of the Bondholders or Couponholders concur with the Issuer, the Financial Guarantors or any other relevant parties in making:

(i) any modification to these Conditions, the Bond Trust Deed, the Financial Guarantees, the Security Documents, the Collateral Deed and any other Relevant Document which is in the opinion of the Bond Trustee of a formal, minor or technical nature or is made to correct a manifest error or an error which is, in the opinion of the Bond Trustee, proven; or

(ii) any other modification of any such document which is in the opinion of the Bond Trustee not materially prejudicial to the interests of Bondholders.

For the avoidance of doubt, and notwithstanding the foregoing, the Bond Trustee, if it is then the Controlling Creditor, shall have the unfettered right to seek the consent of the Bondholders to the making of any such modification, provided that the Bond Trustee shall act in accordance with the directions in writing to it of the holders of at least 25 per cent in aggregate principal amount of the Bonds outstanding or with an Extraordinary Resolution where the same are relevant or passed.

If the Bond Trustee is then the Controlling Creditor, subject to clause 5 (*Consent of Controlling Creditor and Entrenched Rights and Reserved Matters of Senior Creditors*) of the Security Trust and Intercreditor Deed, the Bond Trustee may also, without the consent or sanction of any of the Bondholders or Couponholders, waive or authorise any Event of Default, any Potential Event of Default, any Financial Guarantor Default or any Financial Guarantor Downgrade Event or any other breach or proposed breach of the Bond Trust Deed, the Bonds, the Financial Guarantees, the Security Trust and Intercreditor Deed or any other Relevant Document to which it is a party, or determine that any Financial Guarantor Default or any Financial Guarantor Downgrade or any Event of Default or any Potential Event of Default shall not, or shall not subject to specified conditions, be treated as such or, in the case of a Financial Guarantor Default or Financial Guarantor Downgrade Event, has been cured to its satisfaction, if the Bond Trustee is of the opinion that so to do will not be materially prejudicial to the interests of the Bondholders.

For the avoidance of doubt, (i) if it is then the Controlling Creditor, the Bond Trustee shall have the unfettered right to seek the consent of Bondholders to any such authorisation or waiver, provided that the Bond Trustee shall act in accordance with the directions in writing to it of the holders of at least 25 per cent in aggregate principal amount of the Bonds outstanding or with an Extraordinary Resolution where the same are relevant or passed and (ii) if the Bond Trustee is not the Controlling Creditor, the Controlling Creditor controls all Financing Rights of the Senior Creditors under the Finance Documents, including those of the Bondholders and the Bond Trustee, subject only to clause 5 (*Consent of Controlling Creditor and Entrenched Rights and Reserved Matters of Senior Creditors*) of the Security Trust and Intercreditor Deed.

14. **Exercise and Enforcement**

(a) *Exercise and Enforcement*

As more particularly provided in the Security Trust and Intercreditor Deed, the Bond Trustee will be obliged to take action to exercise or enforce its rights under the Bond Trust Deed or the Security Documents or in respect of the Bonds if required to do so by the Controlling Creditor except in relation to certain specified rights of the Bond Trustee (provided that the Bond Trustee has been prefunded and/or indemnified and/or secured to its satisfaction) but will not in most circumstances be entitled to take any such action without the prior written consent of the Controlling Creditor. In any event, the Bond Trustee shall not be bound as against the Bondholders to take any such action unless:

(i) it has been so requested in writing by the holders of at least 25 per cent in aggregate principal amount of the outstanding Bonds or has been so directed by an Extraordinary Resolution; and

(ii) it has been prefunded and/or indemnified and/or secured to its satisfaction.

The Bond Trustee is entitled to exercise certain rights reserved for the Bond Trustee's exercise in its sole discretion.

(b) *Action by Bondholders*

No Bondholder may take any action against the Issuer, or the Financial Guarantors to enforce its rights in respect of the Bonds or to enforce all or any of the security constituted by the Security Documents or to enforce the Financial Guarantees unless the Bond Trustee having become bound so to proceed fails to do so within a reasonable time and such failure is continuing.

15. **Notices**

Notices to the Bondholders shall be valid if published in a leading English language daily newspaper published in the United Kingdom (which is expected to be the Financial Times). Any such published notice shall be deemed to have been given on the date of first publication. Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Bondholders, provided that for so long as the Bonds are admitted to trading on the Irish Stock Exchange, notices to Bondholders will be valid when such notice is filed at the Companies Announcement Office of the Irish Stock Exchange.

16. **Redenomination**

(a) *Notice of Redenomination*

The Issuer may, without the consent of the Bondholders and Couponholders, on giving at least 30 days' prior notice to the Financial Guarantors, the Bondholders, the Bond Trustee and the Paying Agents, designate a date (the "**Redenomination Date**"), being a Scheduled Payment Date under the Bonds falling on or after the date on which the United Kingdom becomes a Participating Member State (as defined below) (a "**Euro Redenomination**").

(b) *Euro Redenomination*

Notwithstanding the other provisions of these Conditions, in respect of a Euro Redenomination with effect from the Redenomination Date:

(i) the Bonds shall be deemed to be redenominated into euro in denominations which are integral multiples of euro 0.01 with an Outstanding Principal Amount for each Bond equal to the Outstanding Principal Amount of that Bond in sterling, converted into euro at the rate for conversion of sterling into euro established by the Council of the European Union pursuant to the Treaty (including compliance with rules relating to rounding in accordance with European Community regulations); provided, however, that if the Issuer determines that the then market practice in respect of the redenomination into euro 0.01 of internationally offered securities is different from that specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Financial Guarantors, the Bond Trustee, the Bondholders and Couponholders, each stock exchange (if any) on which the Bonds are then listed and the Paying Agents of such deemed amendments;

(ii) if Bonds have been issued in definitive form:

(A) all unmatured Coupons denominated in sterling (whether or not attached to the Bonds) will become void with effect from the date (the "**Euro Exchange Date**") on which the Issuer gives notice (the "**Euro Exchange Notice**") to the Bondholders and the Bond Trustee that replacement Bonds and Coupons denominated in euro are available for exchange (provided that such Bonds and Coupons are available) and no payments will be made in respect thereof;

(B) the payment obligations contained in all Bonds denominated in sterling will become void on the Euro Exchange Date but all other obligations of the Issuer thereunder (including the obligation to exchange such Bonds in accordance with this Condition 16) shall remain in full force and effect; and

(C) new Bonds and Coupons denominated in euro will be issued in exchange for Bonds and Coupons denominated in sterling in such manner as the Principal Paying Agent may specify and as shall be notified to the Bondholders in the Euro Exchange Notice;

(iii) all payments in respect of the Bonds (other than, unless the Redenomination Date is on or after such date as sterling ceases to be a sub-division of the euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in euro by cheque drawn on, or by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) maintained by the payee with, a bank in the principal financial centre of any Member State of the European Communities; and

(iv) a Bond or Coupon may only be presented for payment on a day which is a business day in the place of presentation. In this Condition 16(b), "**business day**" means, in respect of any place of presentation, any day which is a day on which banks are open for business in such place of presentation and which is also a day on which the TARGET system is operating.

(c) *Interest*

Following redenomination of the Bonds pursuant to this Condition 16:

(i) where Bonds have been issued in definitive form, the amount of interest due in respect of the Bonds will be calculated by reference to the aggregate Outstanding Principal Amount of the Bonds presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded in accordance with Condition 18 (*Rounding*); and

(ii) the amount of interest payable in respect of each Bond for any Scheduled Payment Date shall be calculated by applying the Rate of Interest to the Outstanding Principal Amount of such Bond, dividing the product by two and rounding the resulting figure in accordance with Condition 18 (*Rounding*). If interest is required to be calculated for any other period, it will be calculated on the basis of the actual number of days elapsed divided by 365 (or, if any of the days elapsed fall in a leap year, the sum of (x) the number of those days falling in a leap year divided by 366 and (y) the number of those days falling in a non-leap year divided by 365); provided, however, that, if the Issuer determines, with the agreement of the Bond Trustee, that, in respect of a Euro Redenomination, the market practice in respect of internationally offered euro denominated securities. If Bonds are in definitive form, the coupon amount will be specified per period on each coupon.

(d) *Interpretation*

In these Conditions:

"**euro**" means the single currency that was introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty;

"**Participating Member State**" means a Member State of the European Communities which adopts the euro as its lawful currency in accordance with the Treaty;

"**TARGET system**" means the Trans-European Automated Real-time Gross Settlement Express Transfer system; and

"**Treaty**" means the Treaty establishing the European Communities, as amended.

17. **Governing Law and Jurisdiction**

(a) *Governing law*

The Bond Trust Deed, the Bonds and the Coupons and all matters arising from or connected with these are governed by, and shall be construed in accordance with, English law. The Financial Guarantees and all matters arising from or connected with them are governed by, and will be construed in accordance with, English law.

(b) *English courts*

The courts of England have jurisdiction to settle any dispute (a "**Dispute**"), arising from or connected with the Bonds and the Bond Trust Deed.

(c) *Appropriate forum*

The Issuer agrees and the Financial Guarantors have agreed in the Bond Trust Deed that the courts of England are the most appropriate and convenient courts to settle any Dispute and, accordingly, that it will not argue to the contrary.

(d) *Rights of the Bondholders to take proceedings outside England*

Condition 17(c) (*Appropriate forum*) is for the benefit of each of the Bond Trustee, the Bondholders and the Couponholders only. As a result, nothing in this Condition 17 prevents the Bond Trustee or any Bondholder from taking proceedings relating to a Dispute ("**Proceedings**") in any other courts with jurisdiction. To the extent allowed by law, the Bond Trustee and the Bondholders may take concurrent Proceedings in any number of jurisdictions.

18. **Rounding**

For the purposes of any calculations referred to in these Conditions (unless otherwise specified in these Conditions), (a) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with 0.000005 per cent being rounded up to 0.00001 per cent), (b) all Sterling amounts used in or resulting from such calculations will be rounded to the nearest penny (with one half penny being rounded up), and (c) all amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency, with 0.005 being rounded upwards.

19. **Further Issues**

The Issuer may from time to time, without the consent of the Bondholders or Couponholders and in accordance with the Bond Trust Deed but subject to the provisions of the Collateral Deed, create and issue further bonds having the same terms and conditions as the Bonds in all respect (or in all respects except for the first payment of interest) so as to form a single series with the Bonds and such further bonds will have the benefit of the Financial Guarantees.

20. **Rights of Third Parties**

No person shall have any right to enforce any term or condition of the Bonds or the Bond Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

SUMMARY OF PROVISIONS RELATING TO THE BONDS WHILE IN GLOBAL FORM

The Temporary Global Bond and the Permanent Global Bond contain provisions which apply to the Bonds while they are in global form, some of which modify the effect of the terms and conditions of the Bonds set out in this Prospectus. The following is a summary of certain of those provisions:

Initial Issue of Bonds

The Bonds will be issued in new global note ("**NGN**") form and will be delivered on the instructions of the Issuer by the Principal Paying Agent to a common safekeeper for Euroclear and Clearstream, Luxembourg, as described below. The Bonds are intended to be held in a manner which would allow Eurosystem eligibility, and deposited with one of Euroclear or Clearstream, Luxembourg as common safekeeper. Depositing the Global Bonds with a common safekeeper does not necessarily mean that the Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue, or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.

The nominal amount of the Bonds shall be the aggregate amount from time to time entered in the records of Euroclear or Clearstream, Luxembourg. The records of such clearing system shall be conclusive evidence of the nominal amount of Bonds represented by the Global Bonds and a statement issued by such clearing system at any time shall be conclusive evidence of the records of the relevant clearing system at that time.

Exchange

The Bonds will initially be represented by a Temporary Global Bond which will be deposited on or around the Issue Date with a common safekeeper for Euroclear and Clearstream, Luxembourg. The Temporary Global Bond will be exchangeable in whole or in part for interests in a Permanent Global Bond not earlier than 40 calendar days from (but not including) the Issue Date upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Bond unless exchange for interests in the Permanent Global Bond is improperly withheld or refused. In addition, interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership.

The Permanent Global Bond will become exchangeable in whole, but not in part, for Bonds in definitive form ("**Definitive Bonds**") in the denomination of £100,000 and integral multiples of £1,000 in excess thereof each at the request of the bearer of the Permanent Global Bond against presentation and surrender of the Permanent Global Bond to the Principal Paying Agent if either of the following events (each an "**Exchange Event**") occurs: (a) Euroclear or Clearstream, Luxembourg or any additional or substitute clearing system (an "**Additional or Substitute Clearing System**") from time to time nominated by the Issuer or the Bond Trustee and approved by the Controlling Creditor through which the Bonds are cleared is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) the Bonds become due and payable pursuant to Condition 9 (*Events of Default*) of the Bonds.

The Permanent Global Bond will also become exchangeable, in whole but not in part only and at the option of the Issuer, for Definitive Bonds if, by reason of any change in the laws of the United Kingdom, the Issuer is or will be required to make any withholding or deduction from any payment in respect of the Bonds which would not be required if the Bonds were in definitive form.

Whenever the Permanent Global Bond is to be exchanged for Definitive Bonds, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Bonds, duly authenticated and with Coupons and Talons attached, in an aggregate principal amount equal to the principal amount of the Permanent Global Bond to the bearer of the Permanent Global Bond against the surrender of the Permanent Global Bond at the specified office of the Principal Paying Agent within 30 days of the occurrence of the relevant Exchange Event. In any such event, the Issuer will procure that details of such exchange be entered *pro rata* in the records of the relevant clearing system.

In addition, the Temporary Global Bond and the Permanent Global Bond will contain provisions which modify the Terms and Conditions of the Bonds as they apply to the Temporary Global Bond and the Permanent Global Bond. The following is a summary of certain of those provisions:

Payments

All payments in respect of the Temporary Global Bond and the Permanent Global Bond will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Temporary Global Bond or (as the case may be) the Permanent Global Bond at the specified office of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the Issuer in respect of the Bonds. The Issuer shall procure that details of each payment shall be entered *pro rata* in the records of the relevant clearing system and in the case of payments of principal, the nominal amount of the Bonds recorded in the records of the relevant clearing system and represented by the Global Bond will be reduced accordingly.

Notices

Notwithstanding Condition 15 (*Notices*) of the Bonds while all the Bonds are represented by the Permanent Global Bond (or by the Permanent Global Bond and/or the Temporary Global Bond) and the Permanent Global Bond is (or the Permanent Global Bond and/or the Temporary Global Bond are) deposited with a common safekeeper for Euroclear and Clearstream, Luxembourg or any Additional or Substitute Clearing System from time to time nominated by the Controlling Creditor, notices to Bondholders may be given by delivery to Euroclear and Clearstream, Luxembourg or any such Additional or Substitute Clearing System and such notices shall be deemed to have been given to the Bondholders in accordance with Condition 15 (*Notices*) of the Bonds, as the case may be, on the second day after the day of delivery to Euroclear and Clearstream, Luxembourg or any such Additional or Substitute Clearing System.

Meetings

The holder of, or a proxy for the holder of, the Temporary Global Bond or the Permanent Global Bond will be treated as being two persons for the purposes of any quorum requirements of a meeting of the Bondholders.

Cancellation

Cancellation of any Bond represented by the Temporary Global Bond or the Permanent Global Bond will be effected by reduction in the principal amount of the Temporary Global Bond or the Permanent Global Bond (as the case may be). In any such event, the Issuer will procure that details of such exchange be entered *pro rata* in the records of the relevant clearing system.

Nominal Amount

The Issuer shall procure that any exchange, payment or cancellation under the Bonds, as the case may be, in addition to the circumstances set out above shall be entered in the records of the relevant clearing systems and upon any such entry being made, in respect of payments of principal, the nominal amount of the Bonds represented by the Global Bond shall be adjusted accordingly.

Bond Trustee's Powers

In considering the interests of Bondholders while the Temporary Global Bond or the Permanent Global Bond is held on behalf of Euroclear and/or Clearstream, Luxembourg or any Additional or Substitute Clearing System from time to time nominated by the Controlling Creditor, the Bond Trustee may have regard to any information provided to it by such clearing system(s) as to the identity (either individually or by category) of its accountholders with entitlement to the Temporary Global Bond or the Permanent Global Bond and may consider such interests as if such accountholders were the Bondholders represented by the Temporary Global Bond or the Permanent Global Bond (as the case may be).

USE OF PROCEEDS

The net proceeds of the issue of the Bonds expected to amount to approximately £71,695,669 will be used to fund the design, construction, management, finance and operating costs and other expenditure (including fees and incidental costs and expenses) in relation to the Project, to reimburse the expenses of the Issuer in relation to the issue of the Bonds, including the Manager's combined management and underwriting commission, the financial guarantee fee payable to the Financial Guarantors in respect of the issue of the Financial Guarantees and certain of the issue and other related costs. The total expenses of the issue are approximately £1,829,331. On the basis of the issue price of the Bonds of 100 per cent, the yield of the Bonds is 4.926 per cent. The yield is calculated as at the issue date and at the issue price and is not a guarantee of future yield.

FORM OF AGE FINANCIAL GUARANTEE

Dated [●] 2013

ASSURED GUARANTY (EUROPE) LTD.

FINANCIAL GUARANTEE No. 80172 - U

in respect of

£73,525,000 4.926 per cent Fixed Rate

Guaranteed Secured Bonds due 2037

This Financial Guarantee is dated [●] 2013 and given by Assured Guaranty (Europe) Ltd. whose registered office is at 1 Finsbury Square, London EC2A 1AE (the **"Financial Guarantor"**) in favour of BNY Mellon Corporate Trustee Services Limited as trustee for the holders of the Guaranteed Bonds (as defined below) (the **"Bond Trustee"**, which expression shall, whenever the context admits, include such Persons for the time being the trustee or trustees of the Bond Trust Deed for the Guaranteed Bondholders).

1. **Interpretation**

1.1 **Definitions**

Any capitalised terms used in this Financial Guarantee and not otherwise defined shall have the meaning given to such terms in the Bond Trust Deed or the Collateral Deed (each as defined below) unless the context otherwise requires. In the event of any inconsistency between the provisions of this Financial Guarantee and the provisions of the Bond Trust Deed and/or the Collateral Deed, this Financial Guarantee shall prevail. For the purposes of this Financial Guarantee, the following terms will have the following meanings:

"Accelerated Payment" means, following an Acceleration, any payment in full or in part by the Financial Guarantor or AGM, at the Financial Guarantor's or AGM's absolute option, of all or part of the Scheduled Principal in advance of the final Scheduled Payment Date together with accrued but unpaid Scheduled Interest on such Scheduled Principal to the date of such payment (but excluding any amounts referred to in items (i) to (iv) of the definition of "Guaranteed Amount").

"Acceleration" means, in relation to the Guaranteed Bonds, the giving of notice by the Bond Trustee to the Issuer that the Guaranteed Bonds are immediately due and repayable pursuant to Condition 9 (*Events of Default*), and **"Accelerated"** will be construed accordingly.

"Account" has the meaning set out in Clause 3.4 (*Payments by the Financial Guarantor*).

"Affiliate" has the meaning given to it in the Collateral Deed.

"AGE Proportion" means the proportion of the Financial Guarantees provided by the Financial Guarantor, which proportion is 6 per cent.

"Agent" means The Bank of New York Mellon, acting through its London Branch, as paying agent under the Guaranteed Bonds, and the term Agent shall include any successor to such Agent.

"AGM" has the meaning given to it in the Bond Trust Deed.

"AGM Financial Guarantee" means the financial guarantee dated on or about the date hereof, provided by AGM as financial guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*) thereof.

"AGM Proportion" means the proportion of the Financial Guarantees provided by AGM, which proportion is 94 per cent.

"Avoided Payment" means any amount that is paid, credited, transferred or delivered to or to the order of the Bond Trustee or a Guaranteed Bondholder by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds in respect of any Guaranteed Amount, which amount has been recovered from, or is otherwise required to be returned or repaid by, the Bond Trustee or a Guaranteed Bondholder as a result of Insolvency Proceedings by or against the Issuer.

"Bond Trust Deed" means the bond trust deed dated on or about the date hereof among the Issuer, the Bond Trustee, the Financial Guarantor and AGM, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such bond trust deed with the prior written consent of the Financial Guarantor and AGM.

"Business Day" means any day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in London and New York.

"Collateral Deed" means the collateral deed dated on or about the date hereof between, among others, the Issuer, the Bond Trustee, the Security Trustee, the Financial Guarantor and AGM, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of the Collateral Deed with the prior written consent of the Financial Guarantors.

"Conditions" means the terms and conditions of the Guaranteed Bonds as set out in Schedule 4 (Conditions of the Bonds) of the Bond Trust Deed, and **"Condition"** when used herein means such Condition as set out in Schedule 4 of the Bond Trust Deed and referred to herein.

"Defaulted Amount" means the portion of a Guaranteed Amount that is Due for Payment and unpaid by reason of Nonpayment by the Issuer, including any portion of any Guaranteed Amount that has become an Avoided Payment.

"Due for Payment" means, with respect to:

(i) Scheduled Interest on a Scheduled Payment Date, the amount of Scheduled Interest that is due and payable by the Issuer on such Scheduled Payment Date; and

(ii) Scheduled Principal on a Scheduled Payment Date, the amount of Scheduled Principal that is due and payable by the Issuer on such Scheduled Payment Date,

in each case as each such Scheduled Payment Date occurs or would have occurred in accordance with the original terms of the Guaranteed Bonds and without regard to any prepayment, Acceleration or mandatory or optional redemption of the Guaranteed Bonds or any subsequent amendment or modification of the Guaranteed Bonds that has not been consented to in writing by the Financial Guarantor and AGM in accordance with the provisions of the Bond Trust Deed. For the avoidance of doubt, "Due for Payment" does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the Guaranteed Bonds, by reason of prepayment, Acceleration, mandatory or optional redemption or otherwise.

"Financial Guarantee" means this Financial Guarantee No. 80172 - U, without regard to any amendment, modification or supplement hereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*).

"Financial Guarantees" means this Financial Guarantee and the AGM Financial Guarantee.

"Financial Guarantee Fee" has the meaning given to it in the Financial Guarantee Fee Letter.

"Financial Guarantee Fee Letter" means the fee letter dated as of the date of this Financial Guarantee between the Financial Guarantor and the Obligors, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such fee letter with the prior written consent of the Financial Guarantor.

"Financial Guarantor Default" has the meaning given to it in the Security Trust and Intercreditor Deed.

"Fiscal Agent" has the meaning assigned thereto in Clause 9 (*Fiscal Agent*).

"Force Majeure Event" means any unforeseeable event outside the control of the Financial Guarantor that renders the Financial Guarantor's performance under this Financial Guarantee impossible (and not merely impracticable or more onerous).

"Guaranteed Amount" means, with respect to a Scheduled Payment Date:

(a) an amount equal to Scheduled Interest Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date; plus

(b) an amount equal to the Scheduled Principal Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date.

but excluding in each case any amounts due in respect of the Guaranteed Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Guaranteed Bonds; or

(v) in respect of which the Financial Guarantor or AGM has made an Accelerated Payment on or prior to such Scheduled Payment Date.

"Guaranteed Bondholder" means a holder of Guaranteed Bonds.

"Guaranteed Bonds" means the £73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 2037 constituted by the Bond Trust Deed, but excluding any such bonds that are held by or for the account of an Obligor or any Affiliate of an Obligor or Shareholder of an Obligor.

"HoldCo" means S4B (Holdings) Limited, a company incorporated under the laws of England and Wales with registered number 08493057.

"Insolvency Proceedings" means the commencement after the date hereof of any bankruptcy, insolvency or similar proceedings by or against the Issuer, or the commencement after the date hereof of any proceedings by or against the Issuer for the winding up or the liquidation of its affairs, or the consent after the date hereof to the appointment of a trustee-in-bankruptcy, conservator, administrator, receiver or liquidator in any bankruptcy, insolvency or similar proceedings relating to the Issuer.

"Issuer" means S4B (Issuer) plc, a public limited company incorporated with limited liability in England and Wales with registered number 08528504.

"Moody's" means Moody's Investors Service, Inc.

"Nonpayment by the Issuer" means, with respect to a Guaranteed Amount at a time when such Guaranteed Amount is Due for Payment, that the funds, if any, remitted to any Agent or the Bond Trustee under the terms of the Guaranteed Bonds or the Bond Trust Deed for payment to Guaranteed Bondholders are insufficient for payment in full of such Guaranteed Amount. In addition to and without limiting the foregoing, "Nonpayment by the Issuer" applies to any portion of any Guaranteed Amount that has become an Avoided Payment.

"Notice of Demand" means a notice of demand in the form of the Annex hereto.

"Obligors" means the Issuer, ProjectCo and HoldCo and Obligor means any of them.

"Order" means a final, non-appealable order of a court or other body exercising jurisdiction in an Insolvency Proceeding by or against the Issuer, to the effect that the Bond Trustee, any Agent or any Guaranteed Bondholder is required to return or repay all or any portion of an Avoided Payment.

"ProjectCo" means S4B Limited, a company incorporated under the laws of England and Wales with registered number 08493217.

"Rating Agencies" means Moody's and S&P and such rating agencies as may be substituted for either such rating agency from time to time in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and AGM.

"Receipt" and **"Received"** shall mean actual delivery to the Financial Guarantor prior to 12:00 noon, London time, on a Business Day; provided, however, that delivery either on a day that is not a Business Day, or after 12:00 noon, London time, on a Business Day, shall be deemed to be **"Received"** on the next succeeding Business Day. For purposes of this definition, **"actual delivery"** to the Financial Guarantor shall mean (i) the delivery of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*), or (ii) fax transmission of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's fax number for notices in accordance with Clause 11 (*Notices*). If presentation is made by fax transmission, the Bond Trustee (a) shall promptly confirm transmission by telephone to the Financial Guarantor at its telephone number referred to in Clause 11 (*Notices*), and (b) as soon as is reasonably practicable, shall deliver the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*). If any Notice of Demand, notice or other documentation actually delivered (or attempted to be delivered) under the Financial Guarantee by the Bond Trustee is not in proper form or is not properly completed, executed or delivered, **"Receipt"** by the Financial Guarantor shall be deemed not to have occurred, and the Financial Guarantor shall promptly so advise the Bond Trustee of such deficiency and the nature of the deficiency. In such case, the Bond Trustee may submit an amended or corrected Notice of Demand, notice or other documentation, as the case may be, to the Financial Guarantor.

"Recovery" has the meaning set out in Clause 3.2 (*Payments by the Financial Guarantor*).

"S&P" means Standard and Poor's Ratings Services.

"Scheduled Interest" means, in respect of a Scheduled Payment Date, the amount of scheduled interest on the Guaranteed Bonds then payable in accordance with the original terms of the relevant Conditions, (i) without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and (ii) after giving effect to each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement in accordance with Condition 14 (*Exercise and Enforcement*).

"Scheduled Payment Date" has the meaning given to it in the Conditions.

"Scheduled Principal" means, in respect of a Scheduled Payment Date, the amount of scheduled principal payable on the Guaranteed Bonds on such Scheduled Payment Date in accordance with Condition 7(a) (*Scheduled Payments*), in accordance with the original terms of the Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor, as reduced by each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement in accordance with Condition 14 (*Exercise and Enforcement*).

"Security Trust and Intercreditor Deed" means the security trust and intercreditor deed dated on or about the date hereof, between amongst others, the Obligors, the Financial Guarantor, AGM, the Security Trustee and the Bond Trustee, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such security trust and intercreditor deed with the prior written consent of the Financial Guarantor and AGM.

"Shareholder" has the meaning given to it in the Collateral Deed.

"Term of the Financial Guarantee" means the period from and including the date hereof to and including the earlier of:

(A) the termination of the Financial Guarantee in accordance with Condition 2(b) (*Financial Guarantees*); and

(B) the last to occur of the following:

(i) the date on which all Guaranteed Amounts have been paid under the Guaranteed Bonds;

(ii) the date on which any period during which any Guaranteed Amount could have become, in whole or in part, an Avoided Payment has expired; and

if the Issuer becomes subject to any Insolvency Proceedings before the occurrence of (i) and (ii) above, the later of (a) the date of the conclusion or dismissal of the Insolvency Proceedings without continuing jurisdiction by the court in such Insolvency Proceedings and (b) if the Bond Trustee or any Guaranteed Bondholder is required to return any payment (or portion thereof) in respect of a Guaranteed Amount that is avoided as a result of such Insolvency Proceedings, the date on which the Financial Guarantor has made all payments required to be made under this Financial Guarantee to or to the order of the Bond Trustee in respect of all such Avoided Payments.

1.2 **Construction**

In this Financial Guarantee, a reference to:

1.2.1 a statutory provision includes a reference to the statutory provision as modified or re-enacted or both from time to time whether before or after the date of this Financial Guarantee and any subordinate legislation made or other thing done under the statutory provision whether before or after the date of this Financial Guarantee;

1.2.2 the singular includes the plural and vice versa (unless the context otherwise requires);

1.2.3 a time of day is a reference to the time in London, unless a contrary indication appears;

1.2.4 each reference to "Clause" or to "Annex", unless the context otherwise requires, is a reference to a clause of or an annex to this Financial Guarantee;

1.2.5 a **"Person"** includes any individual, company, corporation, unincorporated association or body (including a partnership, trust, joint venture or consortium), government, state, agency, organisation or other entity whether or not having separate legal personality; and

1.2.6 a provision of law is a reference to that provision as extended, applied, amended or re-enacted and includes any subordinate legislation.

1.3 **Headings**

The headings in this Financial Guarantee do not affect its construction or interpretation.

2. **Guarantee**

2.1 In consideration of the payment by the Issuer of the Financial Guarantee Fee and subject to the terms of this Financial Guarantee, the Financial Guarantor unconditionally and irrevocably guarantees to the Bond Trustee during the Term of the Financial Guarantee the full and complete payment of the AGE Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Nonpayment by the Issuer; and

(b) Avoided Payments,

provided that any payment by AGM under the AGM Financial Guarantee in respect of the AGE Proportion of any Defaulted Amount shall constitute a discharge of the Financial Guarantor's obligation to make such payment to the Bond Trustee.

2.2 This Financial Guarantee does not guarantee any prepayment or other accelerated payment which at any time may become due in respect of any Guaranteed Amount, other than at the sole option of the Financial Guarantor as specified in Clause 4 (*Acceleration*) of this Financial Guarantee, nor against any risk other than Nonpayment by the Issuer, including failure of the Bond Trustee or any Agent to make any payment due to the Guaranteed Bondholders or any diminution in the market or fair value of the Guaranteed Bonds.

3. **Payments by the Financial Guarantor**

3.1 Following Receipt by the Financial Guarantor of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) from the Bond Trustee for any Defaulted Amount, the Financial Guarantor will, subject to Clause 7.5, pay the AGE Proportion of the Defaulted Amount to the Bond Trustee, by no later than 10:00 a.m., London time, on the later of:

(a) the date such Defaulted Amount becomes Due for Payment; and

(b) the fourth Business Day following the day on which the Financial Guarantor Received such Notice of Demand.

3.2 In the event that any amount shall be received by the Bond Trustee or the Bond Trustee has actual notice that any Guaranteed Bondholder has received any amount in respect of a Defaulted Amount forming the basis of a claim specified in a Notice of Demand submitted hereunder, which amount had not been received by the Bond Trustee, or which the Bond Trustee did not have actual notice had been received by a Guaranteed Bondholder when the Notice of Demand was prepared but which is received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder prior to the receipt of payment from the Financial Guarantor as contemplated by this Financial Guarantee (each such amount, a **"Recovery"**), the Bond Trustee shall promptly so notify the Financial Guarantor (which notice shall include the amount of any such Recovery). The fact that a

Recovery has been received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder shall be deemed to be incorporated in the applicable Notice of Demand as of the date such Notice of Demand was originally prepared, without the need for any further action by any Person, and the Financial Guarantor shall pay the amount of the claim against the Financial Guarantor specified in paragraph (ii) of the Notice of Demand less the sum of the AGE Proportion of all such Recoveries.

3.3 The Financial Guarantor shall be entitled to elect, in its absolute discretion, to pay part or all of any Defaulted Amount to any such bank account as is specified by the Bond Trustee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand therefor. Any such payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If requested by the Financial Guarantor, the Bond Trustee shall promptly deliver to the Financial Guarantor a properly completed and executed Notice of Demand in respect of any such payment made or to be made by the Financial Guarantor.

3.4 Payments due hereunder in respect of Guaranteed Amounts will be disbursed to or to the order of the Bond Trustee and credited (in immediately available funds) to the bank account (the **"Account"**) specified by the Bond Trustee in the applicable Notice of Demand or pursuant to Clause 3.3 or Clause 4.2. Payment in full to the Account shall discharge the obligations of the Financial Guarantor under this Financial Guarantee to the extent of such payment, whether or not such payment is properly applied by or on behalf of the Bond Trustee or any Agent.

3.5 Once payment by or on behalf of the Financial Guarantor of an amount in respect of any Guaranteed Amount (whether on a Scheduled Payment Date or on an accelerated basis pursuant to Clause 4.2) has been made to the Account, the Financial Guarantor shall have no further obligations under this Financial Guarantee in respect of such Guaranteed Amount to the extent of such payment.

4. **Acceleration**

4.1 At any time or from time to time following Acceleration, the Financial Guarantor may decide, in its absolute discretion, to make an Accelerated Payment under this Financial Guarantee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand.

4.2 The Financial Guarantor shall notify the Bond Trustee in writing of its intention to make any Accelerated Payment and the proposed date of such payment, no later than two Business Days prior to such proposed date of payment. Any such Accelerated Payment shall be considered a payment, by the Financial Guarantor under this Financial Guarantee for all purposes. If so requested by the Financial Guarantor at the time the Financial Guarantor gives such written notice, the Bond Trustee shall deliver to the Financial Guarantor and AGM a corresponding Notice of Demand.

5. **Withholding Tax**

All payments by the Financial Guarantor to or to the order of the Bond Trustee under this Financial Guarantee shall be made without withholding or deduction for, or on account of, any taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state, or any political subdivision or governmental or taxing authority therein or thereof unless such withholding or deduction is required by law. If any withholding or deduction is so required by law, the Financial Guarantor shall pay such amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. The Financial Guarantor shall not be obliged to pay any amount to or to the order of the Bond Trustee in respect of the amount of such withholding or deduction.

6. **Subrogation**

6.1 The Financial Guarantor will be fully, immediately and automatically subrogated to the Guaranteed Bondholders' and the Bond Trustee's rights to payment of any Guaranteed Amounts, and to any rights relating thereto, to the fullest extent permitted by applicable law to the extent and at the time of any payments made by or on behalf of the Financial Guarantor under this Financial Guarantee, including, for the avoidance of doubt, any Accelerated Payment.

6.2 Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee or any Guaranteed Bondholder in respect of any Guaranteed Amount forming the basis of a claim hereunder (and a corresponding claim under this Financial Guarantee and/or the AGM Financial Guarantee, which claims shall have been paid in full by the Financial Guarantor and AGM respectively) shall be received and held on trust by the recipient for the benefit of the Financial Guarantor and AGM and shall be paid by the recipient over to the Financial Guarantor and AGM pro rata in proportion to the respective amounts paid (i) by the Financial Guarantor in respect of a claim made pursuant to this Financial Guarantee, and (ii) by AGM in respect of the related claim made pursuant to the AGM Financial Guarantee.

7. **Waiver of Defences**

7.1 The obligations of the Financial Guarantor under this Financial Guarantee will continue and will not be terminable other than in accordance with Clause 12 (*Termination and Amendment)* of this Financial Guarantee notwithstanding failure to receive payment of the Financial Guarantee Fee or any other amount due in respect of this Financial Guarantee. The Financial Guarantee Fee is not refundable for any reason.

7.2 The Financial Guarantor acknowledges that there is no duty of disclosure by the Bond Trustee under this Financial Guarantee but nonetheless, to the fullest extent permitted by applicable law, hereby waives for the benefit of the Bond Trustee and the Guaranteed Bondholders and agrees not to assert any and all rights (whether by counterclaim, rescission, set-off or otherwise) and any and all equities and defences howsoever arising (including, without limitation, any right, equity or defence based on: (a) any right to require the Bond Trustee or any Guaranteed Bondholder first to proceed against or to enforce any other rights or security against, or to claim payment from, any Person before the Bond Trustee may claim from the Financial Guarantor under this Financial Guarantee; (b) fraud on the part of any Person (including fraud on the part of any agent for the Bond Trustee, but excluding fraud by the Bond Trustee itself); (c) misrepresentation, breach of warranty or non-disclosure of information by any Person; (d) any lack of validity or enforceability of the Guaranteed Bonds or the Bond Trust Deed; (e) any modification or any amendment to the Guaranteed Bonds or the Bond Trust Deed; (f) the granting of any time, indulgence or concession by any Person to the Issuer; (g) any insolvency or similar proceedings in respect of the Issuer or any other Person; (h) any lack of capacity, power or authority or any change in status of the Issuer or any other Person; or (i) the refusal or failure to take up, to hold, to perfect or to enforce by any Person any rights under or in connection with any guarantee, indemnity, security or other document) to the extent such rights, equities and defences may be available to the Financial Guarantor to avoid payment of its obligations under this Financial Guarantee in accordance with the express provisions hereof.

7.3 No warranties are given and nothing in this Financial Guarantee is intended to constitute a warranty or a condition precedent to payment under the Financial Guarantee other than Receipt of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) of this Financial Guarantee.

7.4 Nothing in this Financial Guarantee shall be construed in any way to limit or otherwise affect the Financial Guarantor's right to pursue recovery or claims (based on contractual or other rights, including to the extent applicable such rights resulting from any Person's fraud, negligence or breach of any agreement to which it is a party) for reimbursement against any Persons for any liabilities, losses, damages, costs and expenses incurred by the Financial Guarantor or to exercise at any time any other remedies that may be available to the Financial Guarantor at law or in equity.

7.5 Nothing in this Financial Guarantee shall be construed to require payment by the Financial Guarantor so long as a Force Majeure Event is continuing, in which event the Financial Guarantor agrees to perform its obligations under this Financial Guarantee promptly following cessation of such Force Majeure Event.

8. **Notice of Demand**

8.1 Subject to Clauses 2.2, 3.3 and 4 of this Financial Guarantee, payments of Guaranteed Amounts (including Avoided Payments) will only be made after presentation of a properly completed Notice of Demand signed by the Bond Trustee and Received by the Financial Guarantor.

8.2 Notices of Demand can only be given by the Bond Trustee in the manner set out in Clause 11 (*Notices*).

8.3 Without limitation to the Financial Guarantor's obligations under Clause 8.5, if any Notice of Demand is not in the proper form or is not properly completed, executed or delivered, the Financial Guarantor will not be deemed to have Received such Notice of Demand.

8.4 Any Notice of Demand in respect of an Avoided Payment will not be deemed properly completed unless it is accompanied by:

8.4.1 a copy of the Order; and

8.4.2 a certificate of the Bond Trustee that the Order has been entered and that, on the basis of legal advice received by the Bond Trustee, the Order is not subject to any stay and specifying (to the extent that the Bond Trustee has actual knowledge sufficient to do so) the Guaranteed Amounts that are Avoided Payments.

8.5 The Financial Guarantor will promptly advise the Bond Trustee if a Notice of Demand is not in the proper form or has not been properly completed, executed or delivered and the Bond Trustee may submit an amended Notice of Demand to the Financial Guarantor.

9. **Fiscal Agent**

9.1 At any time during the Term of the Financial Guarantee, the Financial Guarantor may appoint a fiscal agent (the **"Fiscal Agent"**) for purposes of this Financial Guarantee by written notice to the Bond Trustee, specifying the name and notice address of such Fiscal Agent. From and after the date of receipt of such notice by the Bond Trustee:

9.1.1 copies of all notices (including Notices of Demand) and other documents required to be delivered to the Financial Guarantor pursuant to this Financial Guarantee shall be simultaneously delivered to the Fiscal Agent and to the Financial Guarantor; and

9.1.2 all payments required to be made by the Financial Guarantor under this Financial Guarantee may be made directly by the Financial Guarantor or by the Fiscal Agent on behalf of the Financial Guarantor.

9.2 The Fiscal Agent is the agent of the Financial Guarantor only, and the Fiscal Agent shall in no event be liable to the Bond Trustee for any acts of the Fiscal Agent or any failure of the Financial Guarantor to deposit, or cause to be deposited, sufficient funds to make payments due under this Financial Guarantee.

10. **Transfer**

10.1 The rights and obligations of the Financial Guarantor under this Financial Guarantee may be assigned or transferred to, or assumed by, any affiliate of the Financial Guarantor provided that:

10.1.1 no Financial Guarantor Default has occurred and is continuing at the time of such assignment, transfer or assumption or would occur as a result of such assignment, transfer or assumption;

10.1.2 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations delivers to the Bond Trustee written confirmation from the Rating Agencies that, at the time of and immediately following any such assignment, transfer or assumption, the financial strength or claims paying ability of such affiliate will be rated at least equal to the financial strength or claims paying ability of the Financial Guarantor at that time; and

10.1.3 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations thereafter delivers to the Bond Trustee written notice of any such assignment, transfer or assumption.

10.2 The Bond Trustee may not transfer, assign, sub-participate, declare a trust over or otherwise dispose (other than in favour of the Guaranteed Bondholders) of any of its rights under this Financial Guarantee except to a Person as to whom the Financial Guarantor has given its prior written consent. However, if the Bond Trustee transfers or assigns its rights and obligations under the Bond Trust Deed to a new or additional trustee which has been appointed in accordance with the Bond Trust Deed, no such consent shall be required and such new or additional trustee will be able to enforce this Financial Guarantee and references in this Financial Guarantee to "Bond Trustee" shall be construed as including such new trustee or such additional trustee, as applicable.

11. **Notices**

11.1 All notices given under this Financial Guarantee shall be in writing (except as otherwise specifically provided herein) and shall be mailed by registered mail or personally delivered or faxed as follows:

To the Financial Guarantor:

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Re: Brunswick Social Housing PFI, Financial Guarantee No. 80172 - U
Telephone: +44 20 7562 1900
Fax: +44 20 7562 1901

with a copy to the General Counsel at the above address and fax number. Each Notice of Demand shall be marked to indicate "URGENT MATERIAL ENCLOSED".

To the Bond Trustee:

BNY Mellon Corporate Trustee Services Limited
1 Canada Square
London
E14 5AL

Attention: Trustee Administration Manager/Brunswick Transaction
Telephone: +44 20 7163 7748
Fax: +44 20 7964 2509

If presentation to the Bond Trustee is made by fax transmission, the Financial Guarantor (a) shall promptly confirm transmission by telephone to the Bond Trustee at its telephone number referred to above, and (b) as soon as is reasonably practicable, shall deliver the original notice or other applicable documentation to the Bond Trustee's address for notices in accordance with this Clause 11 (*Notices*).

11.2 The Financial Guarantor or the Bond Trustee may designate an additional or different address, or telephone or fax number, by prior written notice. Each notice, presentation, delivery and communication to the Financial Guarantor or the Bond Trustee shall be effective only upon Receipt by the Financial Guarantor or actual receipt by the Bond Trustee, as the case may be.

12. **Termination and Amendment**

12.1 This Financial Guarantee is not cancellable by the Financial Guarantor for any reason, including, without limitation, the failure of the Financial Guarantor to receive payment of any Financial Guarantee Fee due in respect of this Financial Guarantee.

12.2 This Financial Guarantee and the obligations of the Financial Guarantor hereunder shall terminate upon the expiration of the Term of the Financial Guarantee.

12.3 This Financial Guarantee may not be amended, modified or supplemented without the prior written consent of the Bond Trustee.

13. **Miscellaneous**

No waiver of any rights or powers of the Financial Guarantor or the Bond Trustee, or any consent by either of them, shall be valid unless in writing and signed by an authorised officer or agent of the Financial Guarantor or the Bond Trustee, as applicable. The waiver of any right by the Financial Guarantor or the Bond Trustee, or the failure promptly to exercise any such right, shall not be construed as a waiver of any right to exercise the same or any other right at any time thereafter.

14. **Redenomination**

If the Guaranteed Bonds are redenominated into Euro or any other currency pursuant to Condition 16 (*Redenomination*), payments of Guaranteed Amounts hereunder shall be made in such currency.

15. **Law and Jurisdiction**

15.1 This Financial Guarantee, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

15.2 With respect to any suit, action or proceedings relating to this Financial Guarantee (**"Proceedings"**), the Financial Guarantor irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over such party.

16. **Entire Agreement**

This Financial Guarantee constitutes the entire agreement between the Financial Guarantor and the Bond Trustee in relation to the Financial Guarantor's obligation to make payments to the Bond Trustee for the benefit of the Guaranteed Bondholders in respect of the Guaranteed Amounts which become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer, and supersedes any previous agreement between the Financial Guarantor and the Bond Trustee in relation thereto.

17. **Third Party Rights**

No Person other than the Bond Trustee shall have rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Financial Guarantee but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

18. **Surrender of Financial Guarantee**

The Bond Trustee shall deliver its original engrossment of this Financial Guarantee to the Financial Guarantor upon expiration of the Term of this Financial Guarantee.

In Witness Whereof, this Financial Guarantee has been executed as a deed and delivered on the date inserted above.

EXECUTED as a DEED for and on behalf of
ASSURED GUARANTY (EUROPE) LTD. by:

Authorised signatory

in the presence of:

Witness:

ANNEX

NOTICE OF DEMAND

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Attention:

Chief Surveillance Officer

and

General Counsel

The undersigned, BNY Mellon Corporate Trustee Services Limited as Bond Trustee (the **"Bond Trustee"**), hereby certifies to each of Assured Guaranty (Europe) Ltd. (**"AGE"**) and Assured Guaranty Municipal Corp. (**"AGM"** and, together with AGE, the **"Financial Guarantors"**) with reference to Financial Guarantee No. 80172 - U (the **"AGE Financial Guarantee"**) and Financial Guarantee No. 51916 - N (the **"AGM Financial Guarantee"** and, together with the AGE Financial Guarantee, the **"Financial Guarantees"**) that:

(i) [The Guaranteed Amount[s] that [is/are] due and payable on the Scheduled Payment Date falling on [*insert applicable payment date*] [is/are] [●][*insert applicable amount*]./The Guaranteed Amount[s] that [was/were] paid, credited, transferred or delivered to or to the order of the Bond Trustee or the Guaranteed Bondholders by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds on [*insert applicable payment date*] of [●][*insert applicable amount*] [was/were] recovered from, or was otherwise required to be returned or repaid by, the Bond Trustee or [a/the] Guaranteed Bondholder[s] as a result of Insolvency Proceedings by or against the Issuer on [*insert applicable repayment date*].]

(ii) [The deficiency with respect to the Guaranteed Amount Due for Payment and unpaid by reason of Nonpayment by the Issuer on the Scheduled Payment Date falling on [*insert applicable payment date*] is [●][*insert applicable amount*] (the **"Defaulted Amount"**), the AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]]/[The Bond Trustee has been notified by the Account Bank that the deficiency in respect of the Guaranteed Amount[s] which [is/are] Due for Payment on the Scheduled Payment Date falling on [*insert applicable payment date*] will be [●] [*insert applicable amount*] (the **"Defaulted Amount"**). The AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]].

(iii) The Bond Trustee is making (a) a claim against AGE under the AGE Financial Guarantee for the AGE Proportion of the Defaulted Amount, and (b) a claim against AGM under the AGM Financial Guarantee for the AGM Proportion of the Defaulted Amount, with each such amount to be applied to the payment of the above-described Guaranteed Amount[s].

(iv) To the extent that AGE does not pay the AGE Proportion of any Defaulted Amount when due and payable by AGE in accordance with the terms of the AGE Financial Guarantee, the Bond Trustee is making a claim against AGM under Clause 3.1.2 of the AGM Financial Guarantee for such amount. The Bond Trustee agrees that any payment by AGM of such amount shall discharge AGE from any obligation to make such payment under the AGE Financial Guarantee.

(v) The Bond Trustee agrees that following any payment by the Financial Guarantors made with respect to the Defaulted Amount which is the subject of this Notice of Demand, it (a) will cause such amounts to be applied directly to the payment of the applicable Guaranteed Amount[s] in accordance with Clause 7.9 of the Bond Trust Deed; (b) will ensure that such funds are not applied for any other purpose; and (c) will cause an accurate record of such payment to be maintained with respect to the appropriate Guaranteed Amount(s), the corresponding claim on each Financial Guarantee, and the proceeds of such claim.

(vi) Payments should be made by credit to the following account:

[(*insert details of bank account*)] (the **"Account"**).

Capitalised terms used in this Notice of Demand and not otherwise defined herein shall have the respective meanings ascribed thereto in or pursuant to the applicable Financial Guarantee.

This Notice of Demand may be revoked at any time by written notice of such revocation by the Bond Trustee to each Financial Guarantor, if and only to the extent that moneys are actually received by the Bond Trustee prior to any such revocation from a source other than the Financial Guarantors with respect to the Defaulted Amount set forth herein. The Bond Trustee will withdraw this Notice of Demand, or submit a restated Notice of Demand reducing the amount of the claim hereunder, if the required amount of the Defaulted Amount and accordingly each of the AGE Proportion and the AGM Proportion thereof has been reduced (including reduction to zero) on or prior to the date the Financial Guarantors are required to make payment under the Financial Guarantees.

If the Bond Trustee has received, or the Bond Trustee has actual notice that one or more Guaranteed Bondholders has received, from the Issuer or the Financial Guarantors an amount in excess of a Defaulted Amount, the Bond Trustee shall promptly return to each Financial Guarantor the lesser of (i) such Financial Guarantor's proportionate share in such excess amount (such share being calculated by a fraction equal to the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee divided by the total Defaulted Amount paid by both Financial Guarantors to or to the order of the Bond Trustee) and (ii) the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee and not previously distributed by the Bond Trustee to the Guaranteed Bondholders or to any insolvency official appointed in respect of the Issuer. For the avoidance of doubt the Bond Trustee shall only be required to repay any such amounts to the Financial Guarantors that are in the Bond Trustee's possession and under its control, at the time it becomes aware of the requirement to repay such amounts, and the Bond Trustee shall have no liability to any Person for any amounts received by the Bond Trustee from the Financial Guarantors but distributed by the Bond Trustee in accordance with the preceding sentence.

The Bond Trustee acknowledges that as of the date on which any payment by the relevant Financial Guarantor towards a Defaulted Amount is credited to the Account, the relevant Financial Guarantor shall be deemed fully, immediately and automatically subrogated, to the fullest extent permitted by applicable law, to the rights (including, without limitation, any rights and benefits attached thereto, and any security granted at law, by contract or otherwise) of the Guaranteed Bondholders to payment of the Guaranteed Amounts to the extent and at the time of such payment by the relevant Financial Guarantor towards the Defaulted Amount.

The Bond Trustee hereby (i) assigns to each Financial Guarantor its rights to receive any payment for the account of the Guaranteed Bondholders from the Issuer in respect of the Guaranteed Bonds to the extent of any payments made to (or to the order of) the Bond Trustee by the relevant Financial Guarantor under the applicable Financial Guarantee, including without limitation its right to receive payments of principal and interest on the Guaranteed Bonds (including Recoveries) and (ii) confirms that it has taken or will promptly take all steps reasonably required by, and at the expense of the Financial Guarantors to effect and perfect such assignments to the Financial Guarantors. The foregoing assignments are in addition to, and not in limitation of, rights of subrogation otherwise available to each Financial Guarantor in respect of such payments. Payments to each Financial Guarantor in respect of the foregoing assignment shall in all cases be subject to and subordinate to the rights of the Bond Trustee and the Guaranteed Bondholders to receive all Guaranteed Amounts in respect of the Guaranteed Bonds. The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantors, with any request by either Financial Guarantor for action necessary to preserve or enforce such Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation. The Bond Trustee shall also, at the expense of the Financial Guarantors, deliver any such instruments as may be reasonably requested or required by the Financial Guarantors to effectuate the purpose or provisions of this paragraph.

Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee in respect of any Guaranteed Amount forming the basis of a claim hereunder (which claim shall have been paid in full by the Financial Guarantors) shall be received and held on trust for the benefit of the Financial Guarantors and shall be paid over to each Financial Guarantor pro rata in proportion to the respective amounts each Financial Guarantor paid in respect of the Defaulted Amount.

The Bond Trustee hereby agrees that so long as no Financial Guarantor Default shall have occurred and be continuing, each Financial Guarantor may at any time during the continuation of any Insolvency Proceeding by or against the Issuer under any applicable law direct all matters relating thereto, including without limitation, (a) all matters relating to any claim in connection with an Insolvency Proceeding by or against the Issuer seeking the avoidance as a preferential transfer of any payment made with respect to the Guaranteed Bonds (a **"Preference Claim"**), (b) the direction of any appeal of any order relating to any Preference Claim at the expense of the Financial Guarantors and (c) the posting of any surety or performance bond pending any such appeal.

[Pursuant to Clause 8.4 of the Financial Guarantee, the following documents are attached:

- a copy of the Order; and
- a certificate of the Bond Trustee that the Order has been entered and that, on the basis of legal advice received by the Bond Trustee, the Order is not subject to any stay and specifying (to the extent that the Bond Trustee has actual knowledge sufficient to do so) the Guaranteed Amounts that are Avoided Payments.[*]

[*] To be inserted if demand relates to Avoided Payments.]

This Notice of Demand, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

[With respect to any suit, action or proceedings relating to this Notice of Demand (**"Proceedings"**), the Bond Trustee irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over it.][1]

No Person, other than each Financial Guarantor, shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Notice of Demand but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

In Witness Whereof, the undersigned has executed and delivered this Notice of Demand as a deed on the [●] day of [●] of 2[●].

[1] For use when Bond Trustee is not incorporated in England and Wales.

EXECUTED as a DEED for and on behalf of
BNY MELLON CORPORATE TRUSTEE SERVICES LIMITED acting by two of its lawful Attorneys:

Attorney

Attorney

in the presence of:

Witness name:

Signature:

For the Financial Guarantor or
Fiscal Agent Use Only
Wire transfer sent on By:
Confirmation Number:

FORM OF AGM FINANCIAL GUARANTEE

Dated [●] 2013

ASSURED GUARANTY (EUROPE) LTD.

FINANCIAL GUARANTEE No. 51916 - N

in respect of

£73,525,000 4.926 per cent Fixed Rate

Guaranteed Secured Bonds due 2037

This Financial Guarantee is dated [●] 2013 and given by Assured Guaranty Municipal Corp. with its principal place of business at 31 W. 52nd Street, New York, NY 10019 (the **"Financial Guarantor"**) in favour of BNY Mellon Corporate Trustee Services Limited as trustee for the holders of the Guaranteed Bonds (as defined below) (the **"Bond Trustee"**, which expression shall, whenever the context admits, include such Persons for the time being the trustee or trustees of the Bond Trust Deed for the Guaranteed Bondholders).

1. **Interpretation**

1.1 **Definitions**

Any capitalised terms used in this Financial Guarantee and not otherwise defined shall have the meaning given to such terms in the Bond Trust Deed or the Collateral Deed (each as defined below) unless the context otherwise requires. In the event of any inconsistency between the provisions of this Financial Guarantee and the provisions of the Bond Trust Deed and/or the Collateral Deed, this Financial Guarantee shall prevail. For the purposes of this Financial Guarantee, the following terms will have the following meanings:

"Accelerated Payment" means, following an Acceleration, any payment in full or in part by the Financial Guarantor or AGE, at the Financial Guarantor's or AGE's absolute option, of all or part of the Scheduled Principal in advance of the final Scheduled Payment Date together with accrued but unpaid Scheduled Interest on such Scheduled Principal to the date of such payment (but excluding any amounts referred to in items (i) to (iv) of the definition of "Guaranteed Amount").

"Acceleration" means, in relation to the Guaranteed Bonds, the giving of notice by the Bond Trustee to the Issuer that the Guaranteed Bonds are immediately due and repayable pursuant to Condition 9 (*Events of Default*), and **"Accelerated"** will be construed accordingly.

"Account" has the meaning set out in Clause 3.4 (*Payments by the Financial Guarantor*).

"Affiliate" has the meaning given to it in the Collateral Deed.

"AGE" has the meaning given to it in the Bond Trust Deed.

"AGE Financial Guarantee" means the financial guarantee dated on or about the date hereof, provided by AGE as financial guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*) thereof.

"AGE Proportion" means the proportion of the Financial Guarantees provided by AGE, which proportion is 6 per cent.

"Agent" means The Bank of New York Mellon, acting through its London Branch, as paying agent under the Guaranteed Bonds, and the term Agent shall include any successor to such Agent.

"AGM Proportion" means the proportion of the Financial Guarantees provided by the Financial Guarantor, which proportion is 94 per cent.

"Avoided Payment" means any amount that is paid, credited, transferred or delivered to or to the order of the Bond Trustee or a Guaranteed Bondholder by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds in respect of any Guaranteed Amount, which amount has been recovered from, or is otherwise required to be returned or repaid by, the Bond Trustee or a Guaranteed Bondholder as a result of Insolvency Proceedings by or against the Issuer.

"Bond Trust Deed" means the bond trust deed dated on or about the date hereof among the Issuer, the Bond Trustee, the Financial Guarantor and AGE, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such bond trust deed with the prior written consent of the Financial Guarantor and AGE.

"Business Day" means any day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in London and New York.

"Collateral Deed" means the collateral deed dated on or about the date hereof between, among others, the Issuer, the Bond Trustee, the Security Trustee, the Financial Guarantor and AGE, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of the Collateral Deed with the prior written consent of the Financial Guarantors.

"Conditions" means the terms and conditions of the Guaranteed Bonds as set out in Schedule 4 (Conditions of the Bonds) of the Bond Trust Deed, and **"Condition"** when used herein means such Condition as set out in Schedule 4 of the Bond Trust Deed and referred to herein.

"Defaulted Amount" means the portion of a Guaranteed Amount that is Due for Payment and unpaid by reason of Nonpayment by the Issuer, including any portion of any Guaranteed Amount that has become an Avoided Payment.

"Due for Payment" means, with respect to:

(i) Scheduled Interest on a Scheduled Payment Date, the amount of Scheduled Interest that is due and payable by the Issuer on such Scheduled Payment Date; and

(ii) Scheduled Principal on a Scheduled Payment Date, the amount of Scheduled Principal that is due and payable by the Issuer on such Scheduled Payment Date,

in each case as each such Scheduled Payment Date occurs or would have occurred in accordance with the original terms of the Guaranteed Bonds and without regard to any prepayment, Acceleration or mandatory or optional redemption of the Guaranteed Bonds or any subsequent amendment or modification of the Guaranteed Bonds that has not been consented to in writing by the Financial Guarantor and AGE in accordance with the provisions of the Bond Trust Deed. For the avoidance of doubt, "Due for Payment" does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the Guaranteed Bonds, by reason of prepayment, Acceleration, mandatory or optional redemption or otherwise.

"Financial Guarantee" means this Financial Guarantee No. 51916 - N, without regard to any amendment, modification or supplement hereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*).

"Financial Guarantees" means this Financial Guarantee and the AGE Financial Guarantee.

"Financial Guarantee Fee" has the meaning given to it in the Financial Guarantee Fee Letter.

"Financial Guarantee Fee Letter" means the fee letter dated as of the date of this Financial Guarantee between the Financial Guarantor and the Obligors, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such fee letter with the prior written consent of the Financial Guarantor.

"Financial Guarantor Default" has the meaning given to it in the Security Trust and Intercreditor Deed.

"Fiscal Agent" has the meaning assigned thereto in Clause 9 (*Fiscal Agent*).

"Force Majeure Event" means any unforeseeable event outside the control of the Financial Guarantor that renders the Financial Guarantor's performance under this Financial Guarantee impossible (and not merely impracticable or more onerous).

"Guaranteed Amount" means, with respect to a Scheduled Payment Date:

(a) an amount equal to Scheduled Interest Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date; plus

(b) an amount equal to the Scheduled Principal Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date.

but excluding in each case any amounts due in respect of the Guaranteed Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, duties, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, duties, withholding, deduction, assessment or other charge) of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state (including the United Kingdom), or any political subdivision or governmental or taxing authority therein or thereof;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Guaranteed Bonds; or

(v) in respect of which the Financial Guarantor or AGE has made an Accelerated Payment on or prior to such Scheduled Payment Date.

"Guaranteed Bondholder" means a holder of Guaranteed Bonds.

"Guaranteed Bonds" means the £73,525,000 4.926 per cent Fixed Rate Guaranteed Secured Bonds due 2037 constituted by the Bond Trust Deed, but excluding any such bonds that are held by or for the account of an Obligor or any Affiliate of an Obligor or Shareholder of an Obligor.

"HoldCo" means S4B (Holdings) Limited, a company incorporated under the laws of England and Wales with registered number 08493057.

"Insolvency Proceedings" means the commencement after the date hereof of any bankruptcy, insolvency or similar proceedings by or against the Issuer, or the commencement after the date hereof of any proceedings by or against the Issuer for the winding up or the liquidation of its affairs, or the consent after the date hereof to the appointment of a trustee-in-bankruptcy, conservator, administrator, receiver or liquidator in any bankruptcy, insolvency or similar proceedings relating to the Issuer.

"Issuer" means S4B (Issuer) plc, a public limited company incorporated with limited liability in England and Wales with registered number 08528504.

"Moody's" means Moody's Investors Service, Inc.

"Nonpayment by the Issuer" means, with respect to a Guaranteed Amount at a time when such Guaranteed Amount is Due for Payment, that the funds, if any, remitted to any Agent or the Bond Trustee under the terms of the Guaranteed Bonds or the Bond Trust Deed for payment to Guaranteed Bondholders are insufficient for payment in full of such Guaranteed Amount. In addition to and without limiting the foregoing, "Nonpayment by the Issuer" applies to any portion of any Guaranteed Amount that has become an Avoided Payment.

"Notice of Demand" means a notice of demand in the form of the Annex hereto.

"Obligors" means the Issuer, ProjectCo and HoldCo and Obligor means any of them.

"Order" means a final, non-appealable order of a court or other body exercising jurisdiction in an Insolvency Proceeding by or against the Issuer, to the effect that the Bond Trustee, any Agent or any Guaranteed Bondholder is required to return or repay all or any portion of an Avoided Payment.

"ProjectCo" means S4B Limited, a company incorporated under the laws of England and Wales with registered number 08493217.

"Rating Agencies" means Moody's and S&P and such rating agencies as may be substituted for either such rating agency from time to time in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and AGE.

"Receipt" and **"Received"** shall mean actual delivery to the Financial Guarantor prior to 12:00 noon, London time, on a Business Day; provided, however, that delivery either on a day that is not a Business Day, or after 12:00 noon, London time, on a Business Day, shall be deemed to be **"Received"** on the next succeeding Business Day. For purposes of this definition, **"actual delivery"** to the Financial Guarantor shall mean (i) the delivery of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*), or (ii) fax transmission of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's fax number for notices in accordance with Clause 11 (*Notices*). If presentation is made by fax transmission, the Bond Trustee (a) shall promptly confirm transmission by telephone to the Financial Guarantor at its telephone number referred to in Clause 11 (*Notices*), and (b) as soon as is reasonably practicable, shall deliver the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*). If any Notice of Demand, notice or other documentation actually delivered (or attempted to be delivered) under the Financial Guarantee by the Bond Trustee is not in proper form or is not properly completed, executed or delivered, **"Receipt"** by the Financial Guarantor shall be deemed not to have occurred, and the Financial Guarantor shall promptly so advise the Bond Trustee of such deficiency and the nature of the deficiency. In such case, the Bond Trustee may submit an amended or corrected Notice of Demand, notice or other documentation, as the case may be, to the Financial Guarantor.

"Recovery" has the meaning set out in Clause 3.2 (*Payments by the Financial Guarantor*).

"S&P" means Standard and Poor's Ratings Services.

"Scheduled Interest" means, in respect of a Scheduled Payment Date, the amount of scheduled interest on the Guaranteed Bonds then payable in accordance with the original terms of the relevant Conditions, (i) without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and (ii) after giving effect to each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement in accordance with Condition 14 (*Exercise and Enforcement*).

"Scheduled Payment Date" has the meaning given to it in the Conditions.

"Scheduled Principal" means, in respect of a Scheduled Payment Date, the amount of scheduled principal payable on the Guaranteed Bonds on such Scheduled Payment Date in accordance with Condition 7(a) (*Scheduled Payments*], in accordance with the original terms of the Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor, as reduced by each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement in accordance with Condition 14 (*Exercise and Enforcement*).

"Security Trust and Intercreditor Deed" means the security trust and intercreditor deed dated on or about the date hereof, between amongst others, the Obligors, the Financial Guarantor, AGE, the Security Trustee and the Bond Trustee, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such security trust and intercreditor deed with the prior written consent of the Financial Guarantor and AGE.

"Shareholder" has the meaning given to it in the Collateral Deed.

"Term of the Financial Guarantee" means the period from and including the date hereof to and including the earlier of:

(A) the termination of the Financial Guarantee in accordance with Condition 2(b) (*Financial Guarantees*); and

(B) the last to occur of the following:

(i) the date on which all Guaranteed Amounts have been paid under the Guaranteed Bonds;

(ii) the date on which any period during which any Guaranteed Amount could have become, in whole or in part, an Avoided Payment has expired; and

(iii) if the Issuer becomes subject to any Insolvency Proceedings before the occurrence of (i) and (ii) above, the later of (a) the date of the conclusion or dismissal of the Insolvency Proceedings without continuing jurisdiction by the court in such Insolvency Proceedings and (b) if the Bond Trustee or any Guaranteed Bondholder is required to return any payment (or portion thereof) in respect of a Guaranteed Amount that is avoided as a result of such Insolvency Proceedings, the date on which the Financial Guarantor has made all payments required to be made under this Financial Guarantee to or to the order of the Bond Trustee in respect of all such Avoided Payments.

1.2 **Construction**

In this Financial Guarantee, a reference to:

1.2.1 a statutory provision includes a reference to the statutory provision as modified or re-enacted or both from time to time whether before or after the date of this Financial Guarantee and any subordinate legislation made or other thing done under the statutory provision whether before or after the date of this Financial Guarantee;

1.2.2 the singular includes the plural and vice versa (unless the context otherwise requires);

1.2.3 a time of day is a reference to the time in London, unless a contrary indication appears;

1.2.4 each reference to "Clause" or to "Annex", unless the context otherwise requires, is a reference to a clause of or an annex to this Financial Guarantee;

1.2.5 a **"Person"** includes any individual, company, corporation, unincorporated association or body (including a partnership, trust, joint venture or consortium), government, state, agency, organisation or other entity whether or not having separate legal personality; and

1.2.6 a provision of law is a reference to that provision as extended, applied, amended or re-enacted and includes any subordinate legislation.

1.3 **Headings**

The headings in this Financial Guarantee do not affect its construction or interpretation.

2. **Guarantee**

2.1 In consideration of the payment by the Issuer of the Financial Guarantee Fee and subject to the terms of this Financial Guarantee, the Financial Guarantor unconditionally and irrevocably guarantees to the Bond Trustee during the Term of the Financial Guarantee the full and complete payment of:

2.1.1 the AGM Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Nonpayment by the Issuer; and

(b) Avoided Payments; and

2.1.2 the AGE Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Nonpayment by the Issuer to the extent that AGE has not paid such amounts when due and payable by AGE under the terms of the AGE Financial Guarantee; and

(b) Avoided Payments to the extent that AGE has not paid such amounts when due and payable by AGE under the terms of the AGE Financial Guarantee.

Any payment by the Financial Guarantor under Clause 2.1.2 shall constitute a discharge of AGE's obligation to make such payment under the AGE Financial Guarantee.

2.2 This Financial Guarantee does not guarantee any prepayment or other accelerated payment which at any time may become due in respect of any Guaranteed Amount, other than at the sole option of the Financial Guarantor as specified in Clause 4 (*Acceleration*) of this Financial Guarantee, nor against any risk other than Nonpayment by the Issuer, including failure of the Bond Trustee or any Agent to make any payment due to the Guaranteed Bondholders or any diminution in the market or fair value of the Guaranteed Bonds.

3. **Payments by the Financial Guarantor**

3.1 Following Receipt by the Financial Guarantor of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) from the Bond Trustee for any Defaulted Amount, the Financial Guarantor will, subject to Clause 7.5, pay:

3.1.1 the AGM Proportion of the Defaulted Amount to the Bond Trustee, by no later than 10:00 a.m., London time, on the later of:

(a) the date such Defaulted Amount becomes Due for Payment; and

(b) the fourth Business Day following the day on which the Financial Guarantor Received such Notice of Demand, and

3.1.2 if (i) the Bond Trustee has made a claim against AGE under the AGE Financial Guarantee by delivering a Notice of Demand that has been Received (as defined in the AGE Financial Guarantee) by AGE, (ii) such claim has not been paid by AGE in accordance with the terms of the AGE Financial Guarantee, (iii) the AGE Financial Guarantee has not been terminated and (iv) the Financial Guarantor has Received notice from the Bond Trustee that AGE has failed to pay such claim, the AGE Proportion of the Defaulted Amount to the Bond Trustee no later than the Business Day following the day on which such amount was due and payable by AGE in accordance with the terms of the AGE Financial Guarantee.

3.2 In the event that any amount shall be received by the Bond Trustee or the Bond Trustee has actual notice that any Guaranteed Bondholder has received any amount in respect of a Defaulted Amount forming the basis of a claim specified in a Notice of Demand submitted hereunder, which amount had not been received by the Bond Trustee, or which the Bond Trustee did not have actual notice had been received by a Guaranteed Bondholder when the Notice of Demand was prepared but which is received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder prior to the receipt of payment from the Financial Guarantor as contemplated by this Financial Guarantee (each such amount, a **"Recovery"**), the Bond Trustee shall promptly so notify the Financial Guarantor (which notice shall include the amount of any such Recovery). The fact that a Recovery has been received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder shall be deemed to be incorporated in the applicable Notice of Demand as of the date such Notice of Demand was originally prepared, without the need for any further action by any Person, and the Financial Guarantor shall pay the amount of the claim against the Financial Guarantor specified in paragraph (ii) of the Notice of Demand less the sum of the AGM Proportion of all such Recoveries or, in the case of any payment by the Financial Guarantor under Clause 2.1.2, the claim against AGE specified in paragraph (ii) of the Notice of Demand less the sum of the AGE Proportion of all such Recoveries.

3.3 The Financial Guarantor shall be entitled to elect, in its absolute discretion, to pay part or all of any Defaulted Amount to any such bank account as is specified by the Bond Trustee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand therefor. Any such payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If requested by the Financial Guarantor, the Bond Trustee shall promptly deliver to the Financial Guarantor a properly completed and executed Notice of Demand in respect of any such payment made or to be made by the Financial Guarantor.

3.4 Payments due hereunder in respect of Guaranteed Amounts will be disbursed to or to the order of the Bond Trustee and credited (in immediately available funds) to the bank account (the **"Account"**) specified by the Bond Trustee in the applicable Notice of Demand or pursuant to Clause 3.3 or Clause 4.2. Payment in full to the Account shall discharge the obligations of the Financial Guarantor under this Financial Guarantee to the extent of such payment, whether or not such payment is properly applied by or on behalf of the Bond Trustee or any Agent.

3.5 Once payment by or on behalf of the Financial Guarantor of an amount in respect of any Guaranteed Amount (whether on a Scheduled Payment Date or on an accelerated basis pursuant to Clause 4.2) has been made to the Account, the Financial Guarantor shall have no further obligations under this Financial Guarantee in respect of such Guaranteed Amount to the extent of such payment.

4. **Acceleration**

4.1 At any time or from time to time following Acceleration, the Financial Guarantor may decide, in its absolute discretion, to make an Accelerated Payment under this Financial Guarantee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand.

4.2 The Financial Guarantor shall notify the Bond Trustee in writing of its intention to make any Accelerated Payment and the proposed date of such payment, no later than two Business Days prior to such proposed date of payment. Any such Accelerated Payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If so requested by the Financial Guarantor at the time the Financial Guarantor gives such written notice, the Bond Trustee shall deliver to the Financial Guarantor and AGE a corresponding Notice of Demand.

5. **Withholding Tax**

All payments by the Financial Guarantor to or to the order of the Bond Trustee under this Financial Guarantee shall be made without withholding or deduction for, or on account of, any taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state, or any political subdivision or governmental or taxing authority therein or thereof unless such withholding or deduction is required by law. If any withholding or deduction is so required by law, the Financial Guarantor shall pay such amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. The Financial Guarantor shall not be obliged to pay any amount to or to the order of the Bond Trustee in respect of the amount of such withholding or deduction.

6. **Subrogation**

6.1 The Financial Guarantor will be fully, immediately and automatically subrogated to the Guaranteed Bondholders' and the Bond Trustee's rights to payment of any Guaranteed Amounts, and to any rights relating thereto, to the fullest extent permitted by applicable law to the extent and at the time of any payments made by or on behalf of the Financial Guarantor under this Financial Guarantee, including, for the avoidance of doubt, any Accelerated Payment.

6.2 Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee or any Guaranteed Bondholder in respect of any Guaranteed Amount forming the basis of a claim hereunder (and a corresponding claim under this Financial Guarantee and/or the AGE Financial Guarantee, which claims shall have been paid in full by the Financial Guarantor and AGE respectively) shall be received and held on trust by the recipient for the benefit of the Financial Guarantor and AGE and shall be paid by the recipient over to the Financial Guarantor and AGE pro rata in proportion to the respective amounts paid (i) by the Financial Guarantor in respect of a claim made pursuant to this Financial Guarantee, and (ii) by AGE in respect of the related claim made pursuant to the AGE Financial Guarantee.

7. **Waiver of Defences**

7.1 The obligations of the Financial Guarantor under this Financial Guarantee will continue and will not be terminable other than in accordance with Clause 12 (*Termination and Amendment*) of this Financial Guarantee notwithstanding failure to receive payment of the Financial Guarantee Fee or any other amount due in respect of this Financial Guarantee. The Financial Guarantee Fee is not refundable for any reason.

7.2 The Financial Guarantor acknowledges that there is no duty of disclosure by the Bond Trustee under this Financial Guarantee but nonetheless, to the fullest extent permitted by applicable law, hereby waives for the benefit of the Bond Trustee and the Guaranteed Bondholders and agrees not to assert any and all rights (whether by counterclaim, rescission, set-off or otherwise) and any and all equities and defences howsoever arising (including, without limitation, any right, equity or defence based on: (a) any right to require the Bond Trustee or any Guaranteed Bondholder first to proceed against or to enforce any other rights or security against, or to claim payment from, any Person (except in the case only of the guarantee set out in Clause 2.1.2, to the extent of the conditions set out in Clause 3.1.2) before the Bond Trustee may claim from the Financial Guarantor under this Financial Guarantee; (b) fraud on the part of any Person (including fraud on the part of any agent for the Bond Trustee, but excluding fraud by the Bond Trustee itself); (c) misrepresentation, breach of warranty or non-disclosure of information by any Person; (d) any lack of validity or enforceability of the Guaranteed

Bonds or the Bond Trust Deed; (e) any modification or any amendment to the Guaranteed Bonds or the Bond Trust Deed; (f) the granting of any time, indulgence or concession by any Person to the Issuer; (g) any insolvency or similar proceedings in respect of the Issuer or any other Person; (h) any lack of capacity, power or authority or any change in status of the Issuer or any other Person; or (i) the refusal or failure to take up, to hold, to perfect or to enforce by any Person any rights under or in connection with any guarantee (except in the case only of the guarantee set out in Clause 2.1.2, to the extent of the conditions set out in Clause 3.1.2), indemnity, security or other document) to the extent such rights, equities and defences may be available to the Financial Guarantor to avoid payment of its obligations under this Financial Guarantee in accordance with the express provisions hereof.

7.3 No warranties are given and nothing in this Financial Guarantee is intended to constitute a warranty or a condition precedent to payment under the Financial Guarantee other than Receipt of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) of this Financial Guarantee and, in the case only of the guarantee set out in Clause 2.1.2, the conditions set out in Clause 3.1.2.

7.4 Nothing in this Financial Guarantee shall be construed in any way to limit or otherwise affect the Financial Guarantor's right to pursue recovery or claims (based on contractual or other rights, including to the extent applicable such rights resulting from any Person's fraud, negligence or breach of any agreement to which it is a party) for reimbursement against any Persons for any liabilities, losses, damages, costs and expenses incurred by the Financial Guarantor or to exercise at any time any other remedies that may be available to the Financial Guarantor at law or in equity.

7.5 Nothing in this Financial Guarantee shall be construed to require payment by the Financial Guarantor so long as a Force Majeure Event is continuing, in which event the Financial Guarantor agrees to perform its obligations under this Financial Guarantee promptly following cessation of such Force Majeure Event.

8. Notice of Demand

8.1 Subject to Clauses 2.2, 3.3 and 4 of this Financial Guarantee, payments of Guaranteed Amounts (including Avoided Payments) will only be made after presentation of a properly completed Notice of Demand signed by the Bond Trustee and Received by the Financial Guarantor.

8.2 Notices of Demand can only be given by the Bond Trustee in the manner set out in Clause 11 (*Notices*).

8.3 Without limitation to the Financial Guarantor's obligations under Clause 8.5, if any Notice of Demand is not in the proper form or is not properly completed, executed or delivered, the Financial Guarantor will not be deemed to have Received such Notice of Demand.

8.4 Any Notice of Demand in respect of an Avoided Payment will not be deemed properly completed unless it is accompanied by:

8.4.1 a copy of the Order; and

8.4.2 a certificate of the Bond Trustee that the Order has been entered and that, on the basis of legal advice received by the Bond Trustee, the Order is not subject to any stay and specifying (to the extent that the Bond Trustee has actual knowledge sufficient to do so) the Guaranteed Amounts that are Avoided Payments.

8.5 The Financial Guarantor will promptly advise the Bond Trustee if a Notice of Demand is not in the proper form or has not been properly completed, executed or delivered and the Bond Trustee may submit an amended Notice of Demand to the Financial Guarantor.

9. Fiscal Agent

9.1 At any time during the Term of the Financial Guarantee, the Financial Guarantor may appoint a fiscal agent (the **"Fiscal Agent"**) for purposes of this Financial Guarantee by written notice to the Bond Trustee, specifying the name and notice address of such Fiscal Agent. From and after the date of receipt of such notice by the Bond Trustee:

9.1.1 copies of all notices (including Notices of Demand) and other documents required to be delivered to the Financial Guarantor pursuant to this Financial Guarantee shall be simultaneously delivered to the Fiscal Agent and to the Financial Guarantor; and

9.1.2 all payments required to be made by the Financial Guarantor under this Financial Guarantee may be made directly by the Financial Guarantor or by the Fiscal Agent on behalf of the Financial Guarantor.

9.2 The Fiscal Agent is the agent of the Financial Guarantor only, and the Fiscal Agent shall in no event be liable to the Bond Trustee for any acts of the Fiscal Agent or any failure of the Financial Guarantor to deposit, or cause to be deposited, sufficient funds to make payments due under this Financial Guarantee.

10. **Transfer**

10.1 The rights and obligations of the Financial Guarantor under this Financial Guarantee may be assigned or transferred to, or assumed by, any affiliate of the Financial Guarantor provided that:

10.1.1 no Financial Guarantor Default has occurred and is continuing at the time of such assignment, transfer or assumption or would occur as a result of such assignment, transfer or assumption;

10.1.2 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations delivers to the Bond Trustee written confirmation from the Rating Agencies that, at the time of and immediately following any such assignment, transfer or assumption, the financial strength or claims paying ability of such affiliate will be rated at least equal to the financial strength or claims paying ability of the Financial Guarantor at that time; and

10.1.3 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations thereafter delivers to the Bond Trustee written notice of any such assignment, transfer or assumption.

10.2 The Bond Trustee may not transfer, assign, sub-participate, declare a trust over or otherwise dispose (other than in favour of the Guaranteed Bondholders) of any of its rights under this Financial Guarantee except to a Person as to whom the Financial Guarantor has given its prior written consent. However, if the Bond Trustee transfers or assigns its rights and obligations under the Bond Trust Deed to a new or additional trustee which has been appointed in accordance with the Bond Trust Deed, no such consent shall be required and such new or additional trustee will be able to enforce this Financial Guarantee and references in this Financial Guarantee to "Bond Trustee" shall be construed as including such new trustee or such additional trustee, as applicable.

11. **Notices**

11.1 All notices given under this Financial Guarantee shall be in writing (except as otherwise specifically provided herein) and shall be mailed by registered mail or personally delivered or faxed as follows:

To the Financial Guarantor:

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Re:	Brunswick Social Housing PFI, Financial Guarantee No. 51916 - N
Telephone:	+ 1 212 974 0100
Fax:	+ 1 212 581 3268

with a copy to the General Counsel at the above address and fax number. Each Notice of Demand shall be marked to indicate "URGENT MATERIAL ENCLOSED".

To the Bond Trustee:

BNY Mellon Corporate Trustee Services Limited
1 Canada Square
London
E14 5AL

Attention:	Trustee Administration Manager/Brunswick Transaction
Telephone:	+44 20 7163 7748
Fax:	+44 20 7964 2509

If presentation to the Bond Trustee is made by fax transmission, the Financial Guarantor (a) shall promptly confirm transmission by telephone to the Bond Trustee at its telephone number referred to above, and (b) as soon as is reasonably practicable, shall deliver the original notice or other applicable documentation to the Bond Trustee's address for notices in accordance with this Clause 11 (*Notices*).

11.2 The Financial Guarantor or the Bond Trustee may designate an additional or different address, or telephone or fax number, by prior written notice. Each notice, presentation, delivery and communication to the Financial Guarantor or the Bond Trustee shall be effective only upon Receipt by the Financial Guarantor or actual receipt by the Bond Trustee, as the case may be.

12. **Termination and Amendment**

12.1 This Financial Guarantee is not cancellable by the Financial Guarantor for any reason, including, without limitation, the failure of the Financial Guarantor to receive payment of any Financial Guarantee Fee due in respect of this Financial Guarantee.

12.2 This Financial Guarantee and the obligations of the Financial Guarantor hereunder shall terminate upon the expiration of the Term of the Financial Guarantee.

12.3 This Financial Guarantee may not be amended, modified or supplemented without the prior written consent of the Bond Trustee.

13. **Miscellaneous**

No waiver of any rights or powers of the Financial Guarantor or the Bond Trustee, or any consent by either of them, shall be valid unless in writing and signed by an authorised officer or agent of the Financial Guarantor or the Bond Trustee, as applicable. The waiver of any right by the Financial Guarantor or the Bond Trustee, or the failure promptly to exercise any such right, shall not be construed as a waiver of any right to exercise the same or any other right at any time thereafter.

14. **Redenomination**

If the Guaranteed Bonds are redenominated into Euro or any other currency pursuant to Condition 16 (*Redenomination*), payments of Guaranteed Amounts hereunder shall be made in such currency.

15. **Law and Jurisdiction**

15.1 This Financial Guarantee, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

15.2 With respect to any suit, action or proceedings relating to this Financial Guarantee (**"Proceedings"**), the Financial Guarantor irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over such party.

16. **Entire Agreement**

This Financial Guarantee constitutes the entire agreement between the Financial Guarantor and the Bond Trustee in relation to the Financial Guarantor's obligation to make payments to the Bond Trustee for the benefit of the Guaranteed Bondholders in respect of the Guaranteed Amounts which become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer, and supersedes any previous agreement between the Financial Guarantor and the Bond Trustee in relation thereto.

17. **Third Party Rights**

No Person other than the Bond Trustee shall have rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Financial Guarantee but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

18. **THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.**

19. **Surrender of Financial Guarantee**

The Bond Trustee shall deliver its original engrossment of this Financial Guarantee to the Financial Guarantor upon expiration of the Term of this Financial Guarantee.

In Witness Whereof, this Financial Guarantee has been executed as a deed and delivered on the date inserted above.

EXECUTED as a DEED for and on behalf of
ASSURED GUARANTY MUNICIPAL CORP. by:

Authorised signatory

in the presence of

Witness:

ANNEX

NOTICE OF DEMAND

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Attention:

Chief Surveillance Officer

and

General Counsel

The undersigned, BNY Mellon Corporate Trustee Services Limited as Bond Trustee (the **"Bond Trustee"**), hereby certifies to each of Assured Guaranty (Europe) Ltd. (**"AGE"**) and Assured Guaranty Municipal Corp. (**"AGM"** and, together with AGE, the **"Financial Guarantors"**) with reference to Financial Guarantee No. 80172 - U (the **"AGE Financial Guarantee"**) and Financial Guarantee No. 51916 - N (the **"AGM Financial Guarantee"** and, together with the AGE Financial Guarantee, the **"Financial Guarantees"**) that:

(i) [The Guaranteed Amount[s] that [is/are] due and payable on the Scheduled Payment Date falling on [insert applicable payment date] [is/are] [●][*insert applicable amount*]./The Guaranteed Amount[s] that [was/were] paid, credited, transferred or delivered to or to the order of the Bond Trustee or the Guaranteed Bondholders by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds on [insert applicable payment date] of [●][*insert applicable amount*] [was/were] recovered from, or was otherwise required to be returned or repaid by, the Bond Trustee or [a/the] Guaranteed Bondholder[s] as a result of Insolvency Proceedings by or against the Issuer on [insert applicable repayment date].]

(ii) [The deficiency with respect to the Guaranteed Amount Due for Payment and unpaid by reason of Nonpayment by the Issuer on the Scheduled Payment Date falling on [insert applicable payment date] is [●][*insert applicable amount*] (the **"Defaulted Amount"**), the AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]]/[The Bond Trustee has been notified by the Account Bank that the deficiency in respect of the Guaranteed Amount[s] which [is/are] Due for Payment on the Scheduled Payment Date falling on [insert applicable payment date] will be [●] [*insert applicable amount*] (the **"Defaulted Amount"**). The AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]].

(iii) The Bond Trustee is making (a) a claim against AGE under the AGE Financial Guarantee for the AGE Proportion of the Defaulted Amount, and (b) a claim against AGM under the AGM Financial Guarantee for the AGM Proportion of the Defaulted Amount, with each such amount to be applied to the payment of the above-described Guaranteed Amount[s].

(iv) To the extent that AGE does not pay the AGE Proportion of any Defaulted Amount when due and payable by AGE in accordance with the terms of the AGE Financial Guarantee, the Bond Trustee is making a claim against AGM under Clause 3.1.2 of the AGM Financial Guarantee for such amount. The Bond Trustee agrees that any payment by AGM of such amount shall discharge AGE from any obligation to make such payment under the AGE Financial Guarantee.

(v) The Bond Trustee agrees that following any payment by the Financial Guarantors made with respect to the Defaulted Amount which is the subject of this Notice of Demand, it (a) will cause such amounts to be applied directly to the payment of the applicable Guaranteed Amount[s] in accordance with Clause 7.9 of the Bond Trust Deed; (b) will ensure that such funds are not applied for any other purpose; and (c) will cause an accurate record of such payment to be maintained with respect to the appropriate Guaranteed Amount(s), the corresponding claim on each Financial Guarantee, and the proceeds of such claim.

(vi) Payments should be made by credit to the following account:

[(*insert details of bank account*)] (the **"Account"**).

Capitalised terms used in this Notice of Demand and not otherwise defined herein shall have the respective meanings ascribed thereto in or pursuant to the applicable Financial Guarantee.

This Notice of Demand may be revoked at any time by written notice of such revocation by the Bond Trustee to each Financial Guarantor, if and only to the extent that moneys are actually received by the Bond Trustee prior to any such revocation from a source other than the Financial Guarantors with respect to the Defaulted Amount set forth herein. The Bond Trustee will withdraw this Notice of Demand, or submit a restated Notice of Demand reducing the amount of the claim hereunder, if the required amount of the Defaulted Amount and accordingly each of the AGE Proportion and the AGM Proportion thereof has been reduced (including reduction to zero) on or prior to the date the Financial Guarantors are required to make payment under the Financial Guarantees.

If the Bond Trustee has received, or the Bond Trustee has actual notice that one or more Guaranteed Bondholders has received, from the Issuer or the Financial Guarantors an amount in excess of a Defaulted Amount, the Bond Trustee shall promptly return to each Financial Guarantor the lesser of (i) such Financial Guarantor's proportionate share in such excess amount (such share being calculated by a fraction equal to the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee divided by the total Defaulted Amount paid by both Financial Guarantors to or to the order of the Bond Trustee) and (ii) the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee and not previously distributed by the Bond Trustee to the Guaranteed Bondholders or to any insolvency official appointed in respect of the Issuer. For the avoidance of doubt the Bond Trustee shall only be required to repay any such amounts to the Financial Guarantors that are in the Bond Trustee's possession and under its control, at the time it becomes aware of the requirement to repay such amounts, and the Bond Trustee shall have no liability to any Person for any amounts received by the Bond Trustee from the Financial Guarantors but distributed by the Bond Trustee in accordance with the preceding sentence.

The Bond Trustee acknowledges that as of the date on which any payment by the relevant Financial Guarantor towards a Defaulted Amount is credited to the Account, the relevant Financial Guarantor shall be deemed fully, immediately and automatically subrogated, to the fullest extent permitted by applicable law, to the rights (including, without limitation, any rights and benefits attached thereto, and any security granted at law, by contract or otherwise) of the Guaranteed Bondholders to payment of the Guaranteed Amounts to the extent and at the time of such payment by the relevant Financial Guarantor towards the Defaulted Amount.

The Bond Trustee hereby (i) assigns to each Financial Guarantor its rights to receive any payment for the account of the Guaranteed Bondholders from the Issuer in respect of the Guaranteed Bonds to the extent of any payments made to (or to the order of) the Bond Trustee by the relevant Financial Guarantor under the applicable Financial Guarantee, including without limitation its right to receive payments of principal and interest on the Guaranteed Bonds (including Recoveries) and (ii) confirms that it has taken or will promptly take all steps reasonably required by, and at the expense of the Financial Guarantors to effect and perfect such assignments to the Financial Guarantors. The foregoing assignments are in addition to, and not in limitation of, rights of subrogation otherwise available to each Financial Guarantor in respect of such payments. Payments to each Financial Guarantor in respect of the foregoing assignment shall in all cases be subject to and subordinate to the rights of the Bond Trustee and the Guaranteed Bondholders to receive all Guaranteed Amounts in respect of the Guaranteed Bonds. The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantors, with any request by either Financial Guarantor for action necessary to preserve or enforce such Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation. The Bond Trustee shall also, at the expense of the Financial Guarantors, deliver any such instruments as may be reasonably requested or required by the Financial Guarantors to effectuate the purpose or provisions of this paragraph.

Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee in respect of any Guaranteed Amount forming the basis of a claim hereunder (which claim shall have been paid in full by the Financial Guarantors) shall be received and held on trust for the benefit of the Financial Guarantors and shall be paid over to each Financial Guarantor pro rata in proportion to the respective amounts each Financial Guarantor paid in respect of the Defaulted Amount.

The Bond Trustee hereby agrees that so long as no Financial Guarantor Default shall have occurred and be continuing, each Financial Guarantor may at any time during the continuation of any Insolvency Proceeding by or against the Issuer under any applicable law direct all matters relating thereto, including without limitation, (a) all matters relating to any claim in connection with an Insolvency Proceeding by or against the Issuer seeking the avoidance as a preferential transfer of any payment made with respect to the Guaranteed Bonds (a **"Preference Claim"**), (b) the direction of any appeal of any order relating to any Preference Claim at the expense of the Financial Guarantors and (c) the posting of any surety or performance bond pending any such appeal.

[Pursuant to Clause 8.4 of the Financial Guarantee, the following documents are attached:

- a copy of the Order; and
- a certificate of the Bond Trustee that the Order has been entered and that, on the basis of legal advice received by the Bond Trustee, the Order is not subject to any stay and specifying (to the extent that the Bond Trustee has actual knowledge sufficient to do so) the Guaranteed Amounts that are Avoided Payments.*

* To be inserted if demand relates to Avoided Payments.]

This Notice of Demand, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

[With respect to any suit, action or proceedings relating to this Notice of Demand (**"Proceedings"**), the Bond Trustee irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over it.]

No Person, other than each Financial Guarantor, shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Notice of Demand but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

In Witness Whereof, the undersigned has executed and delivered this Notice of Demand as a deed on the [●] day of [●] of 2[●].

EXECUTED as a DEED for and on behalf of
BNY MELLON CORPORATE TRUSTEE SERVICES LIMITED acting by two of its lawful Attorneys:

Attorney

Attorney

in the presence of:

Witness name:

Signature:

For the Financial Guarantor or
Fiscal Agent Use Only
Wire transfer sent on By:
Confirmation Number:

DESCRIPTION OF THE FINANCIAL GUARANTORS

The information appearing in this section has been prepared by the Financial Guarantors and has not been independently verified by the Issuer or the Manager. Neither the Issuer nor the Manager assumes any responsibility for the accuracy, completeness or applicability of such information; except the Issuer assumes responsibility for the accurate reproduction herein of such information provided by the Financial Guarantors.

1. Assured Guaranty (Europe) Ltd.

1.1 General

Assured Guaranty (Europe) Ltd. ("**AGE**") is a direct wholly-owned subsidiary of Assured Guaranty Municipal Corp. ("**AGM**" and together with AGE, "**Assured Guaranty**"), an insurance company organised under the laws of the State of New York, U.S.A. AGM is a wholly-owned indirect subsidiary of Assured Guaranty Ltd. ("**AGL**"), a Bermuda based holding company that, through its operating subsidiaries, provides credit protection products to the public finance, infrastructure and structured finance markets. AGL's shares are publicly listed on the New York Stock Exchange under the symbol "AGO". AGL applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments of interest and principal. AGL's operating subsidiaries market their credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities, as well as to investors in such debt obligations. AGL's operating subsidiaries guarantee debt obligations issued in many countries, although their principal focus is the United States, the United Kingdom, Europe and Australia.

AGE was incorporated with limited liability in England on 8 June 1990 pursuant to the Companies Acts 1985 and 1989 with registered number 02510099. AGE was authorised from 29 April 1994, originally by the UK Department of Trade and Industry and subsequently by the UK Financial Services Authority (the "**FSA**"), to carry out and effect "credit", "suretyship" and "miscellaneous financial loss" insurance business in the United Kingdom (firm reference number 202896). From 1 April 2013, AGE is authorised by the Prudential Regulation Authority and regulated by the Prudential Regulation Authority and the Financial Conduct Authority. These permissions are sufficient for AGE to provide financial guarantees in the UK. In addition, pursuant to the EC third non-life insurance directive (No. 92/49/EEC), AGE is able to provide financial guarantees in twenty European countries, subject to certain conditions.

AGE's registered office is located at 1 Finsbury Square, London EC2A 1AE, United Kingdom, Telephone: +44-20-7562-1900. AGE has no subsidiaries. AGE's legal and commercial name is Assured Guaranty (Europe) Ltd.

AGE is dependent on AGM in that AGM supports AGE through certain contractual arrangements (see "*Material Contracts*" below).

1.2 Ratings

AGE's financial strength is rated "AA-" (stable outlook) by Standard and Poor's Ratings Services ("**S&P**") and "A2" (stable outlook) by Moody's Investors Service, Inc. ("**Moody's**"), respectively. Neither S&P nor Moody's is established in the European Community and neither is registered in accordance with Regulation (EC) No 1060/2009 (as amended).

On 12 June 2013, S&P published a report in which it affirmed AGE's "AA-" (stable outlook) financial strength rating. On 17 January 2013, Moody's issued a press release stating that it had downgraded AGE's insurance financial strength rating to "A2" (stable outlook) from "Aa3".

AGE can give no assurance as to any further ratings action that either rating agency may take.

Each rating of AGE should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any bond or other security, and such ratings are subject to revision or withdrawal at any time by the rating agencies, including withdrawal initiated at the request of AGE in its sole discretion. In addition, the rating agencies may at any time change AGE's long-term ratings outlooks or place AGE's ratings on a watch list for possible downgrade in the near term. Any downward revision or withdrawal of any of the above ratings, the assignment of a negative outlook to such ratings or the placement of such ratings on a negative watch list may have an adverse effect on the market price of any bond or other security guaranteed by AGE.

AGE only guarantees scheduled principal and scheduled interest payments payable by the issuer of bonds or other securities guaranteed by AGE on the date(s) when such amounts were initially scheduled to become due and payable (subject to and in accordance with the terms of the relevant financial guarantee), and does not guarantee the market price or liquidity of the bonds or other securities it insures, nor does it guarantee that the ratings on such bonds or other securities will not be revised or withdrawn.

1.3 **Overview of AGE's Business**

AGE provides financial guarantees in the United Kingdom and other European countries for public finance, structured finance and other project and infrastructure finance transactions.

Financial guarantees generally guarantee to the holder of the guaranteed obligation the timely payment of principal of and interest on such obligation in accordance with such obligation's original payment schedule. Accordingly, in the case of a default on the guaranteed obligation, payments under the financial guarantee may not be accelerated without AGE's consent.

Financial guarantees on public infrastructure finance transactions are typically issued in connection with transactions in which the bonds or other securities being issued are secured by or payable from cashflows coming either from a government or quasi-governmental entity or from users of the relevant asset (e.g., passengers on a light rail system or drivers on a toll road). Projects financed under the UK government's Public Private Partnership based model typically involve the construction of an asset (e.g., hospital, school, or court buildings) and its ongoing management and maintenance for an agreed duration in return for which a performance-based fee is paid by the relevant public sector body; this fee is used to pay interest on and amortise the debt that is guaranteed by the relevant financial guarantor.

Financial guarantees on structured finance or asset-backed obligations are typically issued in connection with transactions in which the bonds or other securities being issued are secured by or payable from a specific pool of assets having an ascertainable cash flow or market value and held by a special purpose issuing entity.

New business written by AGE will be guaranteed using a co-guarantee structure pursuant to which AGE will co-guarantee municipal and infrastructure transactions with AGM and structured finance transactions with its affiliate Assured Guaranty Corp. ("**AGC**"). As described elsewhere in this Prospectus with respect to the Bonds and below under "*Material Contracts*", AGE will cover a proportionate share of the total exposure (expected to be between 3 and 10 per cent), and AGM (or AGC for structured finance transactions) will guarantee the remaining exposure under the transaction (subject to compliance with European Economic Area (the "**EEA**") licensing requirements). In its financial guarantee, AGM (or AGC for structured finance transactions) also will provide a second-to-pay guarantee to cover AGE's share of the total exposure.

AGE or one of its affiliates may purchase a portion of the Bonds offered under this Prospectus and such purchases may constitute a significant proportion of the Bonds offered. AGE or such affiliate may hold such Bonds for investment or may sell or otherwise dispose of such Bonds at any time or from time to time.

1.4 **Information**

Copies of the annual financial statements filed with the Registrar of Companies in the United Kingdom are available upon request to AGE at its registered office.

1.5 **Recent Developments**

Since 31 December 2012, the date as at which its latest audited accounts were prepared, AGE has continued to conduct its financial guarantee business in the United Kingdom and the other European countries into which it is passported to provide financial guarantees.

There are no governmental, legal or arbitration proceedings (pending or threatened) of which AGE is aware during the previous 12 months which may have, or have had in the recent past, significant effects on AGE's financial position or profitability.

1.6 Directors of AGE

The following is a list of the members of the board of directors of AGE by name and function and sets forth any principal activities of such members outside of AGE:

Name	Function	Principal Activities Outside of AGE
Dominic Frederico	Executive	Chief Executive Officer and President, Assured Guaranty Ltd.
Simon Leathes (Chairman)	Non-Executive	Director of Assurance Guaranty Ltd., non-executive director of various other financial institutions, charitable organisations and trusts
James Michener	Executive	General Counsel and Secretary, Assured Guaranty Ltd.
Robert Mills	Executive	Chief Operating Officer, Assured Guaranty Ltd.
Anthony Monro-Davies	Non-Executive	Director (Chairman of the Board) of Assured Guaranty Ltd., non-executive director of various other financial institutions, charitable organisations and trusts
Dominic Nathan	Executive	None
Nick Proud	Executive	None

The business address of Messrs. Nathan and Proud is 1 Finsbury Square, London EC2A 1AE, United Kingdom. The business address of Messrs. Leathes and Monro-Davies in their capacity as non-executive directors is 1 Finsbury Square, London EC2A 1AE, United Kingdom. The business address of Messrs. Frederico, Mills and Michener is 30 Woodbourne Avenue, Hamilton, Bermuda HM 08.

As at the date of this Prospectus, the above-mentioned board members of AGE do not have potential conflicts of interests between any duties to AGE and their private interests or other duties that are material to the Bonds.

1.7 Insurance Regulation

AGE is authorised by the Prudential Regulation Authority and regulated by the Prudential Regulation Authority for prudential regulation and the Financial Conduct Authority for conduct of business regulation, in the conduct of its financial guarantee business in the United Kingdom.

The Prudential Regulation Authority has regulatory objectives specific to insurance which are (1) to promote insurers' safety and soundness, thereby supporting the stability of the UK financial system and (2) to contribute to securing an appropriate degree of protection for those who are or may become policyholders. The Prudential Regulation Authority applies new threshold conditions (Threshold Conditions), which insurers must meet, and against which the Prudential Regulation Authority will assess them on a continuous basis. These conditions are that: (a) an insurer's head office, and in particular its mind and management, has to be in the United Kingdom if it is incorporated in the United

Kingdom; (b) an insurer's business must be conducted in a prudent manner — in particular that the insurer maintains appropriate financial and non-financial resources; (c) the insurer must be fit and proper, and be appropriately staffed; and (d) the insurer and its group must be capable of being effectively supervised.

Solvency

Under United Kingdom regulations, AGE is subject to certain limits and requirements, including the maintenance of a minimum margin of solvency (which depends on the type and amount of insurance business a company writes) and the establishment of loss and unearned premium reserves.

To the extent that the amount of premiums for such classes exceed certain specified minimum thresholds, each insurance company writing property, credit and other specified categories of insurance or reinsurance business is required by the General Prudential Sourcebook ("**GENPRU**"), the Interim Prudential Sourcebook for Insurers ("**IPRU-INS**") and the Prudential Sourcebook for Insurers ("**INSPRU**") (collectively, the "**Prudential Sourcebooks**") to maintain an equalization reserve calculated in accordance with the provisions of INSPRU. Because of the amount of premiums that AGE has earned, AGE must maintain an equalization reserve.

The Prudential Sourcebooks also require that AGE calculate and share with the Prudential Regulation Authority its "enhanced capital requirement" based on risk-weightings applied to assets held and lines of business written. In 2007, the FSA replaced the individual capital assessment for financial guarantee insurers with a "benchmarker" capital adequacy model devised by the FSA. Should the level of capital of AGE fall below the capital requirement as indicated by the benchmarker, the Prudential Regulation Authority may require AGE to undertake further work, following which Individual Capital Guidance may result. Failure to maintain capital at least equal to the minimum capital requirement in the benchmarker model is one of the grounds on which the wide powers of intervention conferred upon the Prudential Regulation Authority may be exercised.

The European Union's Solvency II Directive (Directive 2009/138/EC), which itself is to be amended by the proposed Omnibus II Directive (collectively, Solvency II), is currently not expected to be implemented before 2015 at the earliest. The solvency requirements described above are expected to be replaced by Solvency II. Among other things, Solvency II introduces a revised risk-based prudential regime which includes the following features: (1) assets and liabilities are generally to be valued at their market value; (2) the amount of required economic capital is intended to ensure, with a probability of 99.5 per cent, that regulated firms are able to meet their obligations to policyholders and beneficiaries over the following 12 months; and (3) reinsurance recoveries will be treated as a separate asset (rather than being netted off the underlying insurance liabilities). In many instances, Solvency II is expected to require insurers to maintain an increased amount of capital to satisfy the new solvency capital requirements.

In addition, an insurer (which includes a company conducting only reinsurance business) is required to perform and submit to the Prudential Regulation Authority a group capital adequacy return in respect of its ultimate insurance parent. The calculation at the level of the ultimate EEA insurance parent is required to show a positive result. There is no such requirement in relation to the report at the level of the ultimate insurance parent, although if the report at that level raises concerns, the Prudential Regulation Authority may take regulatory action. Public disclosure of the EEA group calculation will be required.

Financial Services Compensation Scheme

The beneficiaries of AGE's Financial Guarantee are not protected by the Financial Services Compensation Scheme.

1.8 Financial Information

The audited accounts of AGE for the years ended 31 December 2011 and 31 December 2012 are included at Appendix 1 and Appendix 2 hereto. There has been no material adverse change in AGE's prospects and no significant change in AGE's financial or trading position since 31 December 2012, the date to which AGE's most recent audited accounts have been prepared.

1.9 **Auditors**

AGE's auditors are PricewaterhouseCoopers LLP ("**PwC**"), 7 More London Riverside, London SE1 2RT. PwC is a member of the Institute of Chartered Accountants in England and Wales.

PwC's report on the audited accounts of AGE for the years ended 31 December 2012 and 31 December 2011 is included with such accounts, which are included at Appendix 1 and Appendix 2 hereto, respectively.

1.10 **Material Contracts**

Except as discussed below, AGE has not entered into contracts outside the ordinary course of business that could result in AGE being under an obligation or entitlement that is material to AGE's ability to meet its obligations to the Bond Trustee under its Financial Guarantee.

AGM provides support to AGE through an amended and restated quota share and stop loss reinsurance agreement (the "**Reinsurance Agreement**") and an amended and restated net worth maintenance agreement (the "**Net Worth Agreement**"). For transactions closed prior to 2011, AGE typically guaranteed all of the guaranteed obligations directly and AGM reinsured approximately 92 per cent of AGE's retention after cessions to other reinsurers under the quota share cover of the reinsurance agreement. In 2011, AGE implemented a co-guarantee structure pursuant to which AGE directly guarantees a portion of the guaranteed obligations in an amount equal to what would have been AGE's *pro rata* retention percentage under the quota share cover. AGM directly guarantees the balance of the guaranteed obligations and also provides a second-to-pay guarantee for AGE's portion of the guaranteed obligations.

Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to AGE when AGE's annual net incurred losses and expenses exceeds the AGE's annual net earned premium plus any amounts deducted from AGE's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20 per cent of AGE's guaranteed net principal amount outstanding at the prior year-end, plus AGE's guaranteed net principal outstanding at the prior year-end of AGE's two largest transactions.

The quota share and stop loss covers each exclude transactions guaranteed by AGE on or after July 1, 2009 that are not municipal, utility, project finance or infrastructure risks or similar types of risks.

Under the Net Worth Agreement, AGM is obligated to cause AGE to maintain capital resources equal to 110 per cent of the greatest of the amounts as may be required by the Prudential Regulation Authority as a condition for maintaining its authorisation to carry on a financial guarantee business in the U.K., provided that contributions (a) do not exceed 35 per cent of AGM's policyholders' surplus as determined by the laws of the State of New York, and (b) are in compliance with a provision of the New York Insurance Law requiring notice to or approval by the New York State Department of Financial Services for transactions between affiliates that exceed certain thresholds. AGM has never been required to make any contributions to AGE's capital under the current Net Worth Agreement or its prior net worth maintenance agreement.

On the basis of the support provided by the Reinsurance Agreement and the Net Worth Agreement, AGE has the same ratings as AGM. Holders of the Bonds should note that AGE's ability to perform its obligations under its Financial Guarantee and to maintain its current rating substantially depends on the ability of AGM to perform its obligations under the Assured Guaranty Agreements.

The holders of the Bonds should note that the Reinsurance Agreement and the Net Worth Agreement (together, the "Assured Guaranty Agreements") are entered into for the benefit of AGE and are not, and should not be regarded as, guarantees by AGM of the payment of any indebtedness, liability or obligations of the Issuer or AGE, including the Bonds or the Financial Guarantee. The Assured Guaranty Agreements are not guarantees for the benefit of the holders of the Bonds. Neither the Bond Trustee nor holders of the Bonds have any recourse to AGM in respect of the Assured Guaranty Agreements.

Payment of Guaranteed Amounts that are Due for Payment on the Bonds and unpaid by reason of Nonpayment by the Issuer will be guaranteed by the Financial Guarantors pursuant to the Financial Guarantees but will not be additionally covered by the Assured Guaranty Agreements.

2. Assured Guaranty Municipal Corp.

2.1 General

AGM is an insurance company organised under the laws of the State of New York, U.S.A. AGM is a wholly-owned indirect subsidiary of AGL, a Bermuda based holding company that, through its operating subsidiaries, provides credit protection products to the public finance, infrastructure and structured finance markets. AGL's shares are publicly listed on the New York Stock Exchange under the symbol "AGO". AGL applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments of interest and principal. AGL's operating subsidiaries market their credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities, as well as to investors in such debt obligations. AGL's operating subsidiaries guarantee debt obligations issued in many countries, although their principal focus is the United States, the United Kingdom, Europe and Australia.

AGM was organised in the State of New York, U.S.A. as an insurance company on 16 March 1984 and commenced operations in 1985.

AGM maintains its principal executive offices at 31 West 52nd Street, New York, New York 10019, U.S.A. The telephone number of AGM is +1 212 974 0100. AGM's legal and commercial name is Assured Guaranty Municipal Corp.

2.2 Ratings

AGM's financial strength is rated "AA-" (stable outlook) by S&P and "A2" (stable outlook) by Moody's. Neither S&P nor Moody's is established in the European Community and neither is registered in accordance with Regulation (EC) No 1060/2009 (as amended).

On 12 June 2013, S&P published a report in which it affirmed AGM's "AA-" (stable outlook) financial strength rating. On 17 January 2013, Moody's issued a press release stating that it had downgraded AGM's insurance financial strength rating to "A2" (stable outlook) from "Aa3".

AGM can give no assurance as to any further ratings action that either rating agency may take.

Each rating of AGM should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any bond or other security, and such ratings are subject to revision or withdrawal at any time by the rating agencies, including withdrawal initiated at the request of AGM in its sole discretion. In addition, the rating agencies may at any time change AGM's long-term ratings outlooks or place AGM's ratings on a watch list for possible downgrade in the near term. Any downward revision or withdrawal of any of the above ratings, the assignment of a negative outlook to such ratings or the placement of such ratings on a negative watch list may have an adverse effect on the market price of any bond or other security guaranteed by AGM.

AGM only guarantees scheduled principal and scheduled interest payments payable by the issuer of bonds or other securities guaranteed by AGM on the date(s) when such amounts were initially scheduled to become due and payable (subject to and in accordance with the terms of the relevant financial guarantee), and does not guarantee the market price or liquidity of the bonds or other securities it insures, nor does it guarantee that the ratings on such bonds or other securities will not be revised or withdrawn.

2.3 Overview of AGM's business

AGM provides financial guarantees to issuers both within and outside the U.S.A. providing co-insurance on public finance and other project and infrastructure finance transactions in Europe with AGE (see "*Description of the Financial Guarantors – Assured Guaranty (Europe) Ltd. – Overview of AGE's Business*" above). Since mid-2008, AGM has only provided insurance that protects against principal and interest payment defaults on debt obligations in the U.S. public finance and global infrastructure market. Previously, AGM also offered insurance and reinsurance in the global structured finance market. Like AGE, AGM's financial guarantees generally guarantee to the holder of the guaranteed obligation the timely payment of principal of and interest on such obligation in accordance with such obligation's original payment schedule. Accordingly, in the case of a default on the guaranteed obligation, payments under the financial guarantee may not be accelerated without AGM's consent.

Municipal obligations and municipal bonds include taxable and tax-exempt bonds, notes and other evidences of indebtedness issued by states, political subdivisions (cities, counties, towns and villages), water, sewer and other utility districts, higher educational institutions, hospitals, transportation and housing authorities and other similar agencies. Municipal obligations are supported by the taxing authority of the issuer or the issuer's or underlying obligor's ability to collect fees or assessments for certain projects or public services. References herein to "municipal bonds" and "municipal obligations" are to debt obligations of states and other political subdivisions in the U.S.A.

AGM or one of its affiliates may purchase a portion of the Bonds offered under this Prospectus and such purchases may constitute a significant proportion of the Bonds offered. AGM or such affiliate may hold such Bonds for investment or may sell or otherwise dispose of such Bonds at any time or from time to time.

2.4 Information

Copies of the statutory quarterly and annual statements filed by AGM in the U.S.A. are available upon request to AGM at its principal place of business.

2.5 Recent Developments

Since 31 December 2012, the date as at which its latest audited financial statements were prepared, AGM has continued to conduct its financial guarantee business in the U.S.A. and the other states and countries in which it is permitted to provide financial guarantees.

There are no governmental, legal or arbitration proceedings (pending or threatened) of which AGM is aware during the 12 months preceding the date of this Prospectus which may have, or have had in the recent past, significant effects on AGM's financial position or profitability other than as set forth in (a) AGM's audited financial statements as of 31 December 2012, (b) AGM's unaudited interim financial statements as of 30 June 2013 or (c) the events described in the bullet points following this paragraph.

- On August 9, 2012, AGM filed a complaint against OneWest Bank, FSB, the servicer of the mortgage loans underlying the HOA1 Transaction and the IndyMac Home Equity Mortgage Loan Asset-Backed Trust, Series 2007-H1 HELOC transaction seeking damages, specific performance and declaratory relief in connection with OneWest failing to properly service the mortgage loans. In August 2013, AGM reached a settlement with OneWest resolving AGM's claims and dismissed the lawsuit.

- On September 25, 2013, Wells Fargo Bank, N.A., as trust administrator, filed an interpleader complaint in the U.S. District Court for the Southern District of New York against AGM, among others, relating to the right of AGM to be reimbursed from certain cashflows for principal claims paid on insured certificates issued in the MASTR Adjustable Rate Mortgages Trust 2007-3 securitization. AGM estimates that an adverse outcome to the interpleader proceeding could increase losses on the transaction by approximately $10 million, net of settlement payments and reinsurance in force.

- On November 8, 2013, AGM filed a complaint in the U.S. Bankruptcy Court for the Eastern District of Michigan against the City of Detroit seeking a declaratory judgment with respect to the City's unlawful treatment of its Unlimited Tax General Obligation Bonds (the "**Unlimited Tax Bonds**"). The complaint seeks a declaratory judgment and court order establishing that, under Michigan law, the proceeds of *ad valorem* taxes levied and collected by the City for the sole purpose of repaying the Unlimited Tax Bonds are "restricted funds", must be segregated and not co-mingled with other funds of the City, and the City is prohibited from using the restricted funds for any purposes other than repaying holders of the Unlimited Tax Bonds.

- On November 15, 2013, AGM entered into a settlement agreement with a provider of representations and warranties that resolved AGM’s claims relating to a residential mortgage-backed securities ("**RMBS**") transaction that AGM had insured. AGM received a $114 million settlement payment.

- On May 11, 2012, AGM sued GMAC Mortgage, LLC, Residential Asset Mortgage Products, Inc., Ally Bank, Residential Funding Company, LLC, Residential Capital, LLC ("**ResCap**"); Ally Financial and Residential Funding Mortgage Securities II, Inc. on the GMAC RFC Home Equity Loan-Backed Notes, Series 2006-HSA3 and GMAC Home Equity Loan-Backed Notes, Series 2004-HE3 second lien transactions that AGM had insured. On May 14, 2012, ResCap and several of its affiliates (the "**debtors**") filed for Chapter 11 protection with the U.S. Bankruptcy Court. The automatic stay of Bankruptcy Code Section 362(a) stayed lawsuits (such as the suit brought by AGM) against the debtors. The Bankruptcy Court has been asked to confirm, at a hearing scheduled for December 11, 2013, the Joint Chapter 11 Plan, which has the support of the debtors, their secured and unsecured creditors and parent Ally Financial Inc. It is anticipated that the Joint Chapter 11 Plan will become effective on or before December 24, 2013.

Selected U.S. Public Finance Transactions to Which AGM Has Exposure

City of Detroit, Michigan. AGM has net par exposure to the City of Detroit, Michigan of $1.5 billion as of September 30, 2013. On July 18, 2013, the City of Detroit filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Most of AGM's net par exposure relates to $701 million of sewer revenue bonds and $729 million of water revenue bonds, both of which AGM rates BBB. Both the sewer and water systems provide services to areas that extend beyond the city limits, and the bonds are secured by a lien on "special revenues." AGM also has net par exposure of $49 million to the City's general obligation bonds (which are secured by a pledge of the unlimited tax, full faith, credit and resources of the City) which AGM rates below investment grade. On December 3, 2013, the Bankruptcy Court ruled that the City is eligible for protection under Chapter 9.

Jefferson County, Alabama. As of September 30, 2013, AGM had net exposure to $267 million of sewer warrants issued by Jefferson County, Alabama. Jefferson County, which had filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code on November 9, 2011, emerged from bankruptcy on December 3, 2013 when its Chapter 9 plan of adjustment became effective. Under the plan of adjustment, the Jefferson County sewer warrants were accelerated as of the effective date of the plan, and upon distribution of payments specified under the plan, Jefferson County's obligations in respect of the sewer warrants were discharged and satisfied. Under the plan of adjustment, owners of those sewer warrants insured by AGM (some of which were fixed rate sewer warrants and some of which were auction rate sewer warrants) received the following payments of principal and interest on the effective date of the plan:

Fixed Rate Sewer Warrant Payments

- Owners of fixed rate sewer warrants who made the commutation election described within the plan of adjustment when their vote was solicited during the plan confirmation process were paid on the effective date by Jefferson County 80% of the aggregate principal amount of their warrants, together with interest accrued to that date. This payment constituted payment in full for such owners, and they have no right to further payments in respect of their warrants from Jefferson County or, consistent with their commutation election, from AGM.

- Owners of fixed rate sewer warrants who did not make the commutation election when their vote was solicited during the plan confirmation process were paid on the effective date, from funds made available by Jefferson County and AGM, 100% of the aggregate principal amount of their warrants, together with interest accrued to that date; Jefferson County paid 65% of such amount and AGM elected to pay the remaining 35% of such amount on an accelerated basis. This payment constituted payment in full of principal plus accrued interest for such owners.

Auction Rate Sewer Warrant Payments

- Owners of auction rate sewer warrants who made the commutation election when their vote was solicited during the plan confirmation process were paid on the effective date by Jefferson County 80% of the aggregate principal amount of their warrants, together with interest accrued to that date. This payment constituted payment in full for such owners and they have no right to further payments in respect of their warrants from Jefferson County or, consistent with their commutation election, from AGM.

- Owners of auction rate sewer warrants who did not make the commutation election when their vote was solicited during the plan confirmation process: (i) were paid on the effective date by Jefferson County 65% of the aggregate principal amount of their warrants, together with interest accrued to that date; and (ii) will remain entitled to payment by AGM under the warrant insurance policy in accordance with the original sinking fund instalment schedule of the remaining 35% of the aggregate principal amount of their warrants, together with accrued interest to the respective payment dates. AGM is entitled to elect at any point in the future to pay the then remaining accelerated principal at par plus accrued interest to the date of payment.

In order for Jefferson County to refund and retire the sewer warrants that it had previously issued, or to pay past due debt service on such sewer warrants, and to pay other claims under the plan of adjustment, Jefferson County issued approximately $1,785 million of new sewer warrants on December 3, 2013. In that issuance, AGM insured approximately $600 million in initial aggregate principal amount of the senior lien sewer warrants in exchange for $37 million in premium.

In connection with the Jefferson County plan of adjustment becoming effective, AGM has dismissed the litigation that it commenced against JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc., the underwriters of debt issued by Jefferson County, in June 2010. The litigation commenced against a number of financial institutions including AGM and other bond insurers in August 2008 (Charles E. Wilson vs. JPMorgan Chase & Co et al), filed in the Circuit Court of Jefferson County, has not been dismissed; those plaintiffs seek to appeal the bankruptcy court's confirmation of the plan of adjustment.

City of Stockton, California. On June 28, 2012, the City of Stockton, California filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. As of September 30, 2013, AGM's net exposure to the City's general fund is $63 million, consisting of pension obligation bonds. As of September 30, 2013, AGM had paid approximately $7 million in net claims. On October 3, 2013, AGM reached a tentative settlement with the City regarding the treatment of the bonds insured by AGM in the City's proposed plan of adjustment. Under the terms of the settlement, AGM will receive title to an office building, the ground lease of which secures the lease revenue bonds, and will also be entitled to certain fixed payments and certain variable payments contingent on the City's revenue growth. The settlement is subject to a number of conditions, including a sales tax increase (which was approved by voters on November 5, 2013), confirmation of a plan of adjustment that implements the terms of the settlement and definitive documentation. Plan confirmation is expected to be completed in 2014.

City of Harrisburg, Pennsylvania. AGM has $132 million of net par exposure to The City of Harrisburg, Pennsylvania, of which $69 million is below investment grade. As of September 30, 2013, AGM had paid approximately $14 million in net claims. The Commonwealth of Pennsylvania appointed receiver for the City has filed a fiscal recovery plan in state court that provides for full payment of AGM insured bonds through proceeds of asset sales and contributions by AGM, Dauphin County, Pennsylvania and other creditors. The plan is expected to be implemented in December 2013.

Foxwoods Casino. During third quarter 2013 and as part of a negotiated restructuring, AGM paid off the insured bonds secured by the excess free cash flow of the Foxwoods Casino run by the Mashantucket Pequot Tribe. AGM made cumulative claims payments of approximately $99 million on the insured bonds. In return for participating in the restructuring, AGM received new notes with a principal amount of $145 million with the same seniority as the bonds AGM had insured ("**New Pequot Notes**"). AGM currently projects full recovery of its claims paid from amounts to be received on the New Pequot Notes. The New Pequot Notes are held as an investment and accounted for as such.

As of September 30, 2013, AGM projected that its total future expected net loss across its troubled U.S. public finance credits will be $27 million. This amount was a net recovery of $58 million as of December 31, 2012. The two primary drivers of the increase in AGM's reserves are the final payout of Mashantucket insured bonds (and subsequent change in accounting treatment from salvage asset to investment holdings) and the negative development in AGM's Detroit exposure.

Residential Mortgage-Backed Securities Transactions to Which AGM Has Exposure

AGM's RMBS loss projection methodology assumes that the housing and mortgage markets will eventually improve. Each quarter, AGM makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as to whether those changes are normal fluctuations or part of a trend. Based on such observations, AGM chose to use essentially the same assumptions and scenarios to project RMBS losses as of September 30, 2013 as it used as of June 30, 2013 and, with respect to its first lien RMBS, as it used as of December 31, 2012. AGM's use of essentially the same assumptions and scenarios to project RMBS losses as of September 30, 2013, as of June 30, 2013 and, with respect to its first lien RMBS, December 31, 2012, was consistent with its view at September 30, 2013 that the housing and mortgage market recovery is not being reflected as quickly in the performance of those transactions as it had anticipated at June 30, 2013 or December 31, 2012. During second quarter 2013, AGM had observed improvements in the performance of its second lien RMBS transactions that, when viewed in the context of their performance in previous quarters, suggested those transactions were beginning to respond to the improvements in the residential property market and economy being widely reported. Based on such observations, in projecting losses for its second lien RMBS AGM chose to decrease by two months in its base scenario and by three months in its optimistic scenario the period it assumed it would take the mortgage market to recover as compared to March 31, 2013 and December 31, 2012. AGM retained this change to its scenarios in its projections as of September 30, 2013.

AGM observed some improvement in delinquency trends in most of its RMBS transactions during the third quarter, with some of that improvement in second liens driven by a servicing transfer it effectuated. Such improvement is transmitted to its projections for each individual RMBS transaction, since the projections are based on the delinquency performance of the loans in that individual RMBS transaction. AGM also made adjustments during the quarter to its assumptions for specific transactions to reflect loss mitigation developments.

Selected Infrastructure Transactions to Which AGM Has Exposure

AGM has insured exposure of approximately $2.9 billion to infrastructure transactions with refinancing risk as to which AGM may need to make claim payments that it did not anticipate paying when the policies were issued; the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. These transactions generally involve long-term infrastructure projects that are financed by bonds that mature prior to the expiration of the project concession. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, AGM expected it to be refinanced in the market at or prior to its maturity. Due to market conditions, AGM may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. AGM generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments is uncertain and may take a long time, ranging from 10 to 35 years, depending on the transaction and the performance of the underlying collateral. AGM's exposure to infrastructure transactions with refinancing risk was reduced during third quarter 2013 by the termination of its insurance on approximately A$413 million of infrastructure securities having maturities commencing in 2014. AGM estimates total claims for the remaining two largest transactions with significant refinancing risk, assuming no refinancing, could be $1.5 billion gross before reinsurance and $1.0 billion net after reinsurance; such claims would be payable from 2017 through 2022. This estimate is based on certain assumptions AGM has made as to the performance of the transactions.

Exposure to Puerto Rico

AGM insures general obligations of the Commonwealth of Puerto Rico and various obligations of its instrumentalities. In recent months, investors have expressed concern about Puerto Rico's high debt levels and weak economy. Of the net insured par related to Puerto Rico, $0.9 billion is supported principally by a pledge of the good faith, credit and taxing power of the Commonwealth or by Commonwealth lease rental payments or appropriations. Puerto Rico’s Constitution provides that public debt constitutes a first claim on available Commonwealth resources. Public debt includes general obligation bonds and notes of the Commonwealth and payments required to be made under its guarantees of bonds and notes issued by its public instrumentalities. Of the remaining exposures, a significant portion, $1.3 billion, is secured by dedicated revenues such as special taxes, toll collections and revenues from essential utilities. In aggregate, AGM insures $2.5 billion net par to Puerto Rico obligors. Neither Puerto Rico nor its instrumentalities are eligible debtors under Chapter 9 of the U.S. Bankruptcy Code. Puerto Rico credits insured by AGM are presently current on their debt service payments, and the Commonwealth has never defaulted on any of its debt payments. Further, 98% of AGM's exposure is rated investment grade internally and by both Moody's and S&P, while 2%, substantially all of the balance of the exposure, is rated no more than one-notch below investment grade. AGM has reduced its aggregate net par exposure to Puerto Rico credits by approximately 11% since January 2010, and limited its insurance of new issues to transactions that refunded existing exposure, with a general focus on lowering interest rates. Management believes recent measures announced by the new Governor of Puerto Rico and his administration in adopting its fiscal 2014 budget in June 2013 reflect a strong commitment to improve the financial stability of the Commonwealth and several of its key authorities. In addition, other actions -- including adoption in April 2013 of substantive pension reform plans that have been upheld by Puerto Rico's Supreme Court; plans to increase the excise tax on petroleum products, signed into law in June 2013; a 60% average rate increase for the Puerto Rico Aqueduct and Sewer Authority implemented in July 2013; and the government's reduction in the use of deficit financing and responsiveness to capital markets -- demonstrate that officials of the Commonwealth are focused on making the necessary choices to help Puerto Rico operate within its financial resources and maintain its access to the capital markets, which is a critical source of funding for the Commonwealth.

2.6 Directors of AGM

The following is a list of the members of the board of directors of AGM by name and function and sets forth any principal activities of such members outside of AGM:

Name	*Function*	*Principal Activities Outside of AGM*
Howard W. Albert	Executive	Chief Risk Officer, Assured Guaranty Ltd.
Robert A. Bailenson	Executive	Chief Financial Officer, Assured Guaranty Ltd.
Russell B. Brewer II	Executive	Chief Surveillance Officer, Assured Guaranty Ltd.
Stephen Donnarumma	Executive	None.
Dominic Frederico (Chairman)	Executive	Chief Executive Officer and President, Assured Guaranty Ltd.
James M. Michener	Executive	General Counsel and Secretary, Assured Guaranty Ltd.
Robert B. Mills	Executive	Chief Operating Officer, Assured Guaranty Ltd.
Donald H. Paston	Executive	None.
Bruce E. Stern	Executive	None.

The business address of Messrs. Albert, Bailenson, Brewer, Donnarumma, Paston and Stern is 31 West 52nd Street, New York, New York, U.S.A. The business address of Messrs. Frederico, Mills and Michener is 30 Woodbourne Avenue, Hamilton, Bermuda HM 08.

As at the date of this Prospectus, the above-mentioned board members of AGM do not have potential conflicts of interests between any duties to AGM and their private interests or other duties that are material to the Bonds.

2.7 Insurance Regulation

AGM is licensed to do business as an insurance company in all fifty states of the United States, the District of Columbia and Puerto Rico. It is subject to the insurance laws and regulations of the State of New York, its state of incorporation, which has a comprehensive financial guarantee insurance law, and the insurance laws and regulations of other states in which it is licensed to transact business. These laws and regulations, as well as the level of supervisory authority that may be exercised by the various state insurance departments, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, meet certain financial tests, including single risk limits and minimum policyholders' surplus and reserve levels, file certain reports with regulatory authorities, including information concerning their capital structure, ownership and financial condition, and require prior approval of certain changes in control of domestic insurance companies and their direct and indirect parents and the payment of certain dividends and distributions. In addition, these laws and regulations require approval of certain intercorporate transfers of assets and certain transactions between insurance companies and their direct and indirect parents and affiliates, and generally require that all such transactions have terms no less favourable than terms that would result from transactions between parties negotiating at arm's length.

U.S. State insurance laws and regulations (as well as the rating agencies) impose minimum capital requirements on financial guarantee insurance companies, limiting the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. Such companies can use reinsurance to diversify risk, increase underwriting capacity, reduce additional capital needs, stabilize shareholder returns and strengthen financial ratios.

As a primary insurer, AGM is required to honour its obligations to its policyholders whether or not its reinsurers perform their obligations under the various reinsurance agreements with AGM. AGM has excess of loss treaties with various reinsurers, which provide for a program of reinsurance with respect to losses that exceed certain levels, as specified in the treaties. AGM has a quota share treaty with its affiliate, Assured Guaranty Re Ltd. ("**AGR**"), which provides for AGR to share a percentage of premiums and losses with AGM.

AGM has entered into municipal bond and structured and international finance facultative reinsurance agreements. These agreements allow AGM to reduce its large risks, to manage its portfolio of insurance by bond type and geographic distribution, and to provide additional capacity for frequent municipal bond issuers. Under these agreements, portions of AGM's interests and liabilities can be ceded on an issue-by-issue basis. A ceding commission is withheld to defray AGM's underwriting expenses.

AGM is required to file quarterly and annual statutory financial statements in the United States of America, and is subject to single and aggregate risk limits and other statutory restrictions concerning the types and quality of investments and the filing and use of policy forms and premium rates. In addition, AGM's accounts and operations are subject to periodic examination by the New York Department of Financial Services and its market conduct is subject to review by other state insurance regulatory authorities.

The beneficiaries of AGM's Financial Guarantee are not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the Insurance Law of the State of New York, U.S.A.

AGM is not authorised or regulated by the Prudential Regulation Authority or the Financial Conduct Authority in the United Kingdom.

2.8 Financial Information

The consolidated balance sheets of AGM as of 31 December 2011 and 31 December 2012 and the related consolidated statements of operations and comprehensive income, of shareholder's equity and of cash flows for each of the two years in the period ended 31 December, 2012, prepared in accordance with U.S. GAAP are included at Appendix 3 hereto.

The consolidated balance sheets of AGM as of 31 December 2012 and 30 June 2013 and the related consolidated statements of operations (unaudited) and comprehensive income (unaudited) for the three and six months ended 30 June 2012 and 30 June 2013, of shareholder's equity (unaudited) for the six months ended 30 June 2013 and of cash flows (unaudited) for the six months ended 30 June 2012 and 30 June 2013, prepared in accordance with U.S. GAAP, are included at Appendix 4 hereto.

There has been no material adverse change in AGM's prospects and no significant change in its financial or trading position since 31 December 2012, the date to which AGM's most recent audited financial statements have been prepared, other than as set forth in (a) AGM's unaudited financial statements as of 30 June 2013 or (b) the description of developments in Section 2.5 above.

Total shareholder's equity attributable to AGM as of 30 September 2013 was $3,485 million, compared to $3,405 million as of 30 June 2013. The increase was primarily due to net income attributable to AGM, which was partially offset by dividends paid. Net income includes items that may be volatile, such as assets and liabilities that are carried at fair value and therefore vary from period to period.

Under the insurance laws of the State of New York, AGM may pay dividends out of earned surplus, which is the portion of a company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends or transferred to stated capital or capital surplus, or applied to other purposes permitted by law, but does not include unrealized appreciation of assets; provided that, together with all dividends declared or distributed by AGM during the preceding 12 months, the dividends do not exceed the lesser of (a) 10 per cent of policyholders' surplus as of its last annual or quarterly statement filed with the Superintendent of Insurance of the State of New York or (b) adjusted net investment income (net investment income at the preceding 31 December plus net investment income that has not already been paid out as dividends for the three calendar years prior to the preceding calendar year) during this period. As of 30 September 2013, approximately $78 million was available for distribution of dividends, after giving effect to dividends paid in the prior 12 months of $98 million.

2.9 **Auditors**

AGM's auditors are PricewaterhouseCoopers LLP ("**PwC U.S.** "), 300 Madison Avenue, New York, New York 10017 U.S.A. PwC U.S. is a member of the American Institute of Certified Public Accountants.

PwC-U.S.'s report on the audited financial statements of AGM for the years ended 31 December 2012 and 31 December 2011 is included with such accounts, which are included at Appendix 3 hereto.

2.10 **Material Contracts**

AGM has not entered into contracts outside the ordinary course of business that could result in AGM being under an obligation or entitlement that is material to AGM's ability to meet its obligations to the Bond Trustee under its Financial Guarantee. See "*Description of the Financial Guarantors – Assured Guaranty (Europe) Ltd. – Material Contracts*" above.

DESCRIPTION OF THE ISSUER, PROJECTCO, HOLDCO AND THE SHAREHOLDERS

The following is an overview description of the Issuer, ProjectCo, HoldCo and the Shareholders and should be read in conjunction with the rest of the Prospectus.

1. The Issuer

History and development of the Issuer

The legal and commercial name of the Issuer is S4B (Issuer) plc.

The Issuer was incorporated in England and Wales with registered number 08528504.

The Issuer was incorporated under the Companies Act 2006 on 14 May 2013.

The Issuer was incorporated as a public limited company and operates under the Companies Act 2006.

The Issuer's registered office is at Boundary House, 91 - 93 Charterhouse Street, London EC1M 6HR and the telephone number of its registered office is +44(0)207 250 733.

BUSINESS OVERVIEW

Principal activities

The Issuer has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. The Issuer is a special purpose company established to:

(i) issue the Bonds;

(ii) on-lend the proceeds of the Bonds, and the proceeds of the issue of its share capital to the Contractor;

(iii) enter into the documents to which it is expressed to be a party; and

(iv) undertake any ancillary matters relating thereto.

ORGANISATIONAL STRUCTURE

The Issuer is a wholly owned subsidiary of HoldCo.

MAJOR SHAREHOLDERS

The share capital of the Issuer is £50,000 divided into 50,000 ordinary shares of £1 each, all of which are fully paid up. The Issuer is a wholly owned subsidiary of HoldCo.

TREND INFORMATION

There has been no material adverse change in the prospects of Issuer since 14 May 2013. The Issuer has not yet published audited financial statements; see below for further details.

ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

As at the date hereof, the directors of the Issuer are as follows:

Name	Function
Ben Leech	Director
David Rose	Director
Brian Love	Director
Lee Simmons	Director
Judith Winterbourne	Director
Gary Lagar	Director

The business address of each of Ben Leech and David Rose is Boundary House, 91-93 Charterhouse Street, London EC1M 6HR. The business address of Brian Love is Cowley Business Park, Cowley, Uxbridge, Middlesex UB8 2AL. The business address of each of Gary Lagar and Judith Winterbourne is Quay Plaza 2, Lowry Mall, Salford Quays, Salford M50 3AH.

The principal activities performed by each director outside the Issuer, where these are significant in respect to the Issuer are as follows:

Name	Function	Company
Ben Leech	Director	S4B Limited S4B (Issuer) plc S4B (Holdings) Limited
David Rose	Director	S4B Limited S4B (Issuer) plc S4B (Holdings) Limited Derbyshire Learning and Community Partnerships Limited Cambridgeshire Learning and Community Partnerships Limited
Brian Love	Director	S4B Limited S4B (Issuer) plc S4B (Holdings) Limited Graylingwell Energy Services Limited Regeneco (Services) Limited Regeneco Limited Galliford Try Investments Limited
Lee Simmons	Director	S4B Limited S4B (Issuer) plc S4B (Holdings) Limited HTP Grange Holdco Limited HTP PSP Limited HTP Grange Limited Education Link (Holdings) Limited Education Link (2001) Limited Galliford Try Investments Limited
Judith Winterbourne	Director	S4B Limited S4B (Issuer) plc S4B (Holdings) Limited Halton Housing Trust Limited Open Solutions (OSUK) Limited Bolton Community Homes Limited
Gary Lagar		S4B Limited S4B (Issuer) plc S4B (Holdings) Limited

All directors are directors of the Contractor and HoldCo. All directors are also employees or directors of entities which are part of a Shareholder Group (being an Affiliate of any of the Shareholders) and/or entities which are party to a Relevant Document or the Management Services Agreement. Otherwise there are no potential conflicts of interest between any duties of the directors referred to above to the Issuer and their private interests and/or other duties.

FINANCIAL INFORMATION CONCERNING THE ISSUER'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

Historical financial information

The Issuer has not published any financial information. Its annual financial year end-date is 31 March. Its initial financial statements are intended to be published for the period from its date of incorporation to 2015.

Significant change to the Issuer's financial or trading position

There has been no significant change in the financial or trading position of the Issuer which has occurred since 4 May 2013. At the date of this Prospectus, the Issuer has not traded and has not published audited or interim financial information.

THIRD PARTY INFORMATION

No information in relation to the Issuer contained in this Prospectus has been sourced from a third party.

SHAREHOLDER CONTROL

The Issuer is a wholly-owned subsidiary of HoldCo established for the purposes of issuing the Bonds. Amongst other things HoldCo undertakes to act in a manner that is consistent with and shall exercise all voting rights and other powers of control (insofar as it is able to exercise such rights and powers) available to it to procure that the Issuer carries out its primary business of issuing the Bonds and complies with the provisions set out in the Subscription Agreement, the Shareholders" Agreement and the Relevant Documents.

2. ProjectCo

History and development of the ProjectCo

The legal and commercial name of the ProjectCo is S4B Limited.

The ProjectCo was incorporated in England and Wales with registered number 08493217.

The ProjectCo was incorporated under the Companies Act 2006 on 17 April 2013.

The ProjectCo was incorporated as a limited liability company and operates under the Companies Act 2006.

The ProjectCo's registered office is at Boundary House, 91 - 93 Charterhouse Street, London EC1M 6HR and the telephone number of its registered office is +44(0)207 250 733.

BUSINESS OVERVIEW

Principal activities

The ProjectCo has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. The ProjectCo is a special purpose company established to:

(i) carry out the Project;

(ii) enter into the documents to which it is expressed to be a party; and

(iii) undertake any ancillary matters relating thereto.

ORGANISATIONAL STRUCTURE

The ProjectCo is a wholly owned subsidiary of HoldCo.

SHARE CAPITAL AND SHAREHOLDERS

The share capital of the ProjectCo is £50,000 divided into 50,000 ordinary shares of £1 each, all of which are fully paid up. The ProjectCo is a wholly owned subsidiary of HoldCo.

TREND INFORMATION

There has been no material adverse change in the prospects of the ProjectCo since 17 April 2013. The ProjectCo has not yet published audited financial statements; see below for further details.

ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

As at the date hereof, the directors of the ProjectCo, their business addresses and other principal activities are the same as those of the Issuer.

All directors are directors of the Issuer and HoldCo. All directors are also employees or directors of entities which are part of a Shareholder Group (being an Affiliate of any of the Shareholders) and/or entities which are party to a Relevant Document or the Management Services Agreement. Otherwise there are no potential conflicts of interest between any duties of the directors referred to above to the ProjectCo and their private interests and/or other duties.

FINANCIAL INFORMATION CONCERNING THE PROJECTCO'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

Historical financial information

The ProjectCo has not published any financial information. Its annual financial year end-date is 31 March. Its initial financial statements are intended to be published for the period from its date of incorporation to 2015.

Significant change to the ProjectCo's financial or trading position

There has been no significant change in the financial or trading position of the ProjectCo which has occurred since 17 April 2013. At the date of this Prospectus, the ProjectCo has not traded and has not published audited or interim financial information.

THIRD PARTY INFORMATION

No information in relation to the ProjectCo contained in this Prospectus has been sourced from a third party.

3. **HoldCo**

HISTORY AND DEVELOPMENT OF HOLDCO

The legal and commercial name of HoldCo is S4B (Holdings) Limited.

HoldCo was incorporated in England and Wales with registered number 08493057.

HoldCo was incorporated under the Companies Act 2006 on 17 April 2013.

HoldCo was incorporated as a private limited company and operates under the Companies Act 2006.

HoldCo's registered office is at Boundary House, 91 - 93 Charterhouse Street, London EC1M 6HR and the telephone number of its registered office is +44(0)207 250 733.

BUSINESS OVERVIEW

Principal activities

HoldCo has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. HoldCo is a special purpose company established to act as holding company of the Issuer and ProjectCo.

ORGANISATIONAL STRUCTURE

HoldCo is the parent company of the Issuer and ProjectCo.

SHARE CAPITAL AND SHAREHOLDERS

The share capital of HoldCo is £100,000 divided into 100,000 ordinary shares of £1 each, all of which are fully paid up.

As at the date of this Prospectus, HoldCo is owned by Equitix Housing 2 Limited as to 77.5 per cent, Contour Homes Limited as to 15 per cent and Galliford Try Investments Limited as to 7.5 per cent.

Equitix Housing 2 Limited

Equitix Housing 2 Limited is a company registered in England and Wales with company number 08311229 whose registered office is at Boundary House, 91-93 Charterhouse Street, London EC1M 6HR and which was incorporated on 28 November 2012.

Equitix Housing 2 Limited is a wholly owned subsidiary of Equitix Capital Eurobond 2 Limited, a company registered in England and Wales with company number 7449938 whose registered office is at Boundary House, 91-93 Charterhouse Street, London EC1M 6HR and which was incorporated on 24 November 2010.

The Equitix Group is a UK based developer, investor and fund manager specialising in public private partnerships.

Contour Homes Limited

Contour Homes is an industrial and provident society registered in England and Wales with registered number IP23607R and whose registered address is Quay Plaza 2, Lowry Mall, Salford Quays, Salford, M50 3AH and which was registered, pursuant to the Industrial and Provident Act 1965, on 01 April 1982. Contour Homes is an exempt charity and registered as a non-profit making registered provider of social housing in the register maintained by the Homes and Communities Agency acting through its Regulation Committee as the Regulator of Social Housing (within the meaning of the Housing and Regeneration Act (2008) (as amended by the Localism Act 2011)).

Galliford Try Investments Limited

Galliford Try Investments Limited is a company registered in England and Wales with company number 05047034 whose registered office is at Cowley Business Park, Cowley, Uxbridge, Middlesex UB8 2AL and which was incorporated on 17 February 2004. Galliford Try Investments Limited is a UK investor and manager specialising in public private partnerships.

TREND INFORMATION

There has been no material adverse change in the prospects of HoldCo since 17 April 2013. HoldCo has not yet published audited financial statements; see below for further details.

ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

As at the date hereof, the directors of the Contractor, their business addresses and other principal activities are the same as those of the Issuer.

All directors are directors of the Issuer and the Contractor. All directors are also employees or directors of entities which are part of a Shareholder Group (being an Affiliate of any of the Shareholders) and/or entities which are party to a Relevant Document or the Management Services Agreement. Otherwise there are no potential conflicts of interest between any duties of the directors referred to above to HoldCo and their private interests and/or other duties.

FINANCIAL INFORMATION CONCERNING HOLDCO'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

Historical financial information

HoldCo has not published any financial information. Its annual financial year end-date is 31 March. Its initial financial statements are intended to be published for the period from its date of incorporation to 2015.

Significant change to the HoldCo's financial or trading position

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THIRD PARTY INFORMATION

No information in relation to HoldCo contained in this Prospectus has been sourced from a third party.

OVERVIEW OF THE PROJECT DOCUMENTS

1. Project Agreement

General

This section describes and analyses the principal terms of the Project Agreement. This analysis is not exhaustive, but focuses on issues of particular interest to prospective Bondholders. The Project Agreement is the principal agreement between the Authority and the Contractor to give effect to the arrangements described under the section entitled "*Overview of the Project*".

Parties and Duration

The parties to the Project Agreement are the Authority and the Contractor. The Project Agreement comes into effect on the Issue Date and continues for 25 years.

Change in Control

The general principle is that no Change of Ownership is permitted during the Lock in Period. The restrictions on a Change of Ownership extend to:

(a) a sale, transfer or disposal of the legal, beneficial or equitable interest in any or all of the shares in the Issuer, the Contractor, HoldCo, any Shareholder, Equitix Capital Eurobond 2 Limited or Equitix Fund HoldCo 2 Limited, a general partner of (or anyone carrying out management or supervisory functions for) Equitix Fund II LP or an Approved Equitix Fund; or

(b) a change in the general partner of Equitix Fund II LP or an Approved Equitix Fund.

The Lock in Period is the period expiring on the date 12 months from the Initial Refurbishment Works Completion Date.

However, there are exceptions to this principle which include:

(a) the grant or enforcement of security in favour of the Senior Creditors over the shares of the Contractor, Holdco or the Issuer;

(b) any change in legal or beneficial ownership of any shares that are listed on a recognised investment exchange (as defined in section 285 of the Financial Services and Markets Act 2000); and

(c) sale, transfer or disposal of the legal or beneficial interest in any or all shares in the relevant entities to an Affiliate of such entity (subject to certain restrictions where the Affiliate ceases to be an Affiliate).

The Contractor must also obtain the Authority's prior written consent to a Restricted Share Transfer, which is a transfer of the shares in the Contractor, HoldCo or the Issuer to an Unsuitable Third Party (persons interested in tobacco, alcoholic drinks, whose activities are incompatible with the provision of services to the Authority, or who could pose a threat to national security).

Completion of the Works

The Contractor is obliged to carry out the Service Works in accordance with the Output Specification and the Service Works Delivery Plan both as set out in the Project Agreement. The detailed design to be prepared after the Project Agreement is entered into is subject to the Review Procedure under which it is submitted for comment and approval by the relevant Authority representative.

Under the Project Agreement, the Initial Refurbishment Works (which includes the refurbishment of existing properties and the construction of the new build properties but excludes the cyclical maintenance works) have been divided into 104 separate phases ("**Phases**", with each separate phase a "**Phase**") and five zones ("**Zones**") for the purposes of completion. The Contractor is required to complete the Initial Refurbishment Works by a specified date, the Planned Phase Initial Refurbishment Works Completion Date, subject to permitted extensions of time and also meeting certain defined

Milestones (as described in the section entitled "*Risk Factors*"). Prior to refurbishment, the Contractor will be required to provide certain Interim Services to those facilities in order that they achieve the Interim Property Management Standards.

Sweett (UK) Limited (the "**Independent Certifier**") has been jointly appointed by the Authority and the Contractor to certify the completion of each Phase of the Initial Refurbishment Works. The Initial Refurbishment Works to the Low Rise Retained Dwellings and the High Rise Retained Dwellings will be certified and completed on a Phase by Phase basis with Acceptance Certificates being issued for the In-Curtilage Works, the Phased Infrastructure and Communal Works, the Initial Refurbishment Works in relation to the New Build Homes and the Soft Landscaping respectively in each Phase. The Unitary Charge steps-up on the issue of an Acceptance Certificate for each Phase. In addition, the Acceptance Certificate is conclusive that the Initial Refurbishment Works Completion Date for that Phase has occurred (this will be the same date under the Project Agreement and the Construction Contract or Refurbishment Contract as necessary). The effect of the Acceptance Certificate is also to trigger the commencement of the defects liability period for the relevant Phase.

The Authority has the benefit of a delay indemnity from the Contractor in connection with the completion of the Initial Refurbishment Works. The indemnity is only intended to cover the loss of rental income to the Authority where a property is unavailable due to a delay in completion of the relevant Initial Refurbishment Works.

If the Contractor fails to complete the Initial Refurbishment Works by the relevant Milestone Completion Dates or the Longstop Date this will trigger a Contractor Default under the Project Agreement.

The Longstop Dates and Milestone Completion Dates have been flowed down into the Construction Contract and the Refurbishment Contract. Where possible these are designed to give the Contractor an ability to step in and replace the defaulting Sub-Contractor prior to termination being triggered at Project Agreement level.

Defects

Under the Project Agreement, the Contractor takes the risk in latent defects and defects in the retained dwellings (including in the high rise tower block up to an aggregate cap of £175,000 (indexed)) and defects in the new build properties.

The Contractor also takes the risk of defects in any Infrastructure for a period of 12 months from completion of any infrastructure works (not including Soft Landscaping) and 24 months from completion of any Soft Landscaping works.

Compensation Events

There are a number of specified Compensation Events:

(a) breach by the Authority of any of its obligations or of any warranty under the Project Agreement and any other matter expressed as or deemed to be a Compensation Event under the Project Agreement;

(b) if any Rehousing Applications have not been rehoused at the Rehousing End Date (provided that the Contractor has complied with its rehousing obligations); and

(c) where the Authority fails to obtain the necessary statutory orders to deliver the land and related rights and interests necessary for the Contractor to carry out the Works and the Services.

If a Compensation Event has resulted in:

(a) a delay to or failure by the Contractor to achieve any relevant agreed dates in the construction programme (e.g. Start on Site Date, Planned Phase Initial Refurbishment Works Completion Date, Service Commencement Date, Milestone Completion Dates or the Longstop Date);

(b) failure by the Contractor to comply with its obligations under the Project Agreement; or

(c) costs incurred or revenue lost,

then the Contractor is entitled to relief from its obligations, an extension of time and compensation provided that it has complied with the relevant procedures and deadlines to make a claim.

Relief Events

There are a number of specified Relief Events:

(a) fire, explosion, lightning, storm, tempest, flood, bursting or overflowing of water tanks, apparatus or pipes, ionising radiation (to the extent it does not constitute a Force Majeure Event), earthquakes, riot and civil commotion;

(b) failure by any statutory undertaker, utility company, local authority or other like body to carry out works or provide services;

(c) any accidental loss or damage to the Properties or any roads servicing them;

(d) any failure or shortage of power, fuel or transport;

(e) any blockade or embargo which does not constitute a Force Majeure Event;

(f) any:

(i) official or unofficial strike;

(ii) lockout;

(iii) go slow; or

(iv) other dispute,

generally affecting the construction, housing or facilities management industry or a significant sector of it; or

(g) the occurrence of a Service Works or Services Denial Event.

In order to claim relief, the Relief Event must not have occurred as a result of any wilful act or default of the Contractor or any of its related parties. The principal consequence of a Relief Event is relief from termination by reason of a failure to perform the Works or the Services to the extent that such failure to perform occurs because of the Relief Event. However, the Contractor bears the financial consequences of any Relief Events in that no compensation is payable to the Contractor and it is still liable to Deductions where the Relief Event has affected performance of the Services or made any of the Properties Unavailable.

A Relief Event which occurs during the works period may delay the uplift of the Unitary Charge. If the Relief Event is covered by insurance then (subject to the applicable policy deductible) the delay in uplift to the Unitary Charge will be covered. If the Relief Event is not covered by insurance then it will be covered by liquidated damages payable under the Construction Contract and/or Refurbishment Contract as necessary. The cost of reinstatement and loss will in most cases be recovered through the construction all risk insurance policy, subject to any applicable deductible, which will in most cases be passed down to the Construction Contractor and/or Refurbishment Contractor as appropriate.

In respect of the Services, the Contractor will take out business interruption insurance in respect of a number of insurable Relief Events which is intended to mitigate the financial risks of those events. Consequences of a Relief Event which cause Deductions from the Unitary Charge will in most cases be passed down to the relevant Sub-Contractors, subject to their agreed liability caps.

Force Majeure Events

There are number of specific Force Majeure Events:

(a) war, civil war, armed conflict or terrorism;

(b) nuclear, chemical or biological contamination unless the source or the cause of the contamination is the result of the actions or breach by the Contractor or its Sub-Contractors; or

(c) pressure waves caused by devices travelling at supersonic speeds,

which directly causes either party to be unable to comply with all or a material part of its obligations under the Project Agreement.

The immediate consequence of a Force Majeure Event is that where the Contractor is unable to perform its obligations under the Project Agreement and provided the Contractor has given the correct notice under the Project Agreement it shall be relieved from its liability for breach of the Project Agreement and the Authority shall not be entitled to terminate the Project Agreement. The exception to this is where the parties are unable to agree a course of action to deal with the Force Majeure Event within 80 business days. In this situation, where the Force Majeure Event continues for 120 business days, either party can terminate the Project Agreement on 30 business days Sub-Contractor written notice.

Unless and until the Project Agreement is terminated, the Contractor shall not receive any financial compensation for the impact of the Force Majeure Event. If the Force Majeure Event occurs in the works period, any delay in the uplift to the Unitary Charge will be covered by the liquidated damages payable by the Construction Contractor or the Refurbishment Contractor respectively. The Authority is obliged to pay for Services that are actually being provided but can still impose Deductions on those Services. This risk is flowed down to the relevant Sub-Contractors and the Contractor can rely on the project insurances to the extent that the relevant event is covered. Note that not all Force Majeure Events or Relief Events are covered by the project insurances.

Maintenance and Lifecycle

The Contractor is required to prepare and implement the Cyclical Maintenance and Replacement Programme and Plan. This is reviewed on an annual basis to plan for the next five years. The Contractor must also agree the Planned Maintenance Programme with the Authority on an annual basis. The Contractor shall be entitled to claim an Excusing Event (and therefore will not be liable for Deductions) when carrying out any Planned Maintenance.

Services

The Services to be provided or procured by the Contractor are the Housing Management Services and the RRCMR Services. Certain RRCMR Services will be provided on an interim basis to the retained dwellings which are to be demolished or refurbished in accordance with the construction programme.

Unitary Charge

The Authority will pay the Unitary Charge to the Contractor on a monthly basis. The Unitary Charge will be paid subject to Deductions, Pass Through Costs, CNDT Adjustments and other amounts to be agreed between the Authority and the Contractor. There is an overall cap on Deductions in any Contract Year set at the total Unitary Charge for that Contract Year. There is also a cash flow cap which limits the amount of Deductions that can be made in any Contract Month to the level of the Unitary Charge payable in that Contract Month. Any excess Deductions can be rolled over to the next Contract Month (subject to the overall cap). In addition, the Authority cannot make Performance Deductions (other than in respect of rent collection and tenant satisfaction) in any Contract Year which are greater than 27 per cent of the total Unitary Charge for that Contract Year.

The Unitary Charge is to be indexed annually from 1 April 2013 (the "**Base Date**") on 1 April each Contract Year, in accordance with changes in RPIX from the Base Date.

The following types of Services will be subject to market testing:

(a) Policy and Management;

(b) Managing Tenancies;

(c) Rent collection and accounting; and

(d) Leasehold management.

These services will be market tested on the fifth anniversary of the Service Commencement Date and thereafter on a five yearly basis. Following a market testing, the Unitary Charge will be reduced or increased by the amount of any saving or increase. The Housing Management Services which are subject to market testing will be market tested as a whole and the RRCMR Services which are subject to market testing will be market tested as a whole. This means that following a market testing the relevant Sub-Contractor may be replaced.

Deductions/Performance Monitoring in relation to the Services

The key Deductions that the Authority can make against the Unitary Charge are as follows:

(a) **Unavailability Deductions** – these are linked to the availability of a property which is measured against whether the relevant Property Management Standards have been achieved (subject to certain tolerances);

(b) **Performance Deductions** – these are linked to the achievement of key Performance Standards (subject to certain tolerances); and

(c) **Reporting Deductions** – these are incurred where the Contractor fails to report Unavailability or Performance Deductions to the Authority in accordance with the agreed performance monitoring process.

The Contractor will also suffer deductions if rent collection does not satisfy targets. There is a sharing of upside if rent collection exceeds target. The obligations on the Contractor under the Payment Mechanism have been predicated on the basis that where Tenants are in receipt of Housing Benefit this is, and will continue to be, paid directly to the Authority, rather than the Tenant. Should during the term of the Project Agreement this cease to apply for whatever reason, the Authority shall meet with the Contractor as soon as reasonably practical to discuss any changes to the Project Agreement that may be necessary to ensure that both the Authority and the Contractor are left in a no better no worse position than had the alteration in the practice in relation to the payment of Housing Benefit not occurred.

If an Excusing Event (as described below) interferes adversely with the performance of the Services, the Contractor's failure to perform will not constitute a breach of the Project Agreement and it will not be liable to Deductions. The system for monitoring performance of the Services and the mechanism by which the Authority pays the Contractor for the Services shall continue as if the event that caused the Deduction had not occurred.

The Excusing Events relevant to Unavailability are as follows:

(a) a Compensation Event;

(b) the implementation of a Contractor Change or a Authority Change up to the completion of the relevant works and/or Services required to implement such Change to the extent that the period for carrying out such works and/or Services agreed under Clause 18 (*Changes to the Service Works*) has not been exceeded;

(c) an Emergency pursuant to Clause 30 (*Emergencies*);

(d) a Contractor Related Party acting properly on the instruction of the Authority issued in accordance with the Project Agreement;

(e) a Tenant properly acting on the instruction of the Authority or any of its members, officers or employees acting in that capacity;

(f) the carrying out of relevant Planned Maintenance by the Contractor, in accordance with the agreed timescales specified in the Planned Maintenance Programme;

(g) any event as a result of which the Contractor offers and all Affected Persons accept Temporary Accommodation from and including the Start Date up to and including the Return Date agreed in accordance with paragraphs 4.31 to 4.33 (but not for any period thereafter);

(h) the Contractor being unable to obtain access necessarily required to carry out Remedial works as a result of an Access Refusal Event;

(i) the carrying out of works arising from Pre-Existing Disrepair Claims;

(j) the carrying out of Backlog Repairs within the Backlog Repairs Rectification Period or where a Backlog Repair continues to be outstanding;

(k) the Contractor carrying out the relevant Service Works to that Serviced Dwelling provided that such Service Works are carried out .in accordance with Good Industry Practice and timescales for the sequence of works to individual homes in the Service Works Delivery Plan;

(l) the carrying out of Adaptation Work within the timescales agreed pursuant to Schedule 1J (Adaptations Protocol);

(m) the carrying out of works to rectify Snagging Items provided that such work is carried out within six months of the date of the Acceptance Certificate identifying such Snagging Items;

(n) the Contractor's need to comply with the provisions of the Party Wall Act provided that such compliance is in accordance with Good Industry Practice;

(o) Utility Failure; and

(p) a breach of any Service Level Requirement caused solely and directly by works being undertaken by an Authority Related Party or by any public utility provider (or their contractors of any tier) subject to those parties not working under the instruction of the Contractor,

provided always that the Serviced Dwelling does not otherwise become unavailable due to some other cause or event (other than one listed in (a) to (p) above) during the same period.

The Excusing Events relevant to Performance Deductions are as follows:

(a) a Compensation Event;

(b) the implementation of a Contractor Change or an Authority Change up to the completion of the relevant works and/or Services required to implement such Change to the extent that the period for carrying out such works and/or Services agreed under Clause 18 (*Changes to the Service Works*) has not been exceeded;

(c) an Emergency pursuant to Clause 30 (*Emergencies*);

(d) a Contractor Related Party acting properly on the instruction of a Authority Related Party issued in accordance with the Project Agreement;

(e) a Tenant properly acting on the instruction of the Authority or any of its members, officers or employees acting in that capacity;

(f) the carrying out of relevant Planned Maintenance by the Contractor, in accordance with the agreed timescales specified in the Planned Maintenance Programme;

(g) a Utility Failure;

(h) the Contractor's inability to obtain access to a Serviced Dwelling as a direct result of extreme weather conditions of such severity that the Authority is or would be prevented from performing services of the type in respect of which the Contractor requires access to a Serviced Dwelling;

(i) the Contractor being unable to obtain access necessarily required to carry out Remedial Works as a result of an Access Refusal Event;

(j) the carrying out of works arising from Pre-Existing Disrepair Claims;

(k) the carrying out of Backlog Repairs within the Backlog Repairs Rectification Period or where a Backlog Repair continues to be outstanding;

(l) Unavailability of any Serviced Dwelling to the extent that such Unavailability has directly caused the occurrence of the Service Failure or Repeated Service Failure;

(m) the Services no longer being required to a Serviced Dwelling that is Unoccupied and for which the Tenants or Leaseholders are being re-housed in Temporary Accommodation;

(n) the carrying out of works to rectify Snagging Items provided that such work is carried out within six months of the date of the Acceptance Certificate identifying such Snagging Items;

(o) the Contractor carrying out the relevant Service Works to that Serviced Dwelling provided that such Service Works are carried out in accordance with Good Industry Practice; and

(p) the Contractor's need to comply with the provisions of the Party Wall Act provided that such compliance is in accordance with Good Industry Practice,

to the extent that any such event or circumstance is not caused by an act or omission of a Contractor Related Party.

TUPE and Pensions

There are 13 Authority employees who will transfer to the Housing Management Contractor and 1 Authority employee who will transfer to the RRCMR Contractor on agreed dates by virtue of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("**TUPE**"). The Project Agreement records an agreed set of assumptions as to the numbers and characteristics of the transferring employees. If at the date of the transfer the actual numbers and/or characteristics are different then there is a mechanism in the Project Agreement to allow the Unitary Charge to be adjusted accordingly. The Authority will remain liable for employment related liabilities in connection with the transferring employees which arose prior to the date of transfer and indemnifies the Contractor on this basis. The Contractor provides a reciprocal indemnity to the Authority and any future service provider to whom the employees transfer on termination or expiry of the Project Agreement.

The Contractor will either:

(a) enter into an admission agreement in respect of the Local Government Pension Scheme ("**LGPS**") so that it can be an admission body and offer any eligible employees membership. The Unitary Charge has been based on an employer pension contribution rate of 13.6 per cent of the eligible employees' gross pensionable payroll. This rate may change following a valuation of the relevant Authority pension scheme. Increases or reductions as a result of the change will be accounted for on a monthly basis when calculating the Unitary Charge; or

(b) offer employees membership of a Contractor Scheme which is GAD certified as being broadly comparable with the LGPS. This could be where the Contractor does not wish to enter into an admission agreement or is not entitled to or where it ceases to be an admission body.

Change in Law

The Contractor is required to carry out the Service Works and the Services in accordance with any Change in Law.

The Authority takes the financial risk (including capital expenditure) on any Qualifying Change in Law which includes:

(a) a Discriminatory Change in Law – one which expressly applies to the Project and/or the Contractor and not similar projects or companies;

(b) a Specific Change in Law – one which applies to the provision of housing or tenant management services to social housing, construction and maintenance services to residential tenanted accommodation, tenants or leaseholders of social housing or the holding of shares in companies providing those services; and

(c) a General Change in Law (in connection with Service Works or Services) which requires capital expenditure which was not foreseeable as at the date of the Project Agreement or which occurred within the first two years of the contract period.

The Contractor takes the financial risk for:

(a) any General Changes in Law (requiring capital expenditure) which was foreseeable at the date of the Project Agreement or which occurs within the first two years of the contract period; and

(b) any General Change in Law which does not require capital expenditure.

Changes

The Change Protocol sets out a detailed process for the notification, agreement and implementation of changes to the Works and the Services which can be initiated by the Authority or the Contractor.

Neither party can propose or implement a Change which:

(a) which requires the Services or the Service Works to be performed or a Change to be implemented in a way that infringes any Legislation or Guidance or is inconsistent with Good Industry Practice;

(b) which would cause any Necessary Consent to be revoked (or a new Necessary Consent required to implement the relevant Change which, after using reasonable efforts in accordance with Good Industry Practice has been unable to obtain);

(c) which would materially and adversely affect the Contractor's ability to deliver the Services or the Service Works carried out (except for that part of the Service or the Service Works which has been specified as requiring to be amended in the Change Notice) in a manner not compensated pursuant to this Change Protocol;

(d) which would materially and adversely affect the health and safety of any person;

(e) which would require the Contractor to implement the Change in an unreasonable period of time;

(f) which would (if implemented) materially and adversely change the nature of the Project (including its risk profile); and/or

(g) whereby the Authority does not have the legal power or capacity to require the implementation of such Change.

There are five categories of Change: (i) Low Value Change (works of a minor nature less than £10,000); (ii) Medium Value Change (a change which will cost less than £300,000 (Indexed) to implement or require an adjustment to the Unitary Charge that is less than 1 per cent of the annual Unitary Charge); (iii) High Value Change (a change which will cost more than £300,000 (Indexed) to implement or require an adjustment to the Unitary Charge that is more than 1 per cent of the annual Unitary Charge); (iv) a Multiple Retained Dwelling Change and (v) a Contractor Change.

Where the proposed Change requires the Contractor to incur capital expenditure, the Authority may require the Contractor to secure funding. The Contractor is required to use its reasonable endeavours to secure funding for a period of 40 business days from the Authority Notice of Change after which time the Change will either be deemed to be withdrawn or the Authority will fund the capital expenditure itself. Where the Change gives rise to ongoing non-capital expenditure, the Unitary Charge will be adjusted on the basis of the Contractor being in no better or no worse position following the implementation of the Change.

Senior Creditors are entitled to carry out due diligence on the proposed Change where certain value thresholds have been met:

(a) Low Value Changes – more than ten (10) or £75,000 in the aggregate in any contract year;

(b) Medium Value Changes – more than five (5) or £150,000 in the aggregate in any contract year; and

(c) High Value Changes – as required.

The costs of such due diligence should not exceed 3 per cent of the value of the proposed Change.

If the Contractor does not comply with the agreed timetable for responding to a Change, the Authority can deduct an Agreed Abatement from the Unitary Charge until the Contractor does comply.

Insurance

ProjectCo is required to take out the insurances specified in the Project Agreement. These include: Contractor's all risk, public liability, property damage, delay in start up and business interruption insurance (the "**Required Insurances**"), but the nature of the policies to be taken out varies depending on whether it is the construction period or the services period. In addition Project Co shall take out insurance in relation to the Development Works as part of the construction period insurances. This is in part to mitigate any risk of an indemnity being triggered under the Project Agreement which relates to the performance of the Development Works.

All proceeds from the physical damage policies of an amount in excess of £25,000 will be paid into a joint insurance account (between the Authority and the Contractor) and applied to reinstate, replace or repair the properties to which the claim relates (subject to the Economic Test described below).

The Economic Test applies if all of the retained dwellings on a site are destroyed or substantially destroyed in a single event and the insurance proceeds, together with other funds available to the Contractor, are equal to or greater than reinstatement cost. If the test applies, the Contractor is required to calculate whether the senior debt loan life cover ratio (assuming reinstatement) described in the Collateral Deed is greater than or equal to a defined event of default level. If the senior debt loan life cover ratio (assuming reinstatement) is equal or greater then the Contractor will reinstate. If it is less, then an amount equal to the lesser of the insurance proceeds or the Base Senior Debt Termination Amount or the Revised Senior Debt Termination Amount (if any Additional Permitted Borrowing has been advanced) will be released to the Contractor. If this happens the Contractor will still be obliged to reinstate within a reasonable timescale and the most likely scenario is that the Project Agreement will terminate due to a Contractor Event of Default for failure to reinstate.

If there is an Uninsurable risk the Contractor is no longer required to take out such insurance. Where the parties cannot agree how to share or manage the risk then the Authority can either:

(a) choose to act as the insurer and pay the Contractor an amount equal to the insurance proceeds that would have been paid (if the risk arises) and the Project Agreement will continue; or

(b) terminate the Project Agreement and pay ProjectCo compensation on termination (calculated on the basis of a termination for Force Majeure).

Where the Project Agreement continues, the Unitary Charge will be reduced by the relevant amount of the insurance premium which is no longer being paid. An Uninsurable risk is one where either: (i) insurance is not available to the Contractor in respect of the Project in the worldwide insurance market; or (ii) the insurance premium payable in respect of such risk is at such a level that the risk is not generally being insured in the worldwide insurance market.

Insurance Risk Premium Sharing

The latest market position in relation to insurance premium risk sharing has been included in the Project Agreement. This is intended to reduce the level of contingencies currently factored into unitary payments to cover increased premiums.

Termination Events

The termination provisions in the Project Agreement are always subject to the provisions of the Funders Direct Agreement.

Voluntary Termination by the Authority

The Authority can voluntarily terminate the Project Agreement on 20 business days' notice to the Contractor.

Authority Break Point Date

The Authority can terminate the Project Agreement on any of the Authority Break Point Dates – these are set at the tenth, fifteenth and twentieth anniversaries of the date of the Project Agreement.

Authority Default

There are a limited number of Authority Defaults which entitle the Contractor to terminate the Project Agreement including:

(a) expropriation, sequestration or requisition or a material part of the Assets and or shares of the Contractor by the Authority;

(b) a failure by the Authority to make payment of:

   (i) an amount either singly or in the aggregate of the Authority Capital Contribution exceeding £75,000; or

   (ii) any amount either singly or in the aggregate of money exceeding the Net Monthly Unitary Payment,

   and in either case, that is due and payable by the Authority under the Project Agreement within 20 business days of service of a formal written demand by the Contractor, where the relevant amount(s) fell due and payable two or more months prior to the date of service of the written demand;

(c) Authority breach which substantially frustrates or renders it impossible for the Contractor to perform its obligations under the Project Agreement for a continuous period of two or more months; and

(d) a breach of clause 79.1 (*Restrictions on Transfer of the Agreement by the Authority*) of the Project Agreement.

Contractor Events of Default

There are a number of specific events which, when they occur or in certain cases if they are not remedied in accordance with the Project Agreement, entitle the Authority to terminate the Project Agreement including any one or more of the following events:

(a) breach which materially and adversely affects the performance of the Services;

(b) Persistent Breach;

(c) Insolvency;

(d) breach under clause 79.2 (*Restrictions on the Contractor*);

(e) breach of 82 (*Corporate Structures*);

(f) Abandonment;

(g) failure to commence the Initial Refurbishment Works within the three months of the State on Site Date;

(h) failure to complete the Initial Refurbishment Works by the Longstop Date;

(i) reduction of the Unitary Charge in any six Contract Month period by more than 10 per cent through Unavailability Deductions;

(j) reduction of the Unitary Charge in any six Contract Month period by more than 10 per cent through Performance Deductions;

(k) a breach by the Contractor of its obligations to take out and maintain any of the Required Insurances;

(l) failure to replace a Contractor Related Party in accordance with clause 30.3.2 (*Public Safety Incident*);

(m) reduction of the Unitary Charge in any nine Contract Month period the Authority by more than 15 per cent through Deductions; and

(n) failure to complete a Milestone by the Milestone Completion Date.

Breach of Refinancing Provisions

The Authority can terminate the Project Agreement if the Contractor wilfully breaches the refinancing provisions which include requirements for the sharing of refinancing gains with the Authority.

Corrupt Gifts and Fraud

The Authority may terminate the Project Agreement in certain circumstances where a Prohibited Act has been committed and the Authority reasonably considers it to be in the best interests of the Project.

Persistent Breach

The Authority may terminate the Project Agreement for a Persistent Breach which is a breach (other than breach for which a Deduction could be made) which recurs persistently and is not rectified within agreed timescales.

Want of Statutory Order

The Contractor can terminate the Project Agreement where the CPO required for the Works is declined or is approved in an amended form and, in the case of a CPO in an amended form, it is not possible to change the Development Works or adequately compensate the Contractor for the changes.

Compensation on Termination for Contractor Default: Calculation

For termination by reason of default by the Contactor, the amount of compensation payable to the Authority will be calculated by a reference to the market value of the unexpired term of the Project Agreement. This is by way of an election made by the Authority to either retender the provision of the Project (if there is a liquid market) or require an expert determination to value the unexpired project term.

The objective of the retendering procedure is to establish and to pay to the Contractor the Highest Compliant Tender Price, as a result of the tender process. If the Adjusted Highest Compliant Tender Price is less than 0, then the Contractor is required to pay that amount to the Authority on the date of the New Contract.

If the Authority is not entitled to retender the provision of the Project or the Authority elects to require an expert determination, then the Estimated Fair Value of the Contract is to be determined in accordance with the principles set out in the Project Agreement. To the extent of Adjusted Estimated Fair Value of the Contract is less than 0, then the Contractor is required to pay the Authority on the Compensation Date, the amount of the Adjusted Estimated Fair Value of the Contract.

Additional Permitted Borrowing

The provisions for payment of compensation on termination in the Project Agreement also take account of any Additional Permitted Borrowings. If required, the Contractor is entitled to raise further borrowings ("**Additional Permitted Borrowings**") without the consent of the Authority up to a limit ("**Additional Permitted Borrowings Limit**"). Any borrowings in excess of the Additional Permitted Borrowings Limited shall only be raised by the Contractor with the consent of the Authority.

If a Distribution is made while any Additional Permitted Borrowing is outstanding, and the Contractor wilfully or through gross negligence fails to comply with its obligation under the Funders Direct Agreement to notify the Authority of that Distribution, then in addition to the deduction of the Distribution made pursuant to the definition of Revised Senior Debt Termination Amount, the Authority shall be entitled to set off the value of the Distribution a second time against the Force Majeure Termination Sum provided that the amount of the Authority Default Termination Sum shall not be less than the Revised Senior Debt Termination Sum.

2. **Construction Contract**

General

Contractor has signed a sub-contract (the "**Construction Contract**") with Galliford Try Construction Limited (the "**Construction Contractor**") to be dated on or before the Issue Date. Pursuant to the Construction Contract, the Construction Contractor has agreed to demolish certain buildings, design and construct the new build houses (including the Extra Care Category 2 Sheltered Accommodation, the Daycare Centre and Library) and carry out certain environmental, improvement and infrastructure works (the "**Construction Works**").

All the principal risks and obligations borne by the Contractor under the Project Agreement relating to design and construction of the Construction Works are passed through to the Construction Contractor under the Construction Contract.

The Construction Contractor will undertake the Construction Works for a fixed contract sum (the "**Contract Sum**"), subject only to certain specified adjustments in accordance with the Construction Contract.

Completion of Construction Works

The Independent Certifier under the Project Agreement will inspect the Construction Works and issue handover certificates to the Contractor, the Authority and the Construction Contractor stating the date upon which the specified handover criteria have been satisfied in relation to that part of the Construction Works. The Independent Certifier will also issue Construction Works completion certificates when Construction Works completion has occurred in relation to a phase. In other words, the Independent Certifier is, in effect, performing the same role for both the Project Agreement and the Construction Contract.

The issue of a handover certificate or a works completion certificate will not affect the obligations of the Construction Contractor under the Construction Contract.

For twelve months after the completion of each phase, the Construction Contractor will be liable, if instructed by the Contractor, to rectify construction defects. The Construction Contractor is also liable to recompense the Contractor for the cost of rectifying defects and the resulting deductions for twelve years from the works completion certificate for the final phase.

The Construction Contractor is liable to pay liquidated damages to the Contractor in the event that any phase which triggers an increase in the Contractor's income from the Authority is not completed by a specified date save for certain specified circumstances where the risk is largely compensated by the Authority or covered by insurance. The rate of liquidated damages (for each such phase) in this event is an amount calculated by reference to the Contractor's loss of income less avoidable costs (and also picks up any lost Authority Capital Contribution). Payment of liquidated damages by the Construction Contractor should ensure that the Contractor can continue to meet its interest payments to bondholders.

Maximum Liability

The Construction Contractor's maximum aggregate liability under the Construction Contract is limited to 50 per cent of the Contract Sum (excluding liquidated damages). This cap will not apply in certain circumstances. These include:

(a) where the Construction Contractor "abandons" the Construction Works;

(b) on termination for Construction Contractor default as a result of a corrupt gift or fraud;

(c) where covered by the ProjectCo Insurances;

(d) in the case of death or personal injury resulting from the Construction Contractor's negligence; and

(e) any liability arising pursuant to the Interface Agreement.

"**Abandons**" means where the Construction Contractor fails to carry out the Construction Works for 15 consecutive business days or during 45 business days (consecutive or not) in any 12 month period.

The liability of the Construction Contractor to other Sub-Contractors during the continuance of the Construction Contract is also subject to specified caps under the Interface Agreement.

Payment

The Construction Contractor will receive an initial payment of £3.038 million within five business days of the Issue Date. Following this, the Construction Contractor will submit to the Contractor an application for an interim payment on the last Friday of each calendar month. This certificate will set out the sum requested, together with a full breakdown.

The Contractor will then review the application in conjunction with AECOM (the "**Lenders' Technical Adviser**") to determine the amount owing to the Construction Contractor. Subject to the Lenders' Technical Adviser's consent, the Contractor will then issue a payment notice to the Construction Contractor specifying the sum considered to be due to the Construction Contractor and the basis on which such sum is calculated.

The Contractor may give a pay less notice to the Construction Contractor of its intention to pay less than the sum otherwise payable, specifying the sum that it considers to be due to the Construction Contractor at the date such notice is given and the basis on which the sum has been calculated.

Within six months of the issue of the last acceptance certificate, the Construction Contractor shall submit a final account to the Contractor. The final account will set out the Contract Sum together with any adjustments and the sum of amounts already paid to the Construction Contractor.

The final account will be conclusive evidence of the sum due but will not prejudice any right of the Contractor against the Construction Contractor for any defect in the Construction Works.

Termination

Construction Contractor Default

The Contractor can terminate the Construction Contract for events of default analogous to those under the Project Agreement. Many of the events, however, will be triggered before they could lead to default under the Project Agreement. This provides the Contractor with an opportunity to engage a replacement building contractor and restore standards of performance under the Project Agreement. The Construction Contract may be terminated on a number of additional grounds. These include:

(a) a breach by the Construction Contractor of any of its obligations and/or warranties under the Construction Contract that have a material and adverse effect on the Construction Works;

(b) insolvency of the Construction Contractor;

(c) the Construction Works acceptance certificate in respect of the final phase has not been issued by the specified Longstop Date;

(d) the Construction Contractor breaching its obligations to take out insurances as required under the Construction Contract;

(e) the Construction Contract Guarantee and the performance bond (or any replacement performance bond) ceasing to be in full force and effect; and

(f) failure to achieve various Milestones by the relevant Milestone Completion Date.

Contractor Default

Events of default entitling the Construction Contractor to terminate the Construction Contract include:

(a) a failure by the Contractor to pay the Construction Contractor any undisputed sum exceeding £100,000 that remains outstanding for 20 days after service of a formal written demand; and

(b) insolvency of the Contractor.

Compensation on Termination on Construction Contractor Default

For the purposes of clauses 54 (*Compensation on Termination for Sub-Contractor Default*) and 56 (*Compensation on Termination for Corrupt Gifts and Fraud*) of the Construction Contract, "**Contractor's Losses**" will include all Direct Losses incurred by the Contractor or any other party engaged by the Contractor as a result of the termination of the Construction Contract or the Project Agreement less the value of any work by the Construction Sub-Contractor to the Termination Date as certified by the Contractor's Representative and in respect of which payment has not been made.

A mechanism whereby the Independent Certifier, on behalf of the Contractor, provides the Construction Contractor and the Contractor with an Initial Statement setting out the Contractor's Losses is included in the Construction Contract. If the sum stated in the Initial Statement is a positive amount (the "**Initial Statement Amount**") it is payable by the Sub-Contractor to the Contractor within five business days. If the Initial Statement Amount is negative, no sum is payable by either Party.

A further statement (the "**Final Statement**") is then issued by the Independent Certifier within six months of the date of the relevant Acceptance Certificate setting out the actual amounts incurred by the Contractor in respect of the matters set out in the Initial Statement (the actual Contractor's Losses).

If the amount identified in the Final Statement exceeds the amount identified in the Initial Statement issued by the Independent Certifier, the difference (the "**Compensation Shortfall**") is payable by the Sub-Contractor to the Contractor within five business days of the date of the Final Statement. If the amount identified in the Final Statement is less than the amount identified in the Initial Statement, the difference (the "**Compensation Excess**") is payable by the Contractor to the Sub-Contractor within five business days of the date of the Final Statement.

Supporting Documents

The Construction Contractor's obligations under the Construction Contract are guaranteed by Galliford Try plc under the "**Construction Contract Guarantee**". This does not limit the liability of Galliford Try plc to any lesser amount than the Construction Contractor's liability under the Construction Contract. The Construction Contract Guarantee is co-extensive with the Construction Contractor's liabilities under the Construction Contract.

The Construction Contractor Guarantor has entered into an agreement with the Contractor and the Construction Contractor, under which the Construction Contractor Guarantor has agreed, in certain circumstances, to advance to Contractor, interest free, sums that Contractor is obliged to pay to the Construction Contractor before the due date for payment of such sums (the "**Construction Contractor Parallel Loan Agreement**").

The Construction Contractor has entered into a (i) collateral warranty with the Authority and the Contractor and (ii) Construction Contractor funder direct agreement with the Security Trustee, the Construction Contractor Guarantor and Contractor, regulating step-in and other matters.

The following additional performance security is provided:

(a) a retention equal to 5 per cent of the Contract Sum which shall be reduced to 2.5 per cent on a phase by phase basis on certification of completion by the independent certifier and further reduced to 0 per cent on expiry of the relevant defects liability period; and

(b) a performance bond in an amount equal to 10 per cent of the Contract Sum under the Construction Contract from an appropriately rated entity acceptable to the Contractor and the Senior Creditors.

3. **Refurbishment Contract**

General

The Contractor has signed a sub-contract (the "**Refurbishment Contract**") to be dated the Issue Date with Mears Limited (the "**Refurbishment Contractor**") under which the Refurbishment Contractor will carry out refurbishment works and will perform all other associated works and the other obligations set out in the Refurbishment Contract (the "**Initial Refurbishment Works**").

All the principal risks and obligations borne by the Contractor under the Project Agreement relating to design and construction of the Refurbishment Works are passed through to the Refurbishment Contractor under the Refurbishment Contract.

The Refurbishment Contractor will undertake, under the Refurbishment Contract, to perform the Refurbishment Works for a fixed contract sum (the "**Contract Sum**"), subject only to certain specified adjustments in accordance with the Refurbishment Contract.

Completion of Refurbishment Works

The independent certifier under the Project Agreement will inspect the Refurbishment Works and issue handover certificates to the Contractor, the Authority and the Refurbishment Contractor stating the date upon which the specified handover criteria have been satisfied in relation to that part of the Refurbishment Works. The independent certifier will also issue Refurbishment Works completion certificates when Refurbishment Works completion has occurred in relation to a phase. In other words, the independent certifier is, in effect, performing the same role for both the Project Agreement and the Refurbishment Contract.

The Refurbishment Contractor is liable to pay liquidated damages to the Contractor in the event that any phase which triggers an increase in Contractor's income from the Authority is not completed by a specified date save for certain specified circumstances where the risk is largely compensated by the Authority or covered by insurance. The rate of liquidated damages (for each such phase) in this event is an amount calculated by reference to the Contractor's loss of income less avoidable costs (and also picks up any lost Authority capital contribution). Payment of liquidated damages by the Refurbishment Contractor should ensure that the Contractor can continue to meet its interest payments to Bondholders.

Maximum Liability

The Refurbishment Contractor's maximum aggregate liability under the Refurbishment Contract is limited to 60 per cent of the Contract Sum (excluding liquidated damages). This cap will not apply in certain circumstances. These include:

(a) where the Refurbishment Contractor "abandons" the Refurbishment Works;

(b) on termination for Refurbishment Contractor default as a result of a corrupt gift or fraud;

(c) in the case of death or personal injury resulting from the Refurbishment Contractor's negligence; and

(d) any liability arising pursuant to the Interface Agreement.

"**Abandons**" means where the Refurbishment Contractor fails to carry out the Refurbishment Works for 15 consecutive business days or during 45 business days (consecutive or not) in any 12 month period. The cap also does not apply in certain circumstances where the Refurbishment Contractor's insurance covers the liability.

The liability of the Refurbishment Contractor to other Sub-Contractors during the continuance of the Refurbishment Contract is also subject to specified caps under the Interface Agreement.

Payment

The Refurbishment Contractor will receive two initial payments as follows:

(a) £452,000 plus VAT within 5 business days of the Issue Date; and

(b) £1,129,000 plus VAT before 31 December 2013.

The Contract Sum is a lump sum fixed price for the carrying out of the Refurbishment Contractor's obligations under the Refurbishment Contract. Payments will be made to the Sub-Contractor on a milestone basis.

The Contractor will then review the application in conjunction with the Lenders' Technical Adviser to determine the amount owing to the Refurbishment Contractor. Subject to the Lenders' Technical Adviser's consent, Contractor will then issue a payment notice to the Refurbishment Contractor specifying the sum considered to be due to the Refurbishment Contractor and the basis on which sum is calculated.

The Contractor may give a pay less notice to the Refurbishment Contractor of its intention to pay less than the sum otherwise payable, specifying the sum that it considers to be due to the Refurbishment Contractor at the date such notice is given and the basis on which the sum has been calculated.

Within six months of the issue of the last acceptance certificate, the Refurbishment Contractor shall submit a final account to the Contractor. The final account will set out the Contract Sum together with any adjustments and the sum of amounts already paid to the Refurbishment Contractor.

The final account will be conclusive evidence of the sum due but will not prejudice any right of the Contractor against the Refurbishment Contractor for any defect in the Refurbishment Works.

Termination

Refurbishment Contractor Default

The Contractor can terminate the Refurbishment Contract for events of default analogous to those under the Project Agreement. Many of the events, however, will be triggered before they could lead to default under the Project Agreement. This provides the Contractor with an opportunity to engage a replacement refurbishment works contractor and restore standards of performance under the Project Agreement. The Refurbishment Contract may be terminated on a number of additional grounds. These include:

(a) a breach by the Refurbishment Contractor of any of its obligations and/or warranties under the Refurbishment Contract that have a material and adverse effect on the Refurbishment Works;

(b) insolvency of the Refurbishment Contractor;

(c) the Initial Refurbishment Works acceptance certificate in respect of the final Phase of the Initial Refurbishment Works has not been issued by the specified Longstop Date;

(d) the Refurbishment Contractor breaching its obligations to take out insurances as required under the Refurbishment Contract;

(e) the Refurbishment Contract Guarantee and the performance bond (or any replacement performance bond) ceasing to be in full force and effect; and

(f) failure to achieve a number of additional milestones (at Sub-Contract level) by the relevant milestone completion date.

Contractor Default

Events of default entitling the Refurbishment Contractor to terminate the Refurbishment Contract include:

(a) a failure by the Contractor to pay the Refurbishment Contractor any undisputed sum exceeding £100,000 that remains outstanding for 20 days after service of a formal written demand; and

(b) insolvency of the Contractor.

Compensation on Termination on Refurbishment Contractor Default

For the purposes of clauses 54 (*Compensation on Termination for Sub-Contractor Default*) and 56 (*Compensation on Termination for Corrupt Gifts and Fraud*) of the Construction Contract, "**Contractor's Losses**" will include all Direct Losses incurred by the Contractor or any other party engaged by the Contractor as a result of the termination of the Construction Contract or the Project Agreement less the value of any work by the Construction Sub-Contractor to the Termination Date as certified by the Contractor's Representative and in respect of which payment has not been made.

A mechanism whereby the Independent Certifier, on behalf of the Contractor, provides the Refurbishment Contractor and the Contractor with an Initial Statement setting out the Contractor's Losses is included in the Construction Contract. If the sum stated in the Initial Statement is a positive amount (the "**Initial Statement Amount**") it is payable by the Sub-Contractor to the Contractor within five business days. If the Initial Statement Amount is negative, no sum is payable by either Party.

A further statement (the "**Final Statement**") is then issued by the Independent Certifier within six months of the date of the relevant Acceptance Certificate setting out the actual amounts incurred by the Contractor in respect of the matters set out in the Initial Statement (the actual Contractor's Losses).

If the amount identified in the Final Statement exceeds the amount identified in the Initial Statement issued by the Independent Certifier, the difference (the "**Compensation Shortfall**") is payable by the Sub-Contractor to the Contractor within five business days of the date of the Final Statement. If the amount identified in the Final Statement is less than the amount identified in the Initial Statement, the difference (the "**Compensation Excess**") is payable by the Contractor to the Sub-Contractor within five business days of the date of the Final Statement.

Supporting Documents

The Refurbishment Contractor's obligations under the Refurbishment Contract are guaranteed by Mears plc under the "**Refurbishment Contract Guarantee**". This does not limit the liability of Mears plc to any lesser amount than the Refurbishment Contractor's liability under the Refurbishment Contract. The Refurbishment Contract Guarantee is co-extensive with the Refurbishment Contractor's liabilities under the Refurbishment Contract.

The Refurbishment Contractor Guarantor has entered into an agreement with the Contractor and the Refurbishment Contractor, under which the Refurbishment Contractor Guarantor has agreed, in certain circumstances, to advance to the Contractor, interest free, sums that Contractor is obliged to pay to the Refurbishment Contractor before the due date for payment of such sums (the "**Refurbishment Contractor Parallel Loan Agreement**").

The Refurbishment Contractor has entered into a (i) collateral warranty with the Authority and the Contractor and (ii) the Refurbishment Contractor funder direct agreement with the Security Trustee, the Refurbishment Contractor Guarantor and the Contractor, regulating step-in and other matters.

The following additional performance security is provided:

(a) a retention equal to 2.5 per cent of the Contract Sum which shall be released on completion of the making good of any defects on a phase by phase basis; and

(b) a performance bond in an amount equal to 15 per cent of the contract sum under the Refurbishment Contract (which steps down at six monthly intervals against expiry of the relevant defects liability period for the relevant works undertaken and completed at that point) from an appropriately rated entity acceptable to the Contractor and the Senior Creditors.

4. **Housing Management Contract**

General

ProjectCo has signed a sub-contract (the "**Housing Management Contract**") to be dated the Issue Date with Contour Homes Limited (the "**Housing Management Contractor**") under which the Housing Management Contractor will undertake certain housing management services (the "**Housing Management Services**").

In general all of the principal risks and obligations borne by the Contractor under the Project Agreement relating to the Housing Management Services have been passed through to Housing Management Contractor under the Housing Management Contract.

Payment

The Housing Management Contractor is entitled to a fixed fee for providing the Housing Management Services.

Subject to the caps referred to in the paragraph entitled Maximum Liability below, payment deductions suffered by Contractor under the Project Agreement relative to the Housing Management Services provided by the Housing Management Contractor will be passed down to the Housing Management Contractor except when caused by Contractor Default. The Contractor takes the risk on rent collection over an annual measure payment. In the event that rent collection levels fall below target then the deductions are passed down to the Housing Management Contractor subject to a risk sharing mechanism up to the first market testing date whereby the Housing Management Contractor takes the risk of deductions below an agreed floor. Payment deductions suffered by the Housing Management Contractor which are due to the acts or omissions of other Contractor Parties which are party to the Interface Agreement may be claimed by the Housing Management Contractor through the Interface Agreement.

The Housing Management Contractor will be paid monthly in arrears, subject to certain payment adjustments where invoice amounts are disputed.

Deductions made by the Authority from the monthly service payments to the Contractor which are attributable to the Housing Management Contractor are deducted in calculating the actual monthly service payment made by the Contractor to the Housing Management Contractor, subject to the annual deductions cap. Deductions are applied in the same month under the Housing Management Contract as they are applied by the Authority in calculating the service payment due under the Project Agreement.

Maximum Liability

The liabilities of the Housing Management Contractor arising under the Housing Management Contract are, with certain restricted exclusions, limited in the aggregate to:

(a) 100 per cent of the annual service payment in any Contract Year; and

(b) 200 per cent of the annual service payment on termination of the Housing Management Contract.

This cap will not apply in certain circumstances. These include:

(a) where the Housing Management Contractor "abandons" the provision of the Housing Management Services;

(b) in the case of death or personal injury resulting from the Housing Management Contractor's negligence; and

(c) any liability arising pursuant to the Interface Agreement.

The liability of the Housing Management Contractor to other Sub-Contractors during the continuance of the Housing Management Contract is also subject to specified caps under the Interface Agreement.

Termination

Housing Management Contractor Default

The Contractor may terminate the Housing Management Contract on similar terms to those set out in the Project Agreement, except that many of the events will be triggered before they could lead to default under the Project Agreement (thus providing the Contractor with an opportunity to engage a replacement housing management contractor and restore standards of performance under the Project Agreement). In addition, the Housing Management Contractor may be terminated where (for example):

(a) subject to the Housing Management Contractor's right to extend its liability cap the Housing Management Contractor's liability in any Contract Year exceeds an amount equal to 70 per cent of its liability cap;

(b) insolvency of the Housing Management Contractor; and

(c) a breach by the Housing Management Contractor of any of its obligations and/or warranties under the Housing Management Contract that has a material and adverse effect on the performance of the Housing Management Services.

Contractor Default

Events of default entitling the Housing Management Contractor to terminate the Housing Management Contract include:

(a) a failure by the Contractor to pay the Housing Management Contractor any undisputed sum exceeding an amount equal to 90 per cent of the service payment for the previous month within 40 days of service where the amount fell due and payable two months prior to the date of service of a formal written demand; and

(b) insolvency of the Contractor.

Supporting Documents

The Contractor has agreed that there is no parent company guarantee requirement for the Housing Management Contractor.

The Housing Management Contractor has entered into a (i) collateral warranty with the Authority and Contractor and (ii) Housing Management Contract funder direct agreement with the Security Trustee and Contractor, regulating step-in and other matters.

5. **RRCMR Contract**

General

The Contractor has signed a sub-contract (the "**RRCMR Contract**") to be dated the Issue Date with Mears Limited (the "**RRCMR Contractor**") under which the RRCMR Contractor will provide responsive repairs, cyclical maintenance and renewal services (the "**RRCMR Services**").

In general all of the principal risks and obligations borne by the Contractor under the Project Agreement relating to the RRCMR Services have been passed through to the RRCMR Contractor under the RRCMR Contract.

Lifecycle

The Contractor takes the risk on the adequacy of the Lifecycle funds with the risk of carrying out the relevant lifecycle works being passed down to the RRCMR Contractor. The Contractor has sought to mitigate this risk through its contract pricing. Any excess amounts in the Maintenance Reserve

Account in years 15, 20 and on expiry of the Project Agreement are, subject to the Senior Creditor's Technical Adviser approval, shared between the Contractor and the RRCMR Contractor on a 50/50 basis.

Maximum Liability

The liabilities of the RRCMR Contractor arising under the RRCMR Contract are, with certain restricted exclusions, limited in the aggregate to:

(a) 100 per cent of the annual service payment in any Contract Year; and

(b) 200 per cent of the annual service payment on termination of the RRCMR Contract.

This cap will not apply in certain circumstances. These include:

(a) where the RRCMR Contractor "abandons" the provision of the RRCMR Services;

(b) in the case of death or personal injury resulting from the RRCMR Contractor's negligence; and

(c) any liability arising pursuant to the Interface Agreement.

The liability of the RRCMR Contractor to other Sub-Contractors during the continuance of the RRCMR Contract is also subject to specified caps under the Interface Agreement.

Payment

The RRCMR Contractor is entitled to a fixed fee for providing the RRCMR Services.

Subject to the caps referred to above ("*Maximum liability*") above, payment deductions suffered by Contractor under the Project Agreement relative to the RRCMR Services provided by the RRCMR Contractor will be passed down to the RRCMR Contractor, except when caused by Contractor default. Payment deductions suffered by the RRCMR Contractor which are due to the acts or omissions of other Contractor Parties which are party to the Interface Agreement may be claimed by the RRCMR Contractor through the Interface Agreement.

The RRCMR Contractor will be paid monthly in arrears, subject to certain payment adjustments where invoice amounts are disputed.

Deductions made by the Authority from the monthly service payments to the Contractor which are attributable to the RRCMR Contractor are deducted in calculating the actual monthly service payment made by Contractor to the RRCMR Contractor, subject to the annual deductions cap. Deductions are applied in the same month under the RRCMR Contract as they are applied by the Authority in calculating the service payment due under the Project Agreement.

Termination

RRCMR Contractor Default

The Contractor may terminate the RRCMR Contract on similar terms to those set out in the Project Agreement, except that many of the events will be triggered before they could lead to default under the Project Agreement (thus providing the Contractor with an opportunity to engage a replacement responsive repairs, cyclical maintenance and renewals contractor and restore standards of performance under the Project Agreement). In addition, the RRCMR Contractor may be terminated where (for example):

(a) subject to the RRCMR Contractor's right to extend its liability cap the RRCMR Contractor's liability in any Contract Year exceeds amount equal to 70 per cent of its liability cap;

(b) insolvency of the RRCMR Contractor; and

(c) a breach by the RRCMR Contractor of any of its obligations and/or warranties under the RRCMR Contract that have a material and adverse effect on the performance of the RRCMR Services.

Contractor Default

Events of default entitling the RRCMR Contractor to terminate the RRCMR Contract include:

(a) a failure by the Contractor to pay the RRCMR Contractor any undisputed sum exceeding £100,000 (indexed) that remains outstanding for 20 business days after service of a formal written demand; and

(b) insolvency of Contractor.

Supporting Documents

The RRCMR Contractor's obligations under the RRCMR Contract are guaranteed by Mears plc under the "**RRCMR Contract Guarantee**". This does not limit the liability of Mears plc to any lesser amount than the RRCMR Contractor's liability under the RRCMR Contract. The RRCMR Contract Guarantee is co-extensive with the RRCMR Contractor's liabilities under the RRCMR Contract.

The RRCMR Contractor Guarantor has entered into an agreement with Contractor and the RRCMR Contractor, under which the RRCMR Contractor Guarantor has agreed, in certain circumstances, to advance to Contractor, interest free, sums that Contractor is obliged to pay to the RRCMR Contractor before the due date for payment of such sums (the "**RRCMR Contractor Parallel Loan Agreement**").

The RRCMR Contractor has entered into a (i) collateral warranty with the Authority and Contractor and (ii) RRCMR Contractor funder direct agreement with the Security Trustee, the RRCMR Contractor Guarantor and Contractor, regulating step-in and other matters.

6. **Development Works Contract**

General

The Contractor has signed a sub-contract (the "**Development Works Contract**") to be dated the Issue Date with Galliford Try Construction Limited (the "**Development Works Contractor**") under which the Development Works Contractor will carry out the design and construction of the new build for sale properties and will perform all other associated works and the other obligations set out in the Development Works Contract (the **"Development Works**").

Maximum Liability

The Development Contract has no cap on liability under the Development Works Contract.

The liability of the Development Works Contractor to other Sub-Contractors during the continuance of the Development Works Contract is subject to specified caps under the Interface Agreement.

Payment

Under the Development Works Contract, the Development Works Contractor will pay the Contractor a £1,987,000 development fee in four instalments. The first instalment of £687,000 is due on the Issue Date, the second instalment of £700,000 is due on the later of (a) 31 April 2014 and (b) the date on which the Remedial Works have been completed, and the third and fourth instalments of £300,000 are due on 30 November 2014 and 31 October 2015, respectively. The payments being made to the Development Works Contractor are automatic and are not reliant on any performance conditions.

Termination

The Development Works are effectively ring-fenced in the Project Agreement so that failure to deliver the Development Works cannot lead to termination of the Project Agreement rather the Authority's only remedies are pursuant to the indemnities and an entitlement to terminate the relevant Development Works Licence the subject of the failure.

Development Works Contractor Default

The Contractor can terminate the Development Works Contract for events of default analogous to those under the Project Agreement (including Persistent Breach). Many of the events, however, will be triggered before they could lead to default under the Project Agreement. This provides the Contractor with an opportunity to engage a replacement development works contractor and restore standards of performance under the Project Agreement. The Development Works Contract may be terminated on a number of additional grounds. These include:

(a) a breach by the Development Works Contractor of any of its obligations and/or warranties under the Development Works Contract that have a material and adverse effect on the Services;

(b) insolvency of the Development Works Contractor; and

(c) the Development Works Contractor breaching its obligations to take out insurances as required under the Development Works Contract.

Contractor Default

Events of default entitling the Development Works Contractor to terminate the Development Works Contract include:

(a) insolvency of the Contractor; and

(b) a breach by the Contractor of its obligation under the Project Agreement to take out and maintain Required Insurances where such breach is not remedied within 30 days of receipt of written notice.

Supporting Documents

The Development Works Contractor's obligations under the Development Works Contract are guaranteed by Galliford Try plc under the "**Development Works Contract Guarantee**". This does not limit the liability of Galliford Try plc to any lesser amount than the Development Works Contractor's liability under the Development Works Contract. The Development Works Contract Guarantee is co-extensive with the Development Works Contractor's liabilities under the Development Works Contract.

The Development Works Contractor has entered into a (i) collateral warranty with the Authority and the Contractor and (ii) Development Works Contractor funder direct agreement with the Security Trustee, and Contractor, regulating step-in and other matters.

7. **Interface Agreement**

Each of the Construction Contractor, the Refurbishment Contractor, the RRCMR Contractor, the Housing Management Contractor and the Development Works Contractor (together the "**Sub-Contractors**") will enter into an interface agreement with the Contractor (the "**Interface Agreement**"). The purpose of the Interface Agreement is to:

(a) regulate issues of liability; and

(b) manage interface issues between the Sub-Contractors, such as design development, commissioning, training and familiarisation, allocation of Deductions and defects notification and rectification procedures.

Subject to limited exceptions, each Sub-Contractor accepts, as against the Contractor, that it will not hold the Contractor responsible for the acts of the other Sub-Contractor. Instead, the Sub-Contractors will rely on their rights directly against each other under the Interface Agreement where the acts or omissions of one affect each other.

This arrangement underpins the agreed mechanism by which the Contractor will pass down deductions from the Unitary Charge made by the Authority under the Project Agreement.

The Contractor is entitled to make an initial allocation to one or more Sub-Contractors (or, in limited circumstances, the Contractor), based on its view of their contractual liability and on available information. Provided that allocation is made in good faith, the Contractor may validly pass down the deductions on that basis. If the Sub-Contractors disagree as to which of them should bear the deductions, that disagreement will be determined directly between them under the Interface Agreement.

THE COUNCIL OF THE CITY OF MANCHESTER

Manchester is a city and metropolitan borough situated in the south-central part of North West England fringed by the Cheshire Plain to the south and the Pennines to the north and east. The City Centre is on the east bank of the River Irwell, near its confluences with the Rivers Medlock and Irk.

Manchester had an estimated population of 510,800 in 2012 and the city continues to grow. Projections and forecasts show an increase to between 532,200 and 558,000 by 2021. The city covers over 117 km^2, with a population density of 43.5 persons per hectare. Population migration both into and out of the city is significant. Manchester is committed to increasing its population. Although population numbers fell throughout the 1970s and 1980s, over the past decade the population of Manchester has been growing by around 1.7 per cent per year between 2001 and 2011; this is over twice the average rate of growth in England.

The local authority is Manchester City Council. It comprises of 96 elected Councillors (86 Labour, 9 Liberal Democrat and 1 Independent Labour) who are responsible for agreeing policies about provision of services and how the Council's budget is spent.

The Manchester Way is the city's Community Strategy to 2015, and has been refreshed during 2013 with an updated strategic narrative for the city. This confirms the vision for Manchester was a world-class city as competitive as the best international cities by 2015:

(a) that stands out as enterprising, creative and industrious;

(b) with highly skilled and motivated people;

(c) living in successful neighbourhoods whose prosperity is environmentally sustainable; and

(d) where all our residents can meet their full potential, are valued and secure.

To achieve this vision, the Manchester Partnership intends to build on Manchester's role as an engine of growth by creating jobs and economic wealth for the benefit of the city's residents. Central to improving competitiveness is the need to improve productivity and increase the breadth and depth of the labour market, to increase the number of people in work, and raise skill levels across the board. This will involve a focus on people contributing to and benefiting from economic success and the reform of public services.

Manchester is a city of change. The birthplace of the industrial revolution, Manchester is the powerhouse of the north-west region. The city boasts several key drivers that help sustain the economic growth of the area. These include its world-class universities, a knowledge-based economy, a thriving city centre, a skilled workforce, and Manchester International Airport.

Greater Manchester South (the city of Manchester along with southern districts of Trafford, Stockport, Tameside and Salford) generated economic output (Gross Value Added) of £32.507 billion in 2011, which is over a quarter of the region's output. The 1.5 per cent annual increase that this represents is on a par with the Core Cities average. This is an increase of 1.5 per cent on the previous year, indicating some recovery from the economic downturn of 2008–10. Measured in terms of GVA per head of resident population, Greater Manchester South outperforms national and regional comparators, rising from £17,065 in 2001 to £22,081 in 2011. GVA per head for Greater Manchester South amounts to 105.8 per cent of the national rate, which is higher than the Core Cities average of 102.4 per cent. As a major regional centre, the city attracts a high level of entrepreneurial activity and fosters a competitive environment that drives efficiency.

Manchester has a diverse and growing employment base, with approximately 309,400 people employed in the city in 2011. Financial and professional services account for 21.8 per cent of all jobs in the city, compared to the England average of 13.1 per cent. Information technology, finance, professional and scientific activities and business support services account for around one-third of all jobs in the city, compared to a Core Cities' average of a little over one-quarter.

Manchester's thriving commercial centre is in Manchester City Centre, adjacent to Piccadilly, focused on Mosley Street, Deansgate, King Street and Piccadilly. Spinningfields is a £1.5 billion mixed-use development that has expanded the district west of Deansgate. The area contains high quality office space, retail and catering facilities, and courts.

Manchester has won over £61 million of investment for new housing, generating more than 24,000 new homes in the last ten years, improving both housing choice and quality for residents. Investment of £26 million was received for the first newly built council homes in Manchester for over a generation and over £20 million of extra funding through the Government's Kickstart Programme also ensured that new homes were provided throughout the recession. Manchester is continuing to develop a range of creative ways to fund new homes including the development of a new housing investment model with Greater Manchester Pension Fund.

The Government has made available over £150 million in funding for projects to bring empty homes back into use. Manchester City Council, with registered provider partners as part of AGMA, and local community organisations, have secured over £4 million to address the issue. Over 2,000 obsolete homes in Manchester have been demolished in the last five years and replaced with high quality housing. 350 empty homes have also been brought back into use over the last two years. Energy efficiency of around 18,500 homes has been increased.

In partnership with residents, the Council has made dramatic improvements to social housing through the Decent Homes Programme which has transferred housing estates to new not-for-profit landlords and brought over £1.3 billion of investment across the City. Turnover in social rented homes has reduced by 42 per cent in under ten years.

Housing Private Finance Initiatives (PFIs) are also revitalising areas of Ardwick and Miles Platting; creating new homes to rent and for sale, raising housing standards, improving levels of resident satisfaction and helping residents enjoy a sense of place and belonging. The Brunswick Housing PFI is the third PFI regeneration scheme to be delivered.

TAXATION

United Kingdom Taxation

The following is a summary of the Issuer's understanding of the United Kingdom withholding taxation treatment at the date hereof in relation to payments of principal and interest in respect of the Bonds. The comments also summarise the Issuer's understanding of certain other United Kingdom tax aspects of acquiring, holding or disposing of Bonds. The comments relate only to the position of investors who are absolute beneficial owners of the Bonds and do not apply to the Issuer if it holds any Bonds. The following is a general guide and is based on current UK law and what is understood to be current H.M. Revenue & Customs practice (which may not be binding), both of which are subject to change (potentially with retrospective effect), should be treated with appropriate caution and may not apply to certain classes of Bondholders who are subject to special rules. Bondholders or Couponholders who are in any doubt as to their tax position should consult their professional advisers.

Bondholders or Couponholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Bonds are particularly advised to consult their professional advisers as to whether they might be so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain United Kingdom taxation aspects of payments in respect of the Bonds. In particular, Bondholders and Couponholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Bonds even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

1. UK Withholding Tax on UK Source Interest

The Bonds issued by the Issuer will constitute "quoted Eurobonds" provided they are and continue to be listed on a recognised stock exchange within the meaning of section 1005 of the Income Tax Act 2007. The Irish Stock Exchange is a recognised stock exchange for these purposes and this condition should be satisfied so long as the Bonds are and remain both: (i) listed on the Official List of the UK Listing Authority; and (ii) admitted to trading on the Irish Stock Exchange. Whilst the Bonds are and continue to be quoted Eurobonds, payments of interest on the Bonds may be made without withholding or deduction for or on account of United Kingdom income tax.

Interest on the Bonds may also be paid without withholding or deduction on account of United Kingdom tax where interest on the Bonds is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Bonds is paid reasonably believes) that the beneficial owner is within the charge to United Kingdom corporation tax as regards the payment of interest (the "**Excepted Payments Exemption**"), provided that H.M. Revenue & Customs has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid subject to a deduction of tax.

In other cases, interest on the Bonds may fall to be paid under deduction of United Kingdom income tax at the basic rate (currently 20 per cent) subject to such relief as may be available under the provisions of any applicable double taxation treaty.

Interest on the Bonds will have a United Kingdom source and accordingly may be chargeable to United Kingdom tax by direct assessment on the Bondholder or Couponholder. Where the interest is paid without withholding or deduction in respect of tax, the interest will not be subject to United Kingdom tax in the hands of Bondholders or Couponholders who are not resident in the United Kingdom, except where such persons carry on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency (or, in the case of corporate Bondholders or Couponholders, through a United Kingdom permanent establishment) in connection with which the interest is received or to which the Bonds are attributable, in which case (subject to exemptions for interest received by certain categories of agent) United Kingdom tax may be levied on the United Kingdom branch or agency or permanent establishment.

2. Payments by the Financial Guarantors under the Financial Guarantees

If AGE and/or AGM make any payments in respect of interest on the Bonds (or other amounts due under the Bonds other than the repayment of amounts subscribed for the Bonds) such payments may be subject to United Kingdom withholding tax subject to any available exemptions and such relief as may be available under the provisions of any applicable double taxation treaty. Such payments by the Financial Guarantors may not be eligible for the quoted Eurobond exemption or the Excepted Payments Exemption described above.

3. **Provision of Information**

Certain persons (including persons in the United Kingdom paying interest to, or receiving interest on behalf of, another person) may be required to provide certain information to HM Revenue & Customs regarding the identity of the payee or the person entitled to the interest. In certain circumstances, such information may be exchanged with tax authorities in other countries. The provisions referred to above may also apply, in certain circumstances, to payments of amounts due on redemption of Bonds that constitute "deeply discounted securities" (as defined in the Income Tax (Trading and Other Income) Act 2005).

4. **European Union Savings Directive**

The Council of the European Union has adopted a directive regarding the taxation of savings income. Each Member State is required to provide to the tax authorities of another Member State details of payments of interest and other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, except that Luxembourg and Austria will instead operate a withholding system for a transitional period in relation to such payments (until 1 January 2015 in the case of Luxembourg).

5. **Other Rules Relating to United Kingdom Withholding Tax**

Bonds may be issued at an issue price of less than 100 per cent of their principal amount. Any discount element on any such Bonds will not be subject to any United Kingdom withholding tax pursuant to the provisions mentioned above, but may be subject to reporting requirements as outlined above.

Where Bonds are to be, or may fall to be, redeemed at a premium, as opposed to being issued at a discount, then any such element of premium may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax and reporting requirements as outlined above.

Where interest has been paid under deduction of United Kingdom income tax, Bondholders or Couponholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "interest" in this withholding tax summary mean "interest" as understood in United Kingdom tax law. The statements above do not take any account of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the terms and conditions of the Bonds or any related documentation.

The above description of the United Kingdom withholding tax position assumes that there will be no substitution of the Issuer as principal obligor under the Bonds and does not consider the tax consequences of any such substitution.

6. **Stamp Duty and Stamp Duty Reserve Tax**

No United Kingdom stamp duty or stamp duty reserve tax should be payable on the issue or transfer of a Bond or on its redemption.

Republic of Ireland Taxation

The following is a summary of the Irish withholding tax treatment of the Bonds. The summary does not purport to be a comprehensive description of all of the Irish tax considerations that may be relevant to a decision to purchase, own or dispose of the Bonds.

The summary is based upon the laws of Ireland and the published practices of the Revenue Commissioners of Ireland as in effect on the date hereof. Prospective investors in the Bonds should consult their own advisers as to the Irish or other tax consequences of the purchase, beneficial ownership and disposition of the Bonds including, in particular, the effect of any state or local law taxes, if applicable.

1. Irish Withholding Tax

Irish withholding tax applies to certain payments including payments of:

(a) Irish source yearly interest (yearly interest is interest that is capable of arising for a period in excess of one year);

(b) Irish source annual payments (annual payments are payments that are capable of being made for a period in excess of one year and are pure income-profit in the hands of the recipient); and

(c) Distributions (including interest that is treated as a distribution under Irish law) made by companies that are resident in Ireland for the purposes of Irish tax;

at the standard rate of income tax (currently 20 per cent).

On the basis that the Issuer is not resident in Ireland for the purposes of Irish tax, nor does the Issuer operate in Ireland through a branch or agency with which the issue of the Bonds is connected, nor are the Bonds held in Ireland through a depository or otherwise located in Ireland, then to the extent that payments of interest or annual payments arise on the Bonds, such payments should not be regarded as payments having an Irish source for the purposes of Irish taxation.

Accordingly, the Issuer or any paying agent acting on behalf of the Issuer should not be obliged to deduct any amount on account of these Irish withholding taxes from payments made in connection with the Bonds.

Separately, for as long as the Bonds are quoted on a stock exchange, a purchaser of the Bonds should not be obliged to deduct any amount on account of Irish tax from a payment made by it in connection with the purchase of the Bonds.

2. Irish Encashment Tax

Payments on any Bonds paid by a paying agent in Ireland or collected or realised by an agent in Ireland acting on behalf of the beneficial owner of Bonds will be subject to Irish encashment tax at the standard rate of Irish tax (currently 20 per cent), unless it is proved, on a claim made in the required manner to the Revenue Commissioners of Ireland, that the beneficial owner of the Bonds entitled to the interest or distribution is not resident in Ireland for the purposes of Irish tax and such interest or distribution is not deemed, under the provisions of Irish tax legislation, to be income of another person that is resident in Ireland.

SUBSCRIPTION AND SALE

Subscription

Lloyds Bank PLC (the "**Manager**") has, in a bond subscription agreement dated the date of this Prospectus (the "**Bond Subscription Agreement**") between it, the Issuer, ProjectCo, HoldCo and the Financial Guarantors upon the terms and subject to the conditions contained therein, agreed to subscribe and pay for the Bonds at the issue price of 100 per cent of their principal amount less an underwriting commission of the principal amount of the Bonds plus accrued interest, if any. In addition, such amount as may be agreed in writing between the Issuer and the Manager in respect of guarantee fees payable to the Financial Guarantors may be deducted by the Manager from the issue price and paid by the Manager, on behalf of the Issuer to AGE and AGM. The Issuer has also agreed to reimburse the Manager for certain of its expenses incurred in connection with the management of the issue of the Bonds. The Manager is entitled in certain circumstances to be released and discharged from its obligations under the Bond Subscription Agreement prior to the closing of the issue of the Bonds.

Except for the fees payable to the Manager and to the Financial Guarantors and save as otherwise disclosed in this Prospectus, no person has any interest, including conflicting interests, that are material to the issue of the Bonds.

Selling Restrictions — United States

The Bonds, the Obligor Guarantees and the Financial Guarantees have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S of the Securities Act ("**Regulation S**").

The Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the United States Internal Revenue Code of 1986 and regulations thereunder.

The Manager has agreed that, except as permitted by the Bond Subscription Agreement, it will not offer, sell or deliver the Bonds, the Obligor Guarantees and the Financial Guarantees (a) as part of their distribution at any time or (b) otherwise, until 40 days after the later of the commencement of the offering and the issue date of the Bonds, within the United States or to, or for the account or benefit of, a U.S. person, and that it will have sent to each dealer to which it sells Bonds, the Obligor Guarantees and the Financial Guarantees during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Bonds, the Obligor Guarantees and the Financial Guarantees within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S.

In addition, until 40 days after commencement of the offering of the Bonds, the Obligor Guarantees and the Financial Guarantees, an offer or sale of Bonds, the Obligor Guarantees and/or the Financial Guarantees within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Selling Restrictions — United Kingdom

The Manager has represented and agreed that:

(a) it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act ("**FSMA**")) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer, or the Financial Guarantors; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Bonds in, from or otherwise involving the United Kingdom.

Selling Restrictions — Ireland

The Manager has represented and agreed that:

(a) it has not offered, sold, placed or underwritten and will not offer, sell, place or underwrite any Bonds or do anything in Ireland in respect of any Bonds otherwise than in conformity with:

(i) the Irish Prospectus (Directive 2003/71/EC) Regulations 2005 and any rules issued by the Central Bank of Ireland under Section 51 of the Investment Funds, Companies and Miscellaneous Provisions Act 2005 of Ireland (as amended);

(ii) the Irish Companies Acts 1963 to 2009;

(iii) the European Communities (Markets in Financial Instruments) Regulations 2007 (as amended) of Ireland and it will conduct itself in accordance with any rules or codes of conduct and any conditions or requirements, or any other enactment, imposed or approved by the Central Bank of Ireland;

(iv) the Irish Market Abuse (Directive 2003/6/EC) Regulations 2005 and any rules issued by the Central Bank of Ireland under Section 234 of 2005 Act, and will assist the Issuer in complying with its obligations thereunder; and

(b) it has complied and will comply with all applicable provisions of Directive 2004/39/EC and implementing measures in its relevant jurisdiction and is operating within the terms of its authorisation thereunder and it has complied and will comply with any applicable codes of conduct or practice; and

(c) in connection with offers or sales of Bonds, it has only issued or passed on, and will only issue or pass on, any document received by it in connection with the issue of the Bonds to persons who are persons to whom the documents may otherwise lawfully be issued or passed on.

Selling Restrictions — General

No action has been or will be taken in any jurisdiction by the Issuer or the Manager that would, or is intended to, permit a public offering of the Bonds, or possession or distribution of this Prospectus or any other offering material, in any country or jurisdiction where action for that purpose is required. The Manager has undertaken that it will comply (to the extent of its knowledge and belief) with all applicable securities laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Bonds or has in its possession or distributes the Prospectus. Persons into whose hands this Prospectus comes are required by the Issuer and the Manager to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Bonds or have in their possession, distribute or publish this Prospectus or any other offering material relating to the Bonds, in all cases at their own expense.

Attention is also drawn to the information set out in the section entitled "*Important Notice*" above.

GENERAL INFORMATION

1. The creation and issue of the Bonds has been authorised by a resolution of the Board of Directors of the Issuer dated 16 December 2013.

2. AGE has obtained all necessary consents, approvals and authorisations in connection with the issue and performance of the AGE Financial Guarantee.

3. AGM has obtained all necessary consents, approvals and authorisations in connection with the issue and performance of the AGM Financial Guarantee.

4. There has been no significant change in the financial or trading position of the Issuer and no material adverse change in the prospects of the Issuer since its date of incorporation.

5. There has been no significant change in the financial or trading position of ProjectCo, and no material adverse change in the prospects of ProjectCo since the date of its incorporation.

6. There has been no significant change in the financial or trading position of HoldCo and its subsidiaries and no material adverse change in the prospects of HoldCo and its subsidiaries since the date of its incorporation.

7. The Issuer is not, and has not been, involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which it is aware) which may have, or have had during the 12 months prior to the date of this Prospectus, a significant effect on its financial position or profitability.

8. ProjectCo is not, and has not been, involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which it is aware) which may have, or have had during the 12 months prior to the date of this Prospectus, a significant effect on its financial position or profitability.

9. HoldCo and its subsidiaries are not, and have not been, involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which it is aware) which may have, or have had during the 12 months prior to the date of this Prospectus, a significant effect on its financial position or profitability.

10. The auditors of the Issuer, ProjectCo and HoldCo are Deloitte LLP, a member firm of the Institute of Chartered Accountants of England. No audited accounts have been prepared in relation to the Issuer, ProjectCo or HoldCo.

11. For as long as the Prospectus remains in effect or any Bonds shall be outstanding, copies of the following documents may be inspected in physical and/or electronic form during normal business hours at the offices of the Principal Paying Agent at its specified office, currently at One Canada Square, London E14 5AL:

    (i) articles of association of each of the Issuer, ProjectCo and HoldCo;

    (ii) articles of association of AGE;

    (iii) by-laws of AGM;

    (iv) prior to the Issue Date, drafts (subject to notification) of and after the Issue Date:

        (A) the Finance Documents;

        (B) the AGE Financial Guarantee;

        (C) the AGM Financial Guarantee;

        (D) the Bond Trust Deed; and

        (E) the Project Agreement;

(v) audited accounts of AGE for the financial years ended 31 December 2012 and 31 December 2011;

(vi) audited accounts of AGM for the financial years ended 31 December 2012 and 31 December 2011; and

(vii) unaudited interim financial statements of AGM for the six month period ended 30 June 2013.

12. The Bonds and any Coupons and Talons appertaining thereto will bear a legend to the following effect: "Any United States person (as defined in the Internal Revenue Code) who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in section 165(j) and 1287(a) of the Internal Revenue Code."

13. The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN is XS1005263790 and the common code is 100526379.

14. It is expected that the Bonds will be admitted to the Official List and to trading on the Irish Stock Exchange on or about 20 December 2013, subject only to the issue of the Temporary Global Bond and to the execution by AGE of the AGE Financial Guarantee and AGM of the AGM Financial Guarantee.

15. The total estimated expenses to be paid by the Issuer in relation to the admission to trading are £5,000, exclusive of VAT.

16. Save for the Bondholder Report, the Issuer does not intend to provide any post-issuance information.

17. Arthur Cox Listing Services Limited is acting solely in its capacity as listing agent for the Issuer in connection with the Bonds and is not itself seeking admission of the Bonds to the Official List of the Irish Stock Exchange or to trading on its regulated market for the purposes of the Prospectus Directive.

APPENDIX 1

2012 FINANCIAL STATEMENTS OF ASSURED GUARANTY (EUROPE) LTD.

Assured Guaranty (Europe) Ltd.

Registered Number: 2510099

Annual report and financial statements
For the year ended 31 December 2012

Annual report and financial statements
For the year ended 31 December 2012

Contents

Company information

Directors

Executive directors
Dominic John Frederico
Nicholas James Proud
James Michael Michener
Robert Bruce Mills
Dominic James Brian Nathan

Non-executive directors
William Peter Cooke (resigned effective 4 December 2012)
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Company secretary
Bernadine Shaw (resigned effective 11 September 2012)
Ruth Cove (appointed effective 11 September 2012)

Registered office
1 Finsbury Square
London
EC2A 1AE

Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Directors' report for the year ended 31 December 2012

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2012.

Principal activity

The principal activity of Assured Guaranty (Europe) Ltd. (formerly, Financial Security Assurance (U.K.) Limited) ("the Company") is providing financial guarantees for European Union public finance and asset backed obligations. Financial guarantee insurance written by the Company generally guarantees scheduled payments on an issuer's obligations when there is a payment default by the obligor.

The Company is a wholly owned subsidiary of Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), which in turn is wholly owned by Assured Guaranty Municipal Corp. ("AGM").

The Company is authorised to effect and carry out certain classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss). This scope of permission is sufficient to enable the Company to effect and carry out financial guarantee insurance and reinsurance. The insurance and reinsurance businesses of the Company are subject to authorisation and close supervision by the Financial Services Authority ("the FSA"). The Company also has permission to arrange and advise on deals in financial guarantees which it underwrites.

Obligations insured by the Company are generally awarded ratings on the basis of the financial strength ratings given by the major securities rating agencies.

The Company has been assigned the following insurance financial strength ratings as of 26 March, 2013. These ratings are subject to continuous review:

S&P: AA- / Stable Outlook

Moody's: A2 / Stable Outlook

Review of business and future developments

The results of the Company for the year are as set out on pages 13 and 14.

In 2012, the Company continued to be affected by a negative perception of financial guaranty insurers arising from the financial distress suffered by other companies in the industry during the financial crisis. In November 2011, S&P downgraded the financial strength ratings of the Company to AA- (Stable Outlook) under its revised criteria. In January 2013, after a ten month review, Moody's assigned the Company an A2 (Stable) rating. Because the financial strength ratings of the Company were under review for possible downgrade by Moody's throughout most of 2012, the Company believes the demand for the Company's insurance product was negatively impacted.

The Company expects the pipeline of European infrastructure transactions to remain robust. Historically, financial guarantees had been an essential component of capital markets financings for European infrastructure projects. Because of the difficulties experienced by the financial guarantee industry since the onset of the financial crisis, these financings have been largely funded with relatively short-term bank loans. The Company expects that its European infrastructure opportunities will increase as the global economic environment stabilises and issuers return to the public markets for financings and that institutional investors will utilise financial guarantees again, as they value the Company's underwriting skills and surveillance functions as well as the value of the Company's guarantees.

At 31st December 2012, gross outstanding par insured was £17,975.1m and net par after reinsurance was £317.8m. Of this, 85.87% related to public finance exposures and 14.13% to structured finance exposures.

The Company's economic exposure to the selected European countries listed below (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following tables, both gross and net of ceded reinsurance:

Country	Gross exposure £'million	Net exposure £'million
Hungary	306.6	6.1
Ireland	42.8	0.9
Italy	1,379.4	33.2
Spain	401.6	7.0

As of December 31, 2012, the Company has not guaranteed any sovereign bonds of the Selected European Countries. The exposure shown in the above table is from transactions primarily backed by receivable payments from sub-sovereigns in Italy, Spain and Hungary. The Company understands that Moody's recently had undertaken a review of redenomination risk in selected countries in the Eurozone, including some of the selected European countries listed above. No redenomination from the Euro to another currency has yet occurred and it may never occur. Therefore, it is not possible to be certain at this point how a redenomination of an issuer's obligations might be implemented in the future and, in particular, whether any redenomination would extend to the Company's obligations under a related financial guarantee. At June 30, 2012, the Company had £3.2m of net exposure to the sovereign debt of Greece. The Company paid claims under its financial guaranties during the 2012 paying off in full its liabilities with respect to the Greek sovereign bonds it guaranteed. At December 31, 2012, the Company no longer had any direct exposure to Greece.

During 2012, the Company was party to a reinsurance agreement and a net worth maintenance agreement with AGM. Under the quota share cover of the reinsurance agreement transactions closed prior to 2011, AGM reinsured approximately 92% of the Company's retention after cessions to other reinsurers for transactions closed prior to 2011. The quota share cover does not apply to business under a co-guaranty, co-insurance or co-reinsurance structure implemented by the Company in 2011, where such co-guaranty, co-insurance or co-reinsurance is with an affiliate and where the amount guarantied, co-insured or co-guarantied by the Company is equal to approximately its pro rata retention percentage under the quota share cover. Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to the Company when the Company's annual net incurred losses and expenses exceeds the Company's annual net earned premium plus any amounts deducted from the Company's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20% of the net principal insured outstanding at the prior year-end, plus the net principal insured outstanding at last year-end of the Company's two largest transactions. The quota share and stop loss covers exclude transaction guarantied by the Company on or after July 1, 2009 that are not municipal, utility, project finance or infrastructure risks or similar types of risks. Under the net worth maintenance agreement, AGM is obligated to cause the Company to maintain capital resources equal to 110% of the greatest of the amounts as may be required by the FSA as a condition for maintaining its authorisation to carry on an insurance business in the U.K., provided that contributions do not exceed more than 35% of AGM's policyholders' surplus on an accumulated basis and are made in accordance with Article 15 of the New York Insurance Law.

It has been agreed between management and the FSA that any new business written by the Company will be guaranteed using a co-insurance structure pursuant to which the Company will co-insure municipal and infrastructure transactions with AGM, and asset backed transactions with Assured Guaranty Corp. ("AGC"). The Company's financial guarantee will guarantee a proportionate share (expected to be approximately 3 to 10%) of the total exposure, and AGM or AGC, as the case may be, will guarantee the remaining exposure under the transaction (subject to compliance with EEA licensing requirements). AGM or AGC, as the case may be, also will issue a second-to-pay guarantee covering the Company's financial guarantee.

The Company has invested significant financial and management resources into conforming with the requirements established by the European Union's "Solvency II" directive (Directive 2009/138/EC). The Company had been accepted by the FSA into the pre-application process and had begun the process to apply for approval from the FSA for use of the "Partial Internal Model" methodology for calculation of its solvency capital requirement, which combines standard formulas developed by the European Insurance and Occupational Pensions Authority, under the direction of the European Commission, for calculation of certain capital requirements with an internally developed model for calculation of other capital requirements. However, the date for the scheduled adoption of Solvency II has been delayed and the FSA has asked the Company to delay making its submission until mid 2014.

Prior to the adoption of Solvency II the FSA will supplement the individual capital assessment for the Companies with a "benchmarker" capital adequacy model. Should the level of capital at the Company fall below the capital requirement as indicated by the benchmarker, the FSA may require the Company to undertake further work, following which Individual Capital Guidance may result.

During 2011 the FSA conducted an ARROW review of the Company. Following this review the FSA provided the Company with a Risk Mitigation Programme ("RMP") which required the Company to take certain actions. The Company has agreed to an Action Plan with the FSA in order to address all of the points raised in the RMP.

Principal risks and uncertainties

The principal risks in the Company's financial guarantee business include insurance risk, credit risk, market risk, liquidity risk, operational risk and systems and control risk.

Insurance risk means the basic risk that the losses associated with the business will not be adequately covered by the Company's revenues and other resources. Insurance risk includes the risk of unanticipated losses, including catastrophic losses, due to the Company's management failing to understand the loss potential of obligations insured by the Company or unexpected third party events, inappropriate policy wording, unexpected legal judgments or legal change with retroactive effect, as well as the risk of revenues and other resources being below expectations due to inadequate premium rates based on ultimate loss experience or expense levels, inadequate reserves and capital resources and other factors.

Credit risk means the risk of loss if another party fails to perform its obligations. The Company faces credit risk as a result of its transactions with a variety of counterparties, including reinsurers, issuers of securities held in its investment portfolio, servicers of asset pools supporting insured structured transactions and other counterparties within the structures of insured transaction. The Company is exposed to the credit risk of its indirect parent company, AGM, in respect of the intra-group reinsurance and other support arrangements between AGM and the Company, which are material to the ability of the Company to engage in its financial guarantee business. The Company's business is dependent on maintaining its ratings and its ratings are dependent on these intra-group agreements and the ratings of AGM.

Market risk means the risk of a decline in value of the Company's assets as a consequence of market movements, such as interest rates and foreign exchange rates, which are not matched by corresponding movements in the value of the liabilities. Please see the discussion of recent adverse loss developments under "Review of business and future developments" above for more information on market risk.

Liquidity risk means the risk that the Company may have insufficient liquid assets to fund the debt services requirements of a defaulted, insured obligation and that losses will be realised in liquidating assets to fund the portions of claims retained by the Company following reinsurance.

Operational risk means the risk of unanticipated losses relating to error or failure associated with the administrative aspects of the Company's business, failure to comply with applicable laws and internal Company requirements, the impact of significant events such as a financial system crisis or natural disaster, fraud, corporate governance failure, failure to implement appropriate business plans or conduct effective strategic planning and failures associated with the Company's technology.

Systems and control risk is related to operational risk and means the risk that the Company's systems and controls do not include appropriate plans and procedures for dealing adequately with adverse scenarios.

The Company's management seeks to mitigate the foregoing risks by various means and to assure the availability of adequate capital to cover any liabilities or losses which eventuate notwithstanding the implementation of risk mitigants.

Key performance indicators ("KPIs")

The Board monitors the progress of the Company by reference to the following KPIs:

(i) Present value of new business written ("PVP") of transactions written by Company.
PVP, which is a non-GAAP ("Generally Accepted Accounting Principle") financial measure, is defined as gross upfront and instalment premiums received and the present value of gross estimated future instalment premiums, on contracts written in the current period, discounted at 6% per year. We believe PVP is a useful measure for management and other users of the financial statement because it enables the evaluation of the value of new business production by the Company by taking into account the value of estimated future instalment premiums on all new contracts underwritten in a reporting period, which GAAP gross premiums written do not adequately measure

(ii) Solvency
Solvency, which is a FSA regulatory financial measure, is defined as the excess of capital resources over the capital resources requirement. We believe this is a useful measure as it measures the adequacy of the capital resources of the Company and monitors compliance with the FSA capital requirements.

(iii) Number of new transactions
Number of new transactions is the number of new contracts of insurance incepted during the year.

(iv) Loss ratio
The ratio of net claims incurred to net earned premiums.

The KPIs at the end of the year are as follows:

	2012	2011
	£'000	£'000
PVP	**Nil**	94
Capital in excess of capital resources requirement	**135,238**	133,762
Loss ratio	**589%**	Nil
Number of new transactions	**Nil**	1

The increase in the loss ratio during 2012 is related to the company's exposure to Greece.

Results and dividends

The Company's profit after taxation for the year is £0.9m (2011: £2.3m). The directors do not recommend the payment of dividends (2011: Nil).

Directors

The following were the directors at the end of the year:

Executive directors
Dominic John Frederico
James Michael Michener
Robert Bruce Mills
Nicholas James Proud
Dominic James Brian Nathan

Non-Executive directors
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Financial risk management objectives

The Company is exposed to financial risk through its financial investments, reinsurance assets, liabilities to holders of its financial guarantees and financial investments held within the underlying structures of contracts guaranteed. The key financial risk in its financial investments is that the proceeds from its financial investments are not sufficient to fund the obligations arising from financial guarantees as they fall due. The key financial risk in financial investments held within the underlying structure of contracts guaranteed is that the proceeds from those investments are not sufficient to meet obligations inherent in those contracts, and thus trigger defaults. The most important components of this financial risk are interest rate, currency, credit and liquidity risk.

The Company manages its exposures using a range of risk management techniques. Investment policy is set with reference to the overall risks faced by the Company, with the primary objective to conserve and accumulate capital to cover future obligations and to support the Company's business objectives.

Interest rate risk
Interest rate risk arises primarily from investments in fixed interest securities. Interest rate risk is monitored by comparing the average duration of the investment portfolio. The Company's investment guidelines require the portfolio to have an average duration within two years of the market value weighted average of the relevant benchmark index.

Currency risk
The Company is exposed to currency risk in respect of liabilities under financial guarantees denominated in currencies other than pounds sterling. The most significant currency to which the Company is exposed is the Euro.

The Company seeks to mitigate this risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

Credit risk
Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The main areas where the Company is exposed to credit risk are:

- Reinsurer's shares of insurance liabilities
- Amounts due from financial guarantee holders

Reinsurance is used to manage risk. This does not, however, discharge the Company's liability as primary financial guarantor. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of a reinsurer is considered before it is used and strict criteria are applied (including the financial strength of the reinsurer) before a reinsurer is approved.

To manage the risk of non-recoverability of premiums from financial guarantee holders, the Company undertakes extensive due diligence prior to underwriting a contract with its counterparties.

Liquidity risk
Liquidity risk is the risk that cash may not be available to pay obligations as they fall due at a reasonable cost. The Company maintains holdings in short term deposits to ensure there are sufficient funds available to cover anticipated liabilities and unexpected levels of demand. Furthermore, the Company's investment managers are mandated to invest only in debt securities traded on recognised exchanges with the objective of maintaining a high degree of liquidity within the financial resources of the Company. Additionally, in the event of claims arising over a threshold amount, the Company may make claims for reinsurance payments under its reinsurance agreements in advance of paying claims.

Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2012 of which the auditors are unaware; and
2) the director has taken all steps that he ought to have taken in his duty as a director in order to make him aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibilities statement

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. The directors are required to prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2012 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office. A resolution concerning their reappointment was approved at the meeting of the Company's Board of Directors on 26 March 2013.

On behalf of the Board of Directors

Nicholas James Proud
Director
26 March 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ASSURED GUARANTY (UK) LIMITED

We have audited the financial statements of Assured Guaranty (UK) Limited for the year ended 31 December 2012 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 10 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Matthew Nichols (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 March 2013

Profit and loss account for the year ended 31 December 2012

	Note	**2012 £'000**	2011 £'000
Technical Account – General Business			
Earned premiums, net of reinsurance			
Gross premiums written	*3*	**838**	4,463
Outward reinsurance premiums		**(814)**	(3,861)
Net premiums written		**24**	602
Change in the gross provision for unearned premiums		**54,118**	30,084
Change in the provision for unearned premiums, reinsurer's share		**(53,601)**	(32,757)
		517	(2,673)
Earned premiums, net of reinsurance		**541**	(2,071)
Net operating income	*4*	**2,847**	-
Total technical income		**3,388**	(2,071)
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		**195,405**	-
- reinsurer's share		**(192,221)**	-
Claims incurred, net of reinsurance		**3,184**	-
Changes in technical provisions, net of reinsurance		**(31)**	400
Net operating expenses	*4*	**-**	1,754
Total technical charges		**3,153**	2,154
Balance on the technical account for general business		**235**	(4,225)

Profit and loss account for the year ended 31 December 2012

	Note	**2012 £'000**	2011 £'000
Non-Technical Account			
Balance on the general business technical account		**235**	(4,225)
Investment income	*8*	**6,510**	7,110
Unrealised (loss) / gain on investments	*8*	**(1,282)**	781
Investment expenses and charges	*8*	**(8,147)**	(230)
Other income	*21*	**4,107**	121
Profit on ordinary activities before tax		**1,423**	3,557
Tax on profit on ordinary activities	*10*	**(546)**	(1,281)
Profit for the financial year		**877**	2,276

The notes on pages 17 to 29 form part of the financial statements.

All of the results set out are derived from continuing activities.

The Company has no material recognised gains and losses other than the profit above and therefore no separate statement of total recognised gains and losses has been presented.

Neither gains/losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents.

Assured Guaranty (Europe) Ltd.

Registered in England No. 2510099

Balance sheet as at 31 December 2012

	Note	**2012 £'000**	2011 £'000
Assets			
Investments			
Financial investments	*13*	**163,313**	166,591
Reinsurer's share of technical provisions			
Provision for unearned premiums		**564,763**	618,365
Other technical provisions	*20*	**23,314**	29,598
		588,077	647,963
Debtors			
Debtors arising out of direct insurance operations		**354,526**	380,789
Other debtors		**99,583**	113,838
	12	**454,109**	494,627
Other Assets			
Cash at bank and on hand		**12,241**	9,194
Other assets		**77**	155
Deferred tax	*11*	**26,698**	27,297
		39,016	36,646
Prepayments and accrued income			
Accrued interest		**2,555**	2,167
Deferred acquisition costs		**39,557**	43,559
		42,112	45,726
Total assets		**1,286,627**	1,391,553

Balance sheet as at 31 December 2012

	Note	**2012** **£'000**	2011 £'000
Liabilities and shareholder's fund			
Capital and reserves			
Called up share capital	*18*	**55,000**	55,000
Capital contribution	*19*	**62,985**	62,985
Profit and loss account		**60,593**	59,716
Total shareholder's funds		**178,578**	177,701
Technical provisions			
Provision for unearned premium		**568,333**	622,452
Other technical provisions	*20*	**23,667**	29,998
		592,000	652,450
Creditors			
Creditors arising out of reinsurance operations		**345,528**	375,755
Other creditors		**4,353**	3,916
	14	**349,881**	379,671
Accruals and deferred income	*15*	**166,168**	181,731
Total liabilities		**1,108,049**	1,213,852
Total liabilities and shareholder's fund		**1,286,627**	1,391,553

The notes on pages 17 to 29 form part of the financial statements.

The financial statements were approved by the Board of Directors on 26 March 2013 and were signed on its behalf by:

Nicholas James Proud
Director

Notes to the financial statements
For the year ended 31 December 2012

1 Statement of significant accounting policies

The accounts have been prepared in accordance with the applicable Accounting Standards in the United Kingdom. The financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance groups and in accordance with the Companies Act 2006 and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and amended December 2006. The financial statements are prepared a going concern basis. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

Basis of accounting

(a) Premiums written
Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums receivable but not yet due.

The policy for premium recognition is dependent on the timing of the collection of premiums and the contractual terms of the policy.

(i) Where the premium on a policy is received up front, the premium is recognised as written on the date of inception, and earned in the technical account over the period of the policy having regard to the incidence of risk.

(ii) Where a premium is received in instalments and the underlying bonds are callable, management considers the nature of the call provision(s) and the likelihood of exercise of those provisions, and determines whether it is reasonably certain that the contract will run its full term. The full expected premium is recorded when it is reasonably certain that the contract will run its full term. When the contract is not expected to run its full term, the premium that is recognised as written is either the premium amount to the first call point under the contract and guaranteed minimum premium (where such a clause exists in the policy documents) or where the contract is callable without any notice period, the Company records the instalments as they fall due. When the underlying bonds are non-callable, the premium recognised as written is the full expected premium that is reasonably certain to be received over the life of the contract. Written premiums are recognised as earned income over the period of the policy having regard to the incidence of risk.

When instalment premiums to be received under the policy are linked to an outstanding debt that could be paid down faster than anticipated, or where a premium is linked to an index, the Company recognises premiums written based upon an analysis of the premium it is reasonably certain to receive. Any anticipated change in the expected premium receivable is recognised as an adjustment to premium, in the case of decreases in premium, as soon as it is foreseen and in the case of increases, when such an adjustment is assessed as reasonably certain.

(b) Unearned premiums
Unearned premiums represent the proportion of premiums written in the current or prior years that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

1 Statement of significant accounting policies (continued)

(c) Claims and claims expenses
Claims incurred comprise claims and related claims expenses paid in the year and the change in provisions for outstanding claims. When applicable, deductions are made for salvage and subrogation. The provision for unpaid claims and direct claims expenses is recorded when there is a significant deterioration on specific insured obligations and the obligations are in default at the balance sheet date, or when, in management's opinion, the likelihood of default is probable and determinable at the balance sheet date. When appropriate, the provision is discounted to its present value. Provisions are calculated gross of any reinsurance recoveries.

A substantial measure of experience and judgment is involved in assessing outstanding losses, the ultimate cost of which cannot be known with certainty at a balance sheet date. The gross insurance provisions and related reinsurance recoveries are determined on the basis of information currently available; however, it is inherent in the nature of business written that the ultimate liabilities may vary as a result of subsequent developments.

(d) Reinsurance
Contracts entered into by the Company with reinsurers, under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as "outward reinsurance premiums" when due.

(e) Acquisition costs and ceding commission income
Acquisition costs incurred, which represent expenses related to the production of business and ceding commission income to be received are deferred, subject to recoverability, and amortised over the period in which the related premiums are earned. These costs include direct and indirect expenses such as the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral.

(f) Investments
The fair values of investments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair values of financial instruments that are not traded in an active market, are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants, including broker prices and, if applicable, models.

1 Statement of significant accounting policies (continued)

(g) Investment return
Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

(h) Foreign currencies
Transactions in foreign currencies are translated to sterling at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into sterling at the rates of exchange ruling at that date. Differences arising on exchange are reflected in the non-technical account.

(i) Deferred taxation
Deferred taxation has been recognised as a liability or an asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in the future, or a right to pay less taxation in the future. Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets recognised have not been discounted.

(j) Operating leases
Leases of assets where a significant portion of the risk and rewards of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

(k) Unexpired risks provision
Provision has been made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date. The unexpired risks provision is included in Other technical provisions.

2 Cash flow statement and related party disclosures

The Company is a wholly-owned subsidiary of Assured Guaranty Ltd. ("AGL"). The cash flows of the Company are included in the financial statements of AGL, which are publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996). The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are wholly owned subsidiaries of AGL.

3 Segmental analysis

There is only one business segment that of financial guarantee business. The net assets and the business written by the Company are predominantly based in the United Kingdom, with business underwriting decisions made in the United Kingdom.

(a) Gross written premium by geographical segment

	2012	2012	2011	2011
	£'000	£'000	£'000	£'000
- UK	1,308		4,205	
- Europe, excluding UK	53		193	
- US	(481)		105	
- Japan	(42)		(40)	
Total gross premiums written		838		4,463
Gross earned premium		54,956		34,548
Gross operating income		50,955		33,158
Reinsurance balance		153,633		28,048

Total gross premiums written relates to in-force business written in prior periods. The Company does not measure profit and loss by geographical segment.

(b) Gross claim incurred by geographical segment

	2012	2012	2011	2011
	£'000	£'000	£'000	£'000
- Europe, excluding UK	195,405		-	-
Total gross claim incurred		195,405		-

4 Net operating income / (expense) – technical account

	2012	2011
	£'000	£'000
Movement in deferred acquisition costs	(4,002)	(1,389)
Administration expenses	(8,978)	(8,936)
Reinsurance commission receivable	15,827	8,571
	2,847	(1,754)

5 Auditors' remuneration

During the year, the Company obtained the following services from the auditor at costs as detailed below:

	2012	2011
	£'000	£'000
Audit services	**144**	162
Other services not covered above	**324**	880
	468	1,042

6 Directors' emoluments

	2012	2011
	£'000	£'000
Aggregate emoluments	**686**	390
Sums paid to non-executive directors	**73**	50
Company contributions to defined contributions scheme	**54**	28
	813	468

Highest paid director

	2012	2011
	£'000	£'000
Total amount of emoluments	**343**	336
Company contributions to defined contributions scheme	**30**	25
	373	361

All of the 2012 salaries and emoluments are paid by an affiliate, Assured Guaranty (UK) Services Limited ("AG UKS"), and charged back to the Company as part of the management fee.

Five directors are eligible to receive deferred cash and shares under the long-term incentive scheme of the ultimate parent company, AGL. The amount charged to the Company in relation to long-term incentive award during the year was £117,000. In addition, retirement benefits are accruing for the directors under a money purchase pension scheme.

7 Employees

There were no people (including executive directors) employed directly by the Company during the year.

All employees' salaries and benefits were paid by AG UKS, Assured Guaranty Finance Overseas Limited and Assured Guaranty Corp.. In consideration for this service, management service fees were levied on the Company. The total amount levied during the year was £5,934,000 (2011: £5,444,000).

8 Investment return

	2012	2011
	£'000	£'000
Investment Income		
Income from Investments	**6,235**	6,850
Realised gain on investments	**275**	260
	6,510	7,110
Unrealised (loss) / gain on investments	**(1,282)**	781
Investment expenses and charges		
Investment management expenses	**(146)**	(154)
Realised loss on investments	**(8,001)**	(76)
	(8,147)	(230)
Total investment return	**(2,919)**	7,661

9 Profit on ordinary activities before taxation

	2012	2011
	£'000	£'000
Profit on ordinary activities before taxation is stated after charging		
Operating lease charges	**413**	536
Foreign exchange (loss) / gain	**(3,387)**	121

The Company has arrangements with an affiliate Assured Guaranty Finance Overseas Limited ("AGFOL") whereby operating expenses including operating lease charges were paid by AGFOL. These expenses are subsequently recharged to the Company at a mark-up of 10% and these have also been included in Operating lease charges in the above table.

10 Tax on profit on ordinary activities

The Company has made an election with the Internal Revenue Service pursuant to Section 953(d) of the Internal Revenue Code. Section 953(d) allows certain foreign insurance companies to elect to be treated as a U.S. corporation for federal income tax purposes. The impact of the election is that the Company will be taxed as a U.S. corporation subject to tax on its worldwide income, subject to a credit for any taxes paid to a foreign jurisdiction. The current US federal tax rate is 35% (2011: 35%) as compared with an average 24.5% (2011: 26.5%) rate in the UK.

	2012	2011
	£'000	£'000
UK corporation tax		
- Current	**(355)**	(1,081)
- Deferred	-	198
Overseas corporation tax		
- Current	**(1,225)**	1,258
- Deferred	**1,034**	(1,656)
	(546)	(1,281)

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. A reconciliation between the current tax provision and that expected from the standard UK tax rate of 24.5% (2011: 26.5%) is as follows:

	2012	2011
	£'000	£'000
Tax expense at statutory rate	**(352)**	(945)
Effects of:		
Temporary differences		
Employee benefits	-	(130)
UK and US tax differences		
Permanent		
Expenses not deductible for tax purposes	**(3)**	(6)
Overseas corporation tax	**(1225)**	1258
Provision for current income taxes	**(1,580)**	177

For periods subsequent to April 1, 2012, the U.K. corporation tax rate has been reduced to 24%, for the period April 1, 2011 to April 1, 2012 the U.K. corporation tax rate was 26% resulting in a blended tax rate of 24.5% in 2012 and prior to April 1, 2011, the U.K. corporation tax rate was 28% resulting in a blended tax rate of 26.5% in 2011.

10 Tax on profit on ordinary activities (continued)

Further reductions to the UK corporation tax rate were announced in the March 2013 Budget. The changes, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 20% by 1 April 2015. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements. Had they been substantively enacted they would not have had a material impact on the net deferred tax asset at the period end. The impact of these changes in future periods will be dependent on the level of taxable profits in those periods.

During 2010 Dexia, the previous ultimate parent of the Company, filed an amended U.S. tax return for the 2008 tax year. Based on the amended filing, the Company booked additional foreign tax credits in deferred tax assets of £14.3m. For post acquisition periods, the Company is limited by the U.S. tax code on the annual amount it could benefit from these foreign tax credits. The foreign tax credits expire in 2018 through 2021.

11 Deferred tax (liabilities) / assets

Based on its projections for continued future taxable income, the Company believes that its deferred tax assets are more likely than not to be realised. The items that gave rise to the Company's net deferred tax asset are noted below:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
Description	**2012**	2011	**2012**	2011	**2012**	2011
UK and US tax differences	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Unrealised gains	-	-	**(435)**	(1,158)	**(435)**	(1,158)
Market discounts	-	-	**(250)**	-	**(250)**	-
Timing differences on revenue recognition	-	-	**(1260)**	(1,414)	**(1260)**	(1,414)
Total deferred tax liabilities	-	-	**(1945)**	(2,572)	**(1945)**	(2,572)

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2012	2011	**2012**	2011	**2012**	2011
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Deferred acquisition costs	-	-	**9,523**	15,445	**9,523**	15,445
Employee benefits	-	123	**532**	116	**532**	239
Tax credits for UK tax paid	-	-	**18,589**	13,019	**18,589**	13,019
Other temporary timing differences	-	-	-	1,166	-	1,166
Total deferred tax assets	-	123	**28,644**	29,746	**28,644**	29,869
Net deferred tax asset	-	123	**26,699**	27,174	**26,699**	27,297

Notes to the financial statements (continued)
For the year ended 31 December 2012

11 Deferred tax liabilities / (assets) (continued)

The movement in the net deferred tax asset is as follows:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2012	2011	**2012**	2011	**2012**	2011
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
As of 1 January	**123**	75	**27,174**	28,543	**27,297**	28,618
Movement in year	**(123)**	48	**(1,335)**	(1,505)	**(1,458)**	(1,457)
Translation Adjustment	-	-	**859**	136	**859**	136
	-	123	**26,698**	27,174	**26,698**	27,297

12 Debtors

	2012	2011
	£'000	£'000
Arising out of direct insurance operations	**354,526**	380,789
Arising out of reinsurance operations	**99,263**	111,858
Other debtors including taxation and social security	**320**	1,980
At 31 December	**454,109**	494,627

13 Investments

	2012	2011
	£'000	£'000
Financial investments		
- UK government bonds	**122,817**	152,694
- Non-UK government bonds	**742**	796
- Corporate bonds	**38,405**	11,684
- Asset-backed securities	**111**	126
- Short-term investments	**1,238**	1,291
At 31 December	**163,313**	166,591

13 Investments (continued)

The bonds are shown at market value. The book cost of these is £153,339,000 (2011: £155,409,000). Of the above investments, £162,075,000 were listed investments (2011: £165,298,000).

14 Creditors

	2012	2011
	£'000	£'000
Arising out of reinsurance operations	**345,528**	375,755
Amounts owed to group undertakings	**3,878**	2,646
Amounts due under pension plan obligations	**10**	3
Other creditors including taxation and social security	**465**	1,267
At 31 December	**349,881**	379,671

Amounts owed to group undertakings are unsecured, interest free and have no fixed date for repayment.

15 Accruals and deferred income

	2012	2011
	£'000	£'000
Other liabilities	**191**	152
Reinsurance commission deferred	**165,977**	181,579
At 31 December	**166,168**	181,731

16 Other financial commitments and guarantees

The Company has guaranteed the obligations of Assured Guaranty Credit Protection Limited ("AGCPL"), a fellow group company. AGCPL sells credit protection to counterparties through credit default swaps and may incur a loss in the event of payment default by the obligor. The Company is not aware of any actual or potential liabilities in relation to this guarantee. In 2012 and 2011, the transaction fees incurred by the Company totalled approximately £28,000 and £28,000, respectively. The Company, in turn, was paid an administrative fee of £15,000 and £15,000 in 2012 and 2011, respectively, by AGCPL in connection with a cooperative agreement between the two companies for AGCPL's use of Company personnel, property and services. The Company does not intend to sell credit default swaps in the future.

17 Significant risk management activities

The Company relies on the following committees and functions established by the Board of Directors for its risk management policies and procedures: Audit and Risk Oversight Committee, Compliance Function, Credit Committee, Executive Committee, Reserve Committee, Risk Management Function and Surveillance Function. Within the limits established by the Portfolio Risk Management Committee for the Group, which includes the Company's Chief Executive Officer, specific risk policies and limits are set by the Executive Committee. As part of its risk management strategy, the Company may seek to obtain third party reinsurance and may also periodically enter into other arrangements to alleviate all or a portion of this risk.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Risk Management and Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel and the Actuarial Function make recommendations on case loss reserves to a Reserve Committee.

The Surveillance Function may request that the Group's workout committee develop and implement loss mitigation strategies when the Surveillance Function identifies transactions that would benefit from active loss mitigation.

The Company segregates its insured portfolio of investment grade and below investment grade risks into surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. Below investment grade credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies except for a Super Senior category which is not generally used by rating agencies. The Company uses the Super Senior Category on transactions where it is considered that additional credit enhancement exists and such credit enhancement, in management's opinion, causes the Company's attachment point to be materially above the AAA attachment point.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to below investment grade. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new below investment grade credits. The Company refreshes its internal credits ratings on individual credits in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as below investment grade are subjected to further review by surveillance personnel to determine the various probabilities of a loss. Surveillance personnel present analysis related to potential loss scenarios to a reserve committee. The reserve committee consider the information provided by surveillance personnel when setting reserves.

18 Called up share capital

	2012	2011
	£'000	£'000
Authorised		
500,000,000 ordinary shares of £1 each	**500,000**	500,000
Allotted and fully paid		
55,000,000 ordinary shares of £1 each	**55,000**	55,000

19 Reconciliation of movements in shareholders' funds

	Called up share capital	Profit and loss account	Capital contribution	2012	2011
	£'000	£'000	£'000	£'000	£'000
At 1 January	55,000	59,716	62,985	177,701	175,425
Profit for the financial year	-	877	-	877	2,276
At 31 December	55,000	60,593	62,985	178,578	177,701

20 Other technical provisions

	2012	2011
	£'000	£'000
Unexpired risks provision	**23,667**	29,998
Reinsurer's share of unexpired risks provision	**(23,314)**	(29,598)
At 31 December	**353**	400

The discount rate used in calculating the unexpired risk provision is a rate of 3.5%

21 Other income / (charges)

	2012	2011
	£'000	£'000
Foreign exchange (loss) / gain	**(3,387)**	121
Other income	**7,494**	-
At 31 December	**4,107**	121

Other income includes £7.44m of reinsurance recoveries in relation a to realised investment loss on disposal of Greek bonds which were received by the Company in accordance with reinsurance contracts in place.

22 Financial commitments

The Company has arrangements with its indirect parent AGM whereby it pays lease rentals on behalf of AGM in respect of office space previously occupied by the Company. The commitment under the uncancellable operating lease is to pay rentals of £0.6m (2011: £0.9m). As a result of vacating the building, the Company has made a lease provision for the unexpired portion of the lease, taking into account anticipated future sub-lease income from parties not yet identified. The total amount of lease provision provided for is £0.1m (2011: £0.8m). This lease will expire on 24 September 2013.

23 Ultimate and immediate parent company

The immediate parent undertaking is Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), a United States company. The ultimate parent undertaking and controlling party is AGL, a Bermuda incorporated insurance holding company.

AGL is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2012. The consolidated financial statements of AGL can be obtained from 30 Woodbourne Avenue, Hamilton HM 08, Bermuda.

AGMIC is the parent undertaking of the smallest group of undertakings to consolidate these financial statements. The consolidated financial statements of AGMIC can be obtained from 31 West 52nd Street, New York, NY 10019, United States of America.

APPENDIX 2

2011 FINANCIAL STATEMENTS OF ASSURED GUARANTY (EUROPE) LTD.

Assured Guaranty (Europe) Ltd.

Registered Number: 2510099

Annual report and financial statements
For the year ended 31 December 2011

Assured Guaranty (Europe) Ltd.

Registered in England No. 2510099

Annual report and financial statements
For the year ended 31 December 2011

Contents

Company information

Directors

Executive directors
Sean Wallace McCarthy (resigned effective 31 March 2011)
Dominic John Frederico
Nicholas James Proud
James Michael Michener
Robert Bruce Mills
Andrew Hoyt Pickering (resigned effective 31 March 2011)
Dominic James Brian Nathan (appointed effective 12 August 2011)

Non-executive directors
William Peter Cooke
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Company secretary
Bernadine Shaw

Registered office
1 Finsbury Square
London
EC2A 1AE

Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Directors' report for the year ended 31 December 2011

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2011.

Principal activity

The principal activity of Assured Guaranty (Europe) Ltd. (formerly, Financial Security Assurance (U.K.) Limited) ("the Company") is providing financial guarantees for European Union public finance and asset backed obligations. Financial guarantee insurance written by the Company generally guarantees scheduled payments on an issuer's obligations when there is a payment default by the obligor.

The Company is a wholly owned subsidiary of Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), which in turn is wholly owned by Assured Guaranty Municipal Corp. ("AGM").

The Company is authorised to effect and carry out certain classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss). This scope of permission is sufficient to enable the Company to effect and carry out financial guarantee insurance and reinsurance. The insurance and reinsurance businesses of the Company are subject to authorisation and close supervision by the Financial Services Authority ("the FSA"). The Company also has permission to arrange and advise on deals in financial guarantees which it underwrites.

Obligations insured by the Company are generally awarded ratings on the basis of the financial strength ratings given by the major securities rating agencies.

The Company has been assigned the following insurance financial strength ratings as of 29th March, 2012. These ratings are subject to continuous review:

S&P: AA- / Stable Outlook

Moody's: Aa3 / (On Review for Possible Downgrade)

Review of business and future developments

The results of the Company for the year are as set out on pages 14 and 15.

During 2011, the Company faced continued challenges in re-establishing its market position. This was primarily due to uncertainty over the Company's financial strength ratings. On 24 January 2011, S&P released a publication entitled "Request for Comment: Bond Insurance Criteria," in which it requested comments on proposed changes to its bond insurance ratings criteria. Although S&P had assigned the Company, AGM and their affiliate, Assured Guaranty Corp. ("AGC") financial strength ratings of AA+ (Stable Outlook) in October 2010, it noted in the Request for Comment that it could lower the financial strength ratings on existing investment grade bond insurers (which included the Company) by one or more rating categories if the proposed bond insurance ratings criteria were adopted - unless those bond insurers raised additional capital or reduced risk. Over the course of 2011, considerable uncertainty existed as market participants provided comments on the proposed criteria, and awaited the issuance of the new criteria. When S&P released its final criteria in August 2011, the criteria contained a new "largest obligor test" that had not been included in the Request for Comment. The largest obligor test had the effect of significantly reducing the Assured Guaranty group's allowed single risk limits and limiting its financial strength rating levels. Then, in September 2011, S&P placed the financial strength ratings of the Company, AGM and AGC on CreditWatch negative. It was not until November 2011 that S&P assigned the

Directors' report for the year ended 31 December 2011 (continued)

Company, AGM and AGC financial strength ratings of AA- (Stable Outlook). In addition, the Company, AGM and AGC have been rated Aa3 (Negative Outlook) by Moody's since December 2009. In addition to the lack of stability of the Company's financial strength ratings, the financial crisis and the continued seizing up of the capital markets, particularly for infrastructure related financings, had a major impact on the Company's ability to secure new transactions.

Notwithstanding these uncertainties, during 2011 the Company succeeded in closing its first transaction since 2008. The Company and AGM replaced Ambac Assurance UK Limited. as financial guarantor on bonds issued by Worcestershire Hospital SPC PLC (formerly Catalyst Healthcare (Worcester) PLC) ("Worcestershire Hospital"). Investors in the transaction agreed to payment for the replacement through a reduction in coupon. Management believes that the Worcestershire Hospital transaction provides important evidence of investor support for the Company's product. This fact, combined with willingness on the part of issuers, sponsors and arranger to work with the Company, suggests that the Company is well positioned to close new transactions in the coming year.

The Company expects the pipeline of European infrastructure transactions to remain robust. Historically, financial guarantees had been an essential component of capital markets financings for European infrastructure projects. Because of the difficulties experienced by the financial guarantee industry since the onset of the credit crisis, these financings have been largely funded with relatively short-term bank loans. The Company expects that its European infrastructure opportunities will increase as the global economic environment stabilises and issuers return to the public markets for financings and that institutional investors will utilise financial guarantees again, as they value the Company's underwriting skills and surveillance functions as well as the value of the Company's guarantees.

At 31st December 2011, gross outstanding par insured was £19,716.4m and net par after reinsurance was £361.2m. Of this, 85.3% related to public finance exposures and 14.7% to structured finance exposures.

Several European countries are experiencing significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The Company is closely monitoring its exposures in European countries where it believes heightened uncertainties exist: specifically, Greece, Hungary, Ireland, Italy and Spain. The company has exposures in these countries as follows:

Country	Gross exposure £'million	Net exposure £'million
Greece	261.7	3.5
Ireland	58.1	1.2
Italy	1,460.6	35.4
Hungary	328.7	6.5
Spain	423.2	7.4

The Company is closely monitoring the ability and willingness of obligors in these countries to make timely payments on their obligations.

At 31st December 2011, the Company had exposure to sovereign debt of the Hellenic Republic of Greece through financial guarantees of €200.0m of debt (€4.0m on a net basis) due in 2037 ("2037 Bonds") with a 4.5% fixed coupon and €113.9m of inflation-linked debt (€1.4m on a net basis) due in 2057 ("2057 Bonds") with a 2.085% coupon. Greece, as obligor, has been paying interest on such notes on a timely basis. On 23 February 2012, the Greek Parliament enacted legislation that introduces collective action clauses into eligible Greek law governed bonds to permit the terms of such bonds to be amended with the consent of less than all the holders of those bonds. On 24 February 2012, Greece announced the terms of exchange offers and consent solicitations that requested the voluntary participation by holders of certain Greek bonds in an exchange that would result in the reduction of 53.5% of the notional amount of such bonds, and requested the consent of holders to amendments of the bonds that could be used to effectively impose the same terms on holders that do not voluntarily participate in the exchange. The bonds guaranteed under the financial guarantees were included in the list of Greek bonds covered by the exchange offers and consent solicitations. In March 2012, the Company took delivery of the 2037 Bonds and 2057 Bonds that it guarantees. On the 8 March 2012 Greece announced that 85.8% of the holders of eligible Greek-law governed bonds tendered in the exchange and/or voted in favour of the consent solicitation and that they would invoke the collective action clauses on the remaining eligible Greek-law governed bonds. As holder of the 2037 Bonds, the Company received or will receive the exchanged securities. Having evaluated the exchange offer and consent solicitation on the 2057 Bonds, the Company has agreed to participate voluntarily in the exchange for these bonds. As of year-end the Company held a gross unexpired risk provision of £30.0m (net £0.4m) on both the 2037 Bonds and 2057 Bonds. The Company currently does not have enough information to determine the financial effect of these post balance sheet events.

During 2011, the Company was party to a reinsurance agreement and a net worth maintenance agreement with AGM. Under the quota share cover of the reinsurance agreement relating to transactions closed prior to 2011, AGM reinsured approximately 92% of the Company's retention after cessions to other reinsurers. Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to the Company when the Company's annual net incurred losses and expenses exceeds the Company's annual net earned premium plus any amounts deducted from the Company's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20% of the net principal insured outstanding at the prior year-end, plus the net principal insured outstanding at last year-end of the Company's two largest transactions. Under the net worth maintenance agreement, AGM is obligated to cause the Company to maintain free assets of £10m or such greater amount as may be required by the FSA, provided that contributions do not exceed more than 35% of AGM's policyholders' surplus, do not jeopardise AGM's insurer financial strength rating from Moody's or S&P, and comply with Article 15 of the New York Insurance Law.

It has been agreed between management and the FSA that any new business written by the Company will be guaranteed using a co-insurance structure pursuant to which the Company will co-insure municipal and infrastructure transactions with AGM, and structured finance transactions with AGC. The Company's financial guarantee will guarantee a proportionate share (expected to be approximately 3 to 10%) of the total exposure, and AGM or AGC, as the case may he, will guarantee the remaining exposure under the transaction (subject to compliance with EEA licensing requirements). AGM or AGC, as the case may be, also will issue a second-to-pay guarantee covering AGE's financial guarantee. The Worcestershire Hospital transaction was the first transaction to be executed under the co-insurance arrangement.

In 2007, the FSA supplemented the individual capital assessment for financial guarantee insurers with a "benchmarker" capital adequacy model. The Company has filed an individual capital adequacy submission with the FSA. The FSA elected not to issue Individual Capital Guidance but rather to continue with the use of the benchmarker tool to set the level of capital required. In the third quarter of 2011, management and the FSA conducted a review of the benchmarker model. Should the level of capital at AGE fall below the capital requirement as indicated by the benchmarker, the FSA may require the Company to undertake further work, following which Individual Capital Guidance may result.

During the year the FSA conducted an ARROW review of the Company. Following this review the FSA provided the Company with a Risk Mitigation Programme ("RMP") which required the Company to take certain actions. The Company has agreed an Action Plan with the FSA in order to address all of the points raised in the RMP.

The Company has invested significant financial and management resources into conforming with the requirements established by the European Union's "Solvency II" directive (Directive 2009/138/EC). The Company has been accepted by the FSA into the pre-application process and has begun the process to apply for approval from the FSA for use of the "Partial Internal Model" methodology for calculation of its solvency capital requirement, which combines standard formulas developed by the European Insurance and Occupational Pensions Authority, under the direction of the European Commission, for calculation of certain capital requirements with an internally developed model for calculation of other capital requirements.

Principal risks and uncertainties

The principal risks in the Company's financial guarantee business include insurance risk, credit risk, market risk, liquidity risk, operational risk and systems and control risk.

Insurance risk means the basic risk that the losses associated with the business will not be adequately covered by the Company's revenues and other resources. Insurance risk includes the risk of unanticipated losses, including catastrophic losses, due to the Company's management failing to understand the loss potential of obligations insured by the Company or unexpected third party events, inappropriate policy wording, unexpected legal judgments or legal change with retroactive effect, as well as the risk of revenues and other resources being below expectations due to inadequate premium rates based on ultimate loss experience or expense levels, inadequate reserves and capital resources and other factors.

Credit risk means the risk of loss if another party fails to perform its obligations. The Company faces credit risk as a result of its transactions with a variety of counterparties, including reinsurers, issuers of securities held in its investment portfolio, servicers of asset pools supporting insured structured transactions and other counterparties within the structures of insured transaction. The Company is exposed to the credit risk of its indirect parent company, AGM, in respect of the intra-group reinsurance and other support arrangements between AGM and the Company, which are material to the ability of the Company to engage in its financial guarantee business. The Company's business is dependent on maintaining its ratings and its ratings are dependent on these intra-group agreements and the ratings of AGM.

Market risk means the risk of a decline in value of the Company's assets as a consequence of market movements, such as interest rates and foreign exchange rates, which are not matched by corresponding movements in the value of the liabilities. Please see the discussion of recent adverse loss developments under "Review of business and future developments" above for more information on market risk.

Liquidity risk means the risk that the Company may have insufficient liquid assets to fund the debt services requirements of a defaulted, insured obligation and that losses will be realised in liquidating assets to fund the portions of claims retained by the Company following reinsurance.

Directors' report for the year ended 31 December 2011 (continued)

Operational risk means the risk of unanticipated losses relating to error or failure associated with the administrative aspects of the Company's business, failure to comply with applicable laws and internal Company requirements, the impact of significant events such as a financial system crisis or natural disaster, fraud, corporate governance failure, failure to implement appropriate business plans or conduct effective strategic planning and failures associated with the Company's technology.

Systems and control risk is related to operational risk and means the risk that the Company's systems and controls do not include appropriate plans and procedures for dealing adequately with adverse scenarios.

The Company's management seeks to mitigate the foregoing risks by various means and to assure the availability of adequate capital to cover any liabilities or losses which eventuate notwithstanding the implementation of risk mitigants.

Key performance indicators ("KPIs")

The Board monitors the progress of the Company by reference to the following KPIs:

(i) Net written premium
Net written premium comprises of total gross premium written during the year less the proportion of those premiums that are ceded to its reinsurers. We believe that net written premium is a useful financial measure which permits the evaluation of the value of premiums written and retained by the business during the year.

(ii) Solvency
Solvency, which is a FSA regulatory financial measure, is defined as the excess of capital resources over the capital resources requirement. We believe this is a useful measure as it measures the adequacy of the capital resources of the Company and monitors compliance with the FSA capital requirements.

(iii) Number of new transactions
Number of new transactions is the number of new contracts of insurance incepted during the year.

(iv) Loss ratio
The ratio of net claims incurred to net earned premiums.

The KPIs at the end of the year are as follows:

	2011	2010
	£'000	£'000
Net written premium	**602**	(11,735)
Capital in excess of capital resources requirement	**133,762**	130,164
Loss ratio	**Nil**	Nil
Number of new transactions	**1**	Nil

Results and dividends

The Company's profit after taxation for the year is £2.3m (2010: £25.4m). The directors do not recommend the payment of dividends (2010: Nil).

Directors' report for the year ended 31 December 2011 (continued)

Directors

The following were the directors at the end of the year:

Executive directors
Dominic John Frederico
James Michael Michener
Robert Bruce Mills
Nicholas James Proud
Dominic James Brian Nathan (appointed effective 12 August 2011)

Non-Executive directors
William Peter Cooke
Anthony Robin Dominic Monro-Davies

Financial risk management objectives

The Company is exposed to financial risk through its financial investments, reinsurance assets, liabilities to holders of its financial guarantees and financial investments held within the underlying structures of contracts guaranteed. The key financial risk in its financial investments is that the proceeds from its financial investments are not sufficient to fund the obligations arising from financial guarantees as they fall due. The key financial risk in financial investments held within the underlying structure of contracts guaranteed is that the proceeds from those investments are not sufficient to meet obligations inherent in those contracts, and thus trigger defaults. The most important components of this financial risk are interest rate, currency, credit and liquidity risk.

The Company manages its exposures using a range of risk management techniques. Investment policy is set with reference to the overall risks faced by the Company, with the primary objective to conserve and accumulate capital to cover future obligations and to support the Company's business objectives.

Interest rate risk
Interest rate risk arises primarily from investments in fixed interest securities. Interest rate risk is monitored by comparing the average duration of the investment portfolio. The Company's investment guidelines require the portfolio to have an average duration within two years of the market value weighted average of the relevant benchmark index.

Currency risk
The Company is exposed to currency risk in respect of liabilities under financial guarantees denominated in currencies other than pounds sterling. The most significant currency to which the Company is exposed is the Euro.

The Company seeks to mitigate this risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

Credit risk
Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The main areas where the Company is exposed to credit risk are:

- Reinsurer's shares of insurance liabilities
- Amounts due from financial guarantee holders

Directors' report for the year ended 31 December 2011 (continued)

Reinsurance is used to manage risk. This does not, however, discharge the Company's liability as primary financial guarantor. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of a reinsurer is considered before it is used and strict criteria are applied (including the financial strength of the reinsurer) before a reinsurer is approved.

To manage the risk of non-recoverability of premiums from financial guarantee holders, the Company undertakes extensive due diligence prior to underwriting a contract with its counterparties.

Liquidity risk
Liquidity risk is the risk that cash may not be available to pay obligations as they fall due at a reasonable cost. The Company maintains holdings in short term deposits to ensure there are sufficient funds available to cover anticipated liabilities and unexpected levels of demand. Furthermore, the Company's investment managers are mandated to invest only in debt securities traded on recognised exchanges with the objective of maintaining a high degree of liquidity within the financial resources of the Company. Additionally, in the event of claims arising over a threshold amount, the Company may make claims for reinsurance payments under its reinsurance agreements in advance of paying claims.

Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2011 of which the auditors are unaware; and
2) the director has taken all steps that he ought to have taken in his duty as a director in order to make him aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibilities statement

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. The directors are required to prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2011 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors' report for the year ended 31 December 2011 (continued)

Independent auditors

The auditors PricewaterhouseCoopers LLP continued in office during the year and have expressed their willingness to continue in office. A resolution concerning their reappointment was approved at the meeting of the Company's Board of Directors on 29 March 2012.

On behalf of the Board of Directors

Nicholas James Proud
Director
29 March 2012

Independent Auditors' Report to the Members of Assured Guaranty (Europe) Ltd.

We have audited the financial statements of Assured Guaranty (Europe) Ltd. for the year ended 31 December 2011 which comprise the Profit and Loss Account, the Balance Sheet, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 10, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent Auditors' Report to the Members of Assured Guaranty (Europe) Ltd. (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Matthew Nichols (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
30 March 2012

Profit and loss account for the year ended 31 December 2011

	Note	**2011 £'000**	2010 £'000
Technical Account – General Business			
Earned premiums, net of reinsurance			
Gross premiums written	*3*	**4,463**	10,022
Outward reinsurance premiums		**(3,861)**	(21,757)
Net premiums written		**602**	(11,735)
Change in the gross provision for unearned premiums		**30,084**	24,331
Change in the provision for unearned premiums, reinsurer's share		**(32,757)**	(12,819)
		(2,673)	11,512
Earned premiums, net of reinsurance		**(2,071)**	(223)
Other technical income	*21*	**-**	11,120
Total technical income		(2,071)	10,897
Changes in technical provisions, net of reinsurance		**400**	-
Net operating expenses / (income)	*4*	**1,754**	(153)
Total technical charges		**2,154**	(153)
Balance on the technical account for general business		**(4,225)**	11,050

Profit and loss account for the year ended 31 December 2011

	Note	**2011** **£'000**	2010 £'000
Non-Technical Account			
Balance on the general business technical account		**(4,225)**	11,050
Investment income	*8*	**7,110**	7,016
Unrealised gain on investments	*8*	**781**	1,622
Investment expenses and charges	*8*	**(230)**	(136)
Other income / (charges)	*22*	**121**	(1,711)
Profit on ordinary activities before tax		**3,557**	17,841
Tax on profit on ordinary activities	*10*	**(1,281)**	8,022
Profit for the financial year		**2,276**	25,863

The notes on pages 18 to 30 form part of the financial statements.

All of the results set out are derived from continuing activities.

The Company has no material recognised gains and losses other than the profit above and therefore no separate statement of total recognised gains and losses has been presented.

Neither gains/losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents.

Assured Guaranty (Europe) Ltd.

Registered in England No. 2510099

Balance sheet as at 31 December 2011

	Note	**2011 £'000**	2010 £'000
Assets			
Investments			
Financial investments	*13*	**166,591**	169,649
Reinsurer's share of technical provisions			
Provision for unearned premiums		**618,365**	651,122
Other technical provisions	*20*	**29,598**	-
		647,963	651,122
Debtors			
Debtors arising out of direct insurance operations		**380,789**	402,796
Other debtors		**113,838**	129,202
	12	**494,627**	531,998
Other Assets			
Cash at bank and on hand		**9,194**	8,372
Other assets		**155**	140
Deferred tax	*11*	**27,297**	28,618
		36,646	37,130
Prepayments and accrued income			
Accrued interest		**2,167**	2,182
Deferred acquisition costs		**43,559**	44,948
		45,726	47,130
Total assets		**1,391,553**	1,437,029

Balance sheet as at 31 December 2011

	Note	**2011 £'000**	2010 £'000
Liabilities and shareholder's fund			
Capital and reserves			
Called up share capital	*18*	**55,000**	55,000
Capital contribution	*19*	**62,985**	62,985
Profit and loss account		**59,716**	57,440
Total shareholder's funds		**177,701**	175,425
Technical provisions			
Provision for unearned premium		**622,452**	652,536
Other technical provisions	*20*	**29,998**	-
		652,450	652,536
Creditors			
Creditors arising out of reinsurance operations	*14*	**375,755**	412,593
Other creditors	*14*	**3,916**	8,074
		379,671	420,667
Accruals and deferred income	*15*	**181,731**	188,401
Total liabilities		**1,213,852**	1,261,604
Total liabilities and shareholder's fund		**1,391,553**	1,437,029

The notes on pages 18 to 30 form part of the financial statements.

The financial statements were approved by the Board of Directors on 29 March 2012 and were signed on its behalf by:

Nicholas James Proud
Director

Notes to the financial statements
For the year ended 31 Decemher 2011

1 Statement of significant accounting policies

The accounts have been prepared in accordance with the applicable Accounting Standards in the United Kingdom. The financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance groups and in accordance with the Companies Act 2006 and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and amended December 2006. The financial statements are prepared on the going concern basis and under the historical cost convention. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

Basis of accounting

(a) Premiums written
Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums receivable but not yet due.

The policy for premium recognition is dependent on the timing of the collection of premiums and the contractual terms of the policy.

(i) Where the premium on a policy is received up front, the premium is recognised as written on the date of inception, and earned in the technical account over the period of the policy having regard to the incidence of risk.

(ii) Where a premium is received in instalments and the underlying bonds are callable, management considers the nature of the call provision(s) and the likelihood of exercise of those provisions, and determines whether it is reasonably certain that the contract will run its full term. The full expected premium is recorded when it is reasonably certain that the contract will run its full term. When the contract is not expected to run its full term, the premium that is recognised as written is either the premium amount to the first call point under the contract and guaranteed minimum premium (where such a clause exists in the policy documents) or where the contract is callable without any notice period, the Company records the instalments as they fall due. When the underlying bonds are non-callable, the premium recognised as written is the full expected premium that is reasonably certain to he received over the life of the contract. Written premiums are recognised as earned income over the period of the policy having regard to the incidence of risk.

When instalment premiums to be received under the policy are linked to an outstanding debt that could be paid down faster than anticipated, or where a premium is linked to an index, the Company recognises premiums written based upon an analysis of the premium it is reasonably certain to receive. Any anticipated change in the expected premium receivable is recognised as an adjustment to premium, in the case of decreases in premium, as soon as it is foreseen and in the case of increases, when such an adjustment is assessed as reasonably certain.

(b) Unearned premiums
Unearned premiums represent the proportion of premiums written in the current or prior years that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

Notes to the financial statements (continued)
For the year ended 31 December 2011

1 Statement of significant accounting policies (continued)

(c) Claims and claims expenses
Claims incurred comprise claims and related claims expenses paid in the year and the change in provisions for outstanding claims. When applicable, deductions are made for salvage and subrogation. The provision for unpaid claims and direct claims expenses is recorded when there is a significant deterioration on specific insured obligations and the obligations are in default at the balance sheet date, or when, in management's opinion, the likelihood of default is probable and determinable at the balance sheet date. When appropriate, the provision is discounted to its present value. Provisions are calculated gross of any reinsurance recoveries.

A substantial measure of experience and judgment is involved in assessing outstanding losses, the ultimate cost of which cannot be known with certainty at a balance sheet date. The gross insurance provisions and related reinsurance recoveries are determined on the basis of information currently available; however, it is inherent in the nature of business written that the ultimate liabilities may vary as a result of subsequent developments.

(d) Reinsurance
Contracts entered into by the Company with reinsurers, under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as "outward reinsurance premiums" when due.

(e) Acquisition costs and ceding commission income
Acquisition costs incurred, which represent expenses related to the production of business and ceding commission income to be received are deferred, subject to recoverability, and amortised over the period in which the related premiums are earned. These costs include direct and indirect expenses such as the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral.

(f) Investments
The fair values of investments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair values of financial instruments that are not traded in an active market, are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants, including broker prices and, if applicable, models.

Notes to the financial statements (continued)
For the year ended 31 December 2011

1 Statement of significant accounting policies (continued)

(g) Investment return
Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

(h) Foreign currencies
Transactions in foreign currencies are translated to sterling at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into sterling at the rates of exchange ruling at that date. Differences arising on exchange are reflected in the non-technical account.

(i) Deferred taxation
Deferred taxation has been recognised as a liability or an asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in the future, or a right to pay less taxation in the future. Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets recognised have not been discounted.

(j) Operating leases
Leases of assets where a significant portion of the risk and rewards of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

(k) Pension costs
In prior years, the Company maintained defined contrihution pension plans for the benefit of eligible employees. The maintenance of the pensions plans were transferred to an affiliate, Assured Guaranty (UK) Services Ltd. ("AG UKS"), during the year ended 31 December 2010.

(l) Unexpired risks provision
Provision has been made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date. The unexpired risks provision is included in Other technical provisions.

2 Cash flow statement and related party disclosures

The Company is a wholly-owned subsidiary of Assured Guaranty Ltd. ("AGL"). The cash flows of the Company are included in the financial statements of AGL, which are publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996). The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are wholly owned subsidiaries of AGL.

Notes to the financial statements (continued)
For the year ended 31 December 2011

3 Segmental analysis

There is only one business segment that of financial guarantee business. The net assets and the business written by the Company are predominantly based in the United Kingdom, with business underwriting decisions made in the United Kingdom.

(a) Gross written premium by geographical segment

	2011	2011	2010	2010
	£'000	£'000	£'000	£'000
- UK	4,205		3,815	
- Europe, excluding UK	193		5,395	
- US	105		764	
- Canada	-		31	
- Japan	(40)		17	
Total gross premiums written		4,463		10,022
Gross earned premium		34,548		34,353
Gross operating income		33,158		31,802
Reinsurance balance		28,048		25,184

Total gross premiums written relate to new business written in the year and in-force business written in prior periods. The Company does not measure profit and loss by geographical segment.

4 Net operating expenses / (income) – technical account

	2011	2010
	£'000	£'000
Movement in deferred acquisition costs	1,389	2,551
Administration expenses	8,936	6,688
Reinsurance commission receivable	(8,571)	(9,392)
	1,754	(153)

5 Auditors' remuneration

During the year, the Company obtained the following services from the auditor at costs as detailed below:

	2011	2010
	£'000	£'000
Audit services	**162**	3
Other services not covered above	**880**	153
	1,042	156

2010 audit fee includes release of prior period accrual totalling £145,244.

6 Directors' emoluments

	2011	2010
	£'000	£'000
Aggregate emoluments	**390**	200
Sums paid to non-executive directors	**50**	50
Company contributions to defined contributions scheme	**28**	17
	468	267

Highest paid director

	2011	2010
	£'000	£'000
Total amount of emoluments	**336**	200
Company contributions to defined contributions scheme	**25**	17
	361	217

All of the 2011 salaries and emoluments are paid by an affiliate, AG UKS, and charged back to the Company as part of the management fee.

One director is eligible to receive deferred cash and shares under the long-term incentive scheme of the ultimate parent company, AGL. The total value of the long-term incentive award during the year was £66,426. In addition, retirement benefits are accruing for the director under a money purchase pension scheme.

Notes to the financial statements (continued)
For the year ended 31 December 2011

7 Employees

There were no people (including executive directors) employed directly by the Company during the year.

All employees' salaries and benefits were paid by AG UKS, Assured Guaranty Finance Overseas Limited and Assured Guaranty Corp.. In consideration for this service, management service fees were levied on the Company. The total amount levied during the year was £5,444,321 (2010: £3,297,367).

8 Investment return

	2011	2010
	£'000	£'000
Investment Income		
Income from Investments	**6,850**	6,814
Realised gain on investments	**260**	202
	7,110	7,016
Unrealised gain on investments	**781**	1,622
Investment expenses and charges		
Investment management expenses	**(154)**	(136)
Realised loss on investments	**(76)**	
	(230)	
Total investment return	**7,661**	8,502

9 Profit on ordinary activities before taxation

	2011	2010
	£'000	£'000
Profit on ordinary activities before taxation is stated after charging		
Operating lease charges	**536**	770
Foreign exchange gain / (loss)	**121**	(1,711)

The Company has an agreement with AGM for cooperative and joint use of property, and as such was allocated operating lease charges. The amounts allocated during 2011 and 2010 are as included in the above table.

Notes to the financial statements (continued)
For the year ended 31 December 2011

10 Tax on profit on ordinary activities

The Company has made an election with the Internal Revenue Service pursuant to Section 953(d) of the Internal Revenue Code. Section 953(d) allows certain foreign insurance companies to elect to be treated as a U.S. corporation for federal income tax purposes. The impact of the election is that the Company will be taxed as a U.S. corporation subject to tax on its worldwide income, subject to a credit for any taxes paid to a foreign jurisdiction. The current US federal tax rate is 35% (2010: 35%) as compared with an average 26.5% (2010: 28%) rate in the UK.

	2011	2010
	£'000	£'000
UK corporation tax		
- Current	**(1,081)**	(5,076)
- Deferred	**198**	75
Overseas corporation tax		
- Current	**1,258**	(555)
- Deferred	**(1,656)**	13,578
	(1,281)	8,022

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. A reconciliation between the current tax provision and that expected from the standard UK tax rate of 26.5% (2010: 28%) is as follows:

	2011	2010
	£'000	£'000
Tax expense at statutory rate	**(945)**	(4,995)
Effects of:		
Temporary differences		
Employee benefits	**(130)**	(77)
UK and US tax differences		
Permanent		
Net foreign exchange (loss) / gain on translation	**717**	(63)
Tax rate differential	**43**	(1,126)
Timing / temporary		
Unrealised gain / (loss)	**207**	454
Deferred acquisition costs	**(1,879)**	(570)
Timing difference on revenue recognition	**1,929**	401
Other timing differences	**235**	345
Provision for current income taxes	**177**	(5,631)

During the year, as a result of the changes in the UK main corporation tax rate to 26% that was substantively enacted on 29 March 2011 and that was effective from 1 April 2011 and to 25% that was substantively enacted on 5 July 2011 and that will be effective from 1 April 2012, the relevant deferred tax balances have been remeasured at 25%.

Further reductions to the UK corporation tax rate were announced in the March 2012 Budget. The

Notes to the financial statements (continued)
For the year ended 31 December 2011

10 Tax on profit on ordinary activities (continued)

changes, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 22% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements. Had they been substantively enacted they would not have had a material impact on the net deferred tax asset at the period end. The impact of these changes in future periods will be dependent on the level of taxable profits in those periods.

During 2010 Dexia, the previous ultimate parent of the Company, filed an amended U.S. tax return for the 2008 tax year. Based on the amended filing, the Company booked additional foreign tax credits in deferred tax assets of £14.3m. For post acquisition periods, the Company is limited by the U.S. tax code on the annual amount it could benefit from these foreign tax credits. The foreign tax credits expire in 2018 through 2021.

11 Deferred tax (liabilities) / assets

Based on its projections for continued future taxable income, the Company believes that its deferred tax assets are more likely than not to be realised. The items that gave rise to the Company's net deferred tax asset are noted below:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
UK and US tax differences						
Unrealised gains	**-**	-	**(1,158)**	(568)	**(1,158)**	(568)
Timing differences on revenue recognition	**-**	-	**(1,414)**	(1,134)	**(1,414)**	(1,134)
Total deferred tax liabilities	**-**	-	**(2,572)**	(1,702)	**(2,572)**	(1,702)

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Timing differences on revenue recognition	**-**	-	**-**	-	**-**	-
Deferred acquisition costs	**-**	-	**15,445**	15,761	**15,445**	15,761
Employee benefits	**123**	75	**116**	26	**239**	101
Tax credits for UK tax paid	**-**	-	**13,019**	14,274	**13,019**	14,274
Other temporary timing differences	**-**	-	**1,166**	184	**1,166**	184
Total deferred tax assets	**123**	75	**29,746**	30,245	**29,869**	30,320
Net deferred tax asset	**123**	75	**27,174**	28,543	**27,297**	28,618

Notes to the financial statements (continued)
For the year ended 31 December 2011

11 Deferred tax liabilities / (assets) (continued)

The movement in the net deferred tax asset is as follows:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
As of 1 January	**75**	-	**28,543**	14,108	**28,618**	14,108
Movement in year	**48**	75	**(1,505)**	13,578	**(1,457)**	13,653
Translation Adjustment	**-**	-	**136**	857	**136**	857
	123	75	**27,174**	28,543	**27,297**	28,618

12 Debtors

	2011	2010
	£'000	£'000
Arising out of direct insurance operations	**380,789**	402,796
Reinsurance commission receivable from group undertaking	**111,858**	116,889
Other debtors including taxation and social security	**1,980**	-
Amounts owed by group undertakings	**-**	12,313
At 31 December	**494,627**	531,998

13 Investments

	2011	2010
	£'000	£'000
Financial investments		
- UK government bonds	**152,694**	161,456
- Non-UK government bonds	**796**	808
- Corporate bonds	**11,684**	6,098
- Asset-backed securities	**126**	-
- Short-term investments	**1,291**	1,287
At 31 December	**166,591**	169,649

Notes to the financial statements (continued)
For the year ended 31 December 2011

13 Investments (continued)

The bonds are shown at market value. The book cost of these is £155,408,860 (2010: £159,276,912). Of the above investments, £165,298,484 were listed investments (2010: £168,362,409).

14 Creditors

	2011	2010
	£'000	£'000
Arising out of reinsurance operations	**375,755**	412,593
Amounts owed to group undertakings	**2,646**	-
Amounts due under pension plan obligations	**3**	4
Other creditors including taxation and social security	**1,267**	8,070
At 31 December	**379,671**	420,667

Amounts owed to group undertakings are unsecured, interest free and have no fixed date for repayment.

15 Accruals and deferred income

	2011	2010
	£'000	£'000
Other liabilities	**152**	-
Reinsurance commission deferred	**181,579**	188,401
At 31 December	**181,731**	188,401

16 Other financial commitments and guarantees

The Company has guaranteed the obligations of Assured Guaranty Credit Protection Limited ("AGCPL"), a fellow group company. AGCPL sells credit protection to counterparties through credit default swaps and may incur a loss in the event of payment default by the obligor. The Company is not aware of any actual or potential liabilities in relation to this guarantee. In 2011 and 2010, the transaction fees incurred by the Company totalled approximately £28,4973 and £27,060, respectively. The Company, in turn, was paid an administrative fee of £15,000 and £15,000 in 2011 and 2010, respectively, by AGCPL in connection with a cooperative agreement between the two companies for AGCPL's use of Company personnel, property and services.

17 Significant risk management activities

The Company relies on the following committees and functions for its risk management policies and procedures: Audit and Risk Oversight Committee of the Board of Directors, Compliance Function, Credit Committee, Executive Committee, Reserve Committee, Risk Management Function and Surveillance Function. Within the limits established by the board committees, specific risk policies and limits are set by the Portfolio Risk Management Committee, which includes members of senior management and senior Credit and Surveillance officers. As part of its risk management strategy, the Company may seek to obtain third party reinsurance and may also periodically enter into other arrangements to alleviate all or a portion of this risk.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Risk Management and Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel and the Actuarial Function make recommendations on case loss reserves to a Reserve Committee.

The Surveillance Function may request that the Group's workout committee develop and implement loss mitigation strategies when the Surveillance Function identifies transactions that would benefit from active loss mitigation.

The Company segregates its insured portfolio of investment grade and below investment grade risks into surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. Below investment grade credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to below investment grade. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new below investment grade credits. The Company refreshes its internal credits ratings on individual credits in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as below investment grade are subjected to further review by surveillance personnel to determine the various probabilities of a loss. Surveillance personnel present analysis related to potential loss scenarios to a reserve committee. The reserve committee consider the information provided by surveillance personnel when setting reserves.

Notes to the financial statements (continued)
For the year ended 31 December 2011

18 Called up share capital

	2011	2010
	£'000	£'000
Authorised		
500,000,000 ordinary shares of £1 each	**500,000**	500,000
Allotted and fully paid		
55,000,000 ordinary shares of £1 each	**55,000**	55,000

19 Reconciliation of movements in shareholders' funds

	Called up share capital	Profit and loss account	Capital contribution	2011	2010
	£'000	£'000	£'000	£'000	£'000
At 1 January	**55,000**	**57,440**	**62,985**	**175,425**	149,562
Profit for the financial year	**-**	**2,276**	**-**	**2,276**	25,863
At 31 December	**55,000**	**59,716**	**62,985**	**177,701**	175,425

20 Other technical provisions

	2011	2010
	£'000	£'000
Unexpired risks provision	**29,998**	-
Reinsurer's share of unexpired risks provision	**(29,598)**	-
At 31 December	**400**	-

The discount rate used in calculating the unexpired risk provision is a rate of 3.5%

21 Other technical income

	2011	2010
	£'000	£'000
Other technical income	-	11,120
At 31 December	-	11,120

Other technical income relates to settlements received on the cancellation of reinsurance contracts.

22 Other income / charges

	2011	2010
	£'000	£'000
Foreign exchange gain / (loss)	121	(1,711)
At 31 December	121	(1,711)

23 Financial commitments

The Company has arrangements with its indirect parent AGM whereby it pays lease rentals on behalf of AGM in respect of office space previously occupied by the Company. The commitment under the uncancellable operating lease is to pay annual rentals of £0.9m (2010: £0.9m). As a result of vacating the building, the Company has made a lease provision for the unexpired portion of the lease, taking into account anticipated future sub-lease income from parties not yet identified. The total amount of lease provision provided for is £0.8m (2010: £1.2m). This lease will expire on 24 September 2013.

24 Subsequent events

AGE has €313.9m of outstanding gross exposure and €5.4m of outstanding net exposure to the Greek government at year-end. This exposure consists of bilateral guarantees on €200m of bonds with a fixed rate coupon of 4.5% due in 2037 and €113.9m of inflation linked bonds with a fixed rate coupon of 2.085% due in 2057, both with bullet maturities. In March 2012, under the terms of its financial guarantees, the Company took delivery of these bonds. Subsequently, the 2037 bonds were exchanged under a Greek government exchange offer, and the Company has tendered the 2057 notes under the same offer. The purpose of the exchange offer is to reduce Greece's obligation by 53.5% of the notional amounts of the original securities. The Company's original obligation on these securities remains unchanged. As of year-end the Company held a gross unexpired risk provision of £30.0m (net £0.4m). The Company currently does not have enough information to determine financial effect of these post balance sheet events.

25 Ultimate and immediate parent company

The immediate parent undertaking is Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), a United States company. The ultimate parent undertaking and controlling party is AGL, a Bermuda incorporated insurance holding company.

AGL is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2011. The consolidated financial statements of AGL can be obtained from 30 Woodbourne Avenue, Hamilton HM 08, Bermuda.

AGMIC is the parent undertaking of the smallest group of undertakings to consolidate these financial statements. The consolidated financial statements of AGMIC can be obtained from 31 West 52nd Street, New York, NY 10019, United States of America.

APPENDIX 3

2012 FINANCIAL STATEMENTS OF ASSURED GUARANTY MUNICIPAL CORP.

Exhibit 99.1

Assured Guaranty Municipal Corp.

Consolidated Financial Statements

December 31, 2012 and 2011

ASSURED GUARANTY MUNICIPAL CORP.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditor's Report

To the Board of Directors and Shareholder of Assured Guaranty Municipal Corp.:

We have audited the accompanying consolidated financial statements of Assured Guaranty Municipal Corp. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and December 31, 2011, and the related consolidated statements of operations, of comprehensive income, of shareholder's equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Assured Guaranty Municipal Corp. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for the costs associated with acquiring or renewing insurance contracts in 2012. Our opinion is not modified with respect to this matter.

/s/ PricewaterhouseCoopers LLP

New York, New York
April 23, 2013

Assured Guaranty Municipal Corp.

Consolidated Balance Sheets

(dollars in millions except per share and share amounts)

	As of December 31, 2012	As of December 31, 2011
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of $4,473 and $4,674)	$ 4,831	$ 4,916
Short-term investments, at fair value	473	412
Other invested assets (including note receivable from affiliate of $300 for 2012 and 2011)	444	422
Total investment portfolio	5,748	5,750
Loan receivable from affiliate	83	—
Cash	47	59
Premiums receivable, net of ceding commissions payable	653	645
Ceded unearned premium reserve	1,187	1,373
Reinsurance recoverable on unpaid losses	75	79
Salvage and subrogation recoverable	383	316
Credit derivative assets	131	140
Deferred tax asset, net	409	631
Current income tax receivable	0	131
Financial guaranty variable interest entities' assets, at fair value	1,870	2,057
Other assets	127	149
Total assets	**$ 10,713**	**$ 11,330**
Liabilities and shareholder's equity		
Unearned premium reserve	$ 3,866	$ 4,515
Loss and loss adjustment expense reserve	230	297
Reinsurance balances payable, net	292	248
Notes payable	66	104
Credit derivative liabilities	414	456
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,605	1,926
Financial guaranty variable interest entities' liabilities without recourse, at fair value	678	704
Other liabilities	343	276
Total liabilities	**7,494**	**8,526**
Commitments and contingencies (See Note 16)		
Preferred stock ($1,000 par value, 5,000.1 shares authorized; 0 shares issued and outstanding)	—	—
Common stock ($45,455 par value, 330 shares authorized; issued and outstanding)	15	15
Additional paid-in capital	1,092	1,142
Retained earnings	1,880	1,491
Accumulated other comprehensive income, net of tax of $125 and $84	232	156
Total shareholder's equity	**3,219**	**2,804**
Total liabilities and shareholder's equity	**$ 10,713**	**$ 11,330**

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

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

	Year Ended December 31,	
	2012	2011
Revenues		
Net earned premiums	$ 590	$ 661
Net investment income	233	216
Net realized investment gains (losses):		
Other-than-temporary impairment losses	(19)	(79)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(14)	(41)
Other net realized investment gains (losses)	0	20
Net realized investment gains (losses)	(5)	(18)
Net change in fair value of credit derivatives:		
Realized gains and other settlements	11	70
Net unrealized gains (losses)	41	92
Net change in fair value of credit derivatives	52	162
Fair value gain (loss) on committed capital securities	(8)	15
Fair value gains (losses) on financial guaranty variable interest entities	115	(61)
Other income	103	47
Total revenues	1,080	1,022
Expenses		
Loss and loss adjustment expenses	397	382
Amortization of deferred ceding commissions	(12)	(8)
Interest expense	7	6
Other operating expenses	105	95
Total expenses	497	475
Income (loss) before income taxes	583	547
Provision (benefit) for income taxes:		
Current	23	(157)
Deferred	141	306
Total provision (benefit) for income taxes	164	149
Net income (loss)	**$ 419**	**$ 398**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Comprehensive Income

(in millions)

	Year Ended December 31,	
	2012	2011
Net income (loss)	**$ 419**	**$ 398**
Unrealized holding gains (losses) arising during the period:		
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $29 and $63	54	118
Investments with other-than-temporary impairment, net of tax provision (benefit) of $6 and $5	10	9
Unrealized holding gains (losses) arising during the period, net of tax	64	127
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(6) and $(8)	(12)	(15)
Other comprehensive income (loss)	76	142
Comprehensive income (loss)	**$ 495**	**$ 540**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Shareholder's Equity

(dollars in millions, except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity
	Shares	Amount				
Balance at December 31, 2010 (as originally reported)	**330**	**$ 15**	**$ 1,192**	**$ 1,100**	**$ 14**	**$ 2,321**
Cumulative effect of accounting change - deferred acquisition costs (Note 5)	—	—	—	(7)	—	(7)
Balance at December 31, 2010 (as adjusted)	330	15	1,192	1,093	14	2,314
Net income	—	—	—	398	—	398
Other comprehensive income	—	—	—	—	142	142
Return on capital	—	—	(50)	—	—	(50)
Balance at December 31, 2011	330	15	1,142	1,491	156	2,804
Net income	—	—	—	419	—	419
Dividends	—	—	—	(30)	—	(30)
Other comprehensive income	—	—	—	—	76	76
Return of capital	—	—	(50)	—	—	(50)
Balance at December 31, 2012	**330**	**$ 15**	**$ 1,092**	**$ 1,880**	**$ 232**	**$ 3,219**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Cash Flows

(in millions)

	Year Ended December 31, 2012	2011
Operating activities		
Net income (loss)	$ 419	$ 398
Net amortization of premium (discount) on fixed maturity securities	(13)	10
Provision (benefit) for deferred income taxes	141	306
Net realized investment (gains) losses	5	18
Net unrealized gains (losses) on credit derivatives	(41)	(92)
Fair value (gain) loss on committed capital securities	8	(15)
Change in deferred ceding commissions, net	11	5
Change in premiums receivable	29	31
Change in deferred premium revenue net of ceded deferred premium revenue	(463)	(685)
Change in net loss and loss adjustment expense reserve and salvage and subrogation, net	(221)	409
Change in current income taxes	171	(335)
Changes in financial guaranty variable interest entities assets and liabilities, net	(10)	282
(Purchases) sales of trading securities, net	(37)	(5)
Other	64	(40)
Net cash flow provided by (used in) operating activities	63	287
Investing activities		
Fixed maturity securities:		
Sales	298	573
Maturities	492	283
Purchases	(526)	(1,036)
Net sales (purchases) of short-term investments	(26)	200
Net proceeds from paydowns on financial guaranty variable interest entities’ assets	468	677
Loan to affiliate	(83)	—
Other investments	36	20
Net cash flow provided by (used in) investing activities	**659**	**717**
Financing activities		
Dividends paid	(30)	—
Repayment of notes payable	(36)	(22)
Paydown of financial guaranty variable interest entities' liabilities	(618)	(918)
Return of capital	(50)	(50)
Net cash provided by (used in) financing activities	**(734)**	**(990)**
Effect of exchange rate changes	0	1
Increase (decrease) in cash	**(12)**	**15**
Cash at beginning of period	59	44
Cash at end of period	**$ 47**	**$ 59**
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$ (108)	$ 158
Interest	$ 8	$ 7

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

1. Business and Basis of Presentation

Business

Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. (“AGM,” or together with its direct and indirect owned subsidiaries, the “Company”), a New York domiciled insurance company, is a wholly owned subsidiary of Assured Guaranty Municipal Holdings Inc. (“AGMH”). AGMH is an indirect and wholly owned subsidiary of Assured Guaranty Ltd. (“AGL” and, together with its subsidiaries, “Assured Guaranty”). AGL is a Bermuda based holding company that provides, through its operating subsidiaries, credit protection products to the United States (“U.S.”) and international public finance (including infrastructure) and structured finance markets.

The Company applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The Company markets its credit protection products directly to issuers and underwriters of public finance securities as well as to investors in such obligations. The Company guarantees obligations issued in many countries, although its principal focus is on the U.S., as well as Europe and Australia. The Company had previously offered insurance and reinsurance in the global structured finance market, but has not done so since mid-2008.

Financial guaranty insurance policies provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest ("Debt Service") when due. Upon an obligor's default on scheduled principal or interest payments due on the obligation, the Company is required under the financial guaranty policy to pay the principal or interest shortfall. The Company has issued financial guaranty insurance policies on public finance obligations and, prior to mid-2008, structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets such as residential or commercial mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value. While AGM has ceased insuring new originations of asset-backed securities, a significant portfolio of such obligations remains outstanding and its wholly owned subsidiary Assured Guaranty (Europe) Ltd. (“AGE”) provides financial guarantees in both the international public finance and structured finance markets.

In the past, the Company had sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives. Financial guaranty contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company’s obligation to make loss payments are similar to those for financial guaranty insurance contracts and only occurs upon one or more defined credit events such as failure to pay or bankruptcy, in each case, as defined within the transaction documents, with respect to one or more third party referenced securities or loans. Financial guaranty contracts accounted for as credit derivatives are primarily comprised of credit default swaps (“CDS”). The Company’s credit derivative transactions are governed by International Swaps and Derivative Association, Inc. (“ISDA”) documentation.

The Company has not entered into any new CDS in order to sell credit protection since 2008. In addition, regulatory guidelines issued in 2009 that limited the terms under which such protection could be sold, and capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), also contributed to the decision of the Company not to enter into new CDS in the foreseeable future. The Company actively pursues opportunities to terminate existing CDS. These actions have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities ("FG VIEs") for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of AGM and its direct and indirect subsidiaries (collectively, the "Subsidiaries"), and its consolidated FG VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

In June 2011, the Financial Accounting Standards Board ("FASB") issued guidance that eliminates the option to report other comprehensive income and its components in the statement of changes in shareholder's equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. Upon adoption, the Company expanded the Consolidated Statements of Comprehensive Income to include the other comprehensive income items now presented in the Consolidated Statement of Shareholder's Equity, with retrospective application. In February 2013, the FASB issued authoritative guidance which will require the disclosure of information about the amounts reclassified out of accumulated other comprehensive income by component. The nature of the disclosure will depend on whether the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. If the reclassification is required in its entirety to net income, the guidance will require the disclosure of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, either on the face of the statement where net income is presented or in the notes. If reclassification to net income is not required under U.S. GAAP, the guidance will require a cross reference to other required disclosures that provide additional detail about the reclassified amount. This guidance will impact the disclosures relating to other comprehensive income in the Company's financial statements and will have no impact on the results of operations, financial position or cash flows.

In December 2011, the FASB issued guidance which will require disclosures for entities with financial instruments and derivatives that are either offset on the balance sheet or subject to a master netting arrangement. The guidance is effective for interim and annual periods beginning on or after January 1, 2013. The guidance is not applicable to the Company as the Company does not have financial instruments that are either offset on the balance sheet or subject to a master netting arrangement.

Significant Accounting Policies

The Company's significant accounting policies include when and how to measure fair value of assets and liabilities, when to consolidate an entity, and when and how to recognize premium revenue and loss expense. All other significant accounting policies are either discussed below or included in the following notes.

Significant Accounting Policies

Premium revenue recognition on financial guaranty contracts accounted for as insurance	Note 4
Policy acquisition costs	Note 5
Expected loss to be paid	Note 6
Loss and loss adjustment expense on financial guaranty contracts accounted for as insurance	Note 7
Fair value measurement	Note 8
Credit derivatives	Note 9
Variable interest entities	Note 10
Investments	Note 11
Income taxes	Note 13
Reinsurance and Other Monoline Exposures	Note 14

The Company revalues assets, liabilities, revenue and expenses denominated in non-U.S. currencies into U.S. dollars using applicable exchange rates. Gains and losses relating to AGM's foreign currency transactions are reported in the consolidated statement of operations.

2. Business Changes, Risks, Uncertainties and Accounting Developments

Summarized below are updates of the most significant recent events that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

Market Conditions

The overall economic environment in the U.S. has improved over the last few years and indicators such as lower delinquency rates and more stable housing prices point toward improvement in the housing market. However, unemployment rates remain too high for a robust general economic recovery to have taken hold and concerns over the fiscal cliff may have hampered the recovery towards the end of 2012. The low interest rate environment has also negatively affected new business opportunities. The Company's business and its financial condition will continue to be subject to the risk of global financial and economic conditions that could materially and negatively affect the demand for its products, the amount of losses incurred on transactions it guarantees, future profitability, financial position, investment portfolio, cash flow, statutory capital, financial strength ratings and stock price.

The financial crisis that began in 2008 has caused many state and local governments that issue some of the obligations the Company insures to experience significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations. While the U.S. government has provided some financial support to state and local governments, significant budgetary pressures remain. If the issuers of the obligations in the Company's public finance portfolio do not have sufficient funds to cover their expenses and are unable or unwilling to raise taxes, decrease spending or receive federal assistance, the Company may experience increased levels of losses or impairments on its public finance obligations, which would materially and adversely affect its business, financial condition and results of operations. Additionally, future legislative, regulatory or judicial changes in the jurisdictions regulating the Company may adversely affect its ability to pursue its current mix of business, materially impacting its financial results.

Internationally, several European countries are experiencing significant economic, fiscal and /or political strains. The European countries where it believes heightened uncertainties exist are: Greece, Hungary, Ireland, Italy, Portugal and Spain (the “Selected European Countries”). See Note 3, Outstanding Exposure.

Rating Actions

When a rating agency assigns a public rating to a financial obligation guaranteed by AGM or its subsidiary AGE, it generally awards that obligation the same rating it has assigned to the financial strength of AGM or AGE. Investors in products insured by AGM and guaranteed by AGE frequently rely on ratings published by nationally recognized statistical rating organizations (“NRSROs”) because such ratings influence the trading value of securities and form the basis for many institutions’ investment guidelines as well as individuals’ bond purchase decisions. Therefore, AGM and AGE manage their business with the goal of achieving high financial strength ratings. If the financial strength ratings were reduced below current levels, the Company expects it could have adverse effects on its future business opportunities as well as the premiums or fees it could charge for its insurance policies or guarantees and consequently, a further downgrade could harm the Company’s new business production and results of operations in a material respect. However, the models used by NRSROs differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. The models are not fully transparent, contain subjective data (such as assumptions about future market demand for the Company’s products) and change frequently. Ratings reflect only the views of the respective NRSROs and are subject to continuous review and revision or withdrawal at any time.

In the last several years, Standard and Poor’s Ratings Services (“S&P”) and Moody’s Investors Service, Inc. (“Moody’s”) have downgraded the financial strength ratings of AGM and AGE. On January 17, 2013, Moody’s downgraded the Insurance Financial Strength ("IFS") rating of AGM and AGE to A2 from Aa3. While the outlook for the ratings from S&P and Moody's is stable, there can be no assurance that S&P and Moody's will not take further action on the Company’s ratings. For a discussion of the effect of rating actions on the Company, see the following:

- Note 6, Expected Loss to be Paid
- Note 14, Reinsurance and Other Monoline Exposures
- Note 17, Notes Payable and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

In addition, a rating downgrade may cause AGM to pay claims in respect of the former financial products business of its parent AGMH. When Assured Guaranty purchased AGMH and its subsidiaries from Dexia SA and certain of its affiliates (collectively, "Dexia") on July 1, 2009, Assured Guaranty did not purchase AGMH's guaranteed investment contracts ("GIC") business, its medium term notes business or the equity payment agreements associated with AGMH's leveraged lease business (collectively, the "former financial products business"). Instead, Assured Guaranty entered into agreements with Dexia in order to transfer to Dexia the credit and liquidity risks associated with AGMH's former financial products business. If Dexia does not comply with its obligations following a downgrade of the financial strength rating of AGM, AGM may be required to pay claims on GICs insured by AGM, most of which allow for the termination of the GIC contract and the withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM, unless the relevant GIC issuer posts collateral or otherwise enhances its credit. The relevant rating thresholds are specified in the transaction documents; below A- by S&P or A3 by Moody's, the GIC issuer generally has no right to avoid withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. The January 2013 Moody's downgrade of AGM could result in withdrawal of $226.5 million of GIC funds and the need to post collateral on GICs with a balance of $1.9 billion. A further downgrade of AGM to below AA- by S&P could result in an incremental withdrawal or require collateral posting on GICs with a balance of $882.7 million. In the event of such a downgrade, assuming collateral posting on all transactions potentially impacted as a result of any additional rating action, with an average margin of 105%, the market value as of December 31, 2012 that the GIC issuers would be required to post in order to avoid withdrawal of any GIC funds would be $2.9 billion. There are sufficient eligible and liquid assets within the GIC business to satisfy the withdrawal and collateral posting obligations that arose as a result of the January 2013 AGM downgrade and would be expected to arise as a result of potential future rating action.

Accounting Changes

There has been significant GAAP rule making activity which has affected the accounting policies and presentation of the Company's financial information, particularly:

- adoption of new guidance that restricted the types and amounts of financial guaranty insurance acquisition costs that may be deferred, (see Note 5, Financial Guaranty Insurance Acquisition Costs),
- adoption of guidance that changed the presentation of other comprehensive income ("OCI"), (see "Consolidated Statements of Comprehensive Income)," and
- adoption of guidance requiring additional fair value disclosures (see Note 8, Fair Value Measurement).

In July 2012, the FASB issued Accounting Standards Update ("ASU") 2012-02, "Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). ASU 2012-02 amends prior indefinite-lived intangible asset impairment testing guidance. Under ASU 2012-02, the Company has the option to first assess qualitative factors to determine whether it is more likely than not (a likelihood of more than 50%) that an indefinite-lived intangible asset is impaired. If, after considering the totality of events and circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is not impaired, then calculating the fair value of such asset is unnecessary. The Company adopted ASU 2012-02 at December 31, 2012. There was no cumulative effect upon the adoption of ASU 2012-02 on the Company's consolidated financial position, results of operations or cash flows.

Significant Transactions

- There have been four settlements of representation and warranty claims over the past three years. See Note 6, Expected Loss to be Paid.
- The Company has entered into several agreements with reinsurers, including re-assumption agreements with Radian Asset Assurance Inc. ("Radian"), a re-assumption agreement with Tokio Marine & Nichido Fire

Insurance Co., Ltd. ("Tokio") and a $435 million excess of loss reinsurance facility. See Note 14, Reinsurance and Other Monoline Exposures.

3. Outstanding Exposure

The Company's financial guaranty contracts are written in different forms, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Some of these VIEs are consolidated as described in Note 10, Consolidation of Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
	(in millions)			
Public finance	$ 537,810	$ 598,712	$ 391,826	$ 412,016
Structured finance	60,926	76,049	53,449	67,202
Total financial guaranty	$ 598,736	$ 674,761	$ 445,275	$ 479,218

Summary of Public Finance and Structured Finance Insured Portfolio

Sector	Gross Par Outstanding As of December 31, 2012	Gross Par Outstanding As of December 31, 2011	Ceded Par Outstanding As of December 31, 2012	Ceded Par Outstanding As of December 31, 2011	Net Par Outstanding As of December 31, 2012	Net Par Outstanding As of December 31, 2011
			(in millions)			
Public finance:						
U.S.:						
General obligation	$ 137,601	$ 147,855	34,217	$ 42,726	$ 103,384	$ 105,129
Tax backed	57,512	64,466	14,001	18,462	43,511	46,004
Municipal utilities	50,017	55,184	10,119	13,131	39,898	42,053
Transportation	24,997	28,944	5,862	9,541	19,135	19,403
Healthcare	12,880	15,941	4,375	7,160	8,505	8,781
Higher education	10,146	10,314	2,668	2,961	7,478	7,353
Housing	4,621	6,041	676	1,350	3,945	4,691
Infrastructure finance	2,389	2,352	1,163	1,140	1,226	1,212
Other public finance-U.S.	2,060	2,183	339	400	1,721	1,783
Total public finance-U.S.	302,223	333,280	73,420	96,871	228,803	236,409
Non-U.S.:						
Infrastructure finance	17,045	16,510	5,482	5,287	11,563	11,223
Regulated utilities	14,314	14,454	7,758	7,611	6,556	6,843
Other public finance-non-U.S.	7,184	9,072	1,919	2,738	5,265	6,334
Total public finance-non-U.S.	38,543	40,036	15,159	15,636	23,384	24,400
Total public finance obligations	$ 340,766	$ 373,316	88,579	$ 112,507	$ 252,187	$ 260,809
Structured finance:						
U.S.:						
Pooled corporate obligations	27,148	$ 32,967	1,718	$ 2,554	$ 25,430	$ 30,413
Residential Mortgage-Backed Securities ("RMBS")	9,409	11,745	1,228	1,442	8,181	10,303
Financial products	3,653	5,217	—	—	3,653	5,217
Insurance securitizations	383	476	77	107	306	369
Consumer receivables	247	993	15	186	232	807
Structured credit	175	176	86	97	89	79
Commercial receivables	56	61	3	3	53	58
Other structured finance-U.S.	1,620	1,769	1,242	1,279	378	490
Total structured finance-U.S.	42,691	53,404	4,369	5,668	38,322	47,736
Non-U.S.:						
Pooled corporate obligations	8,500	11,648	1,478	2,014	7,022	9,634
Residential Mortgage-Backed Securities	1,455	1,552	152	157	1,303	1,395
Structured credit	361	531	78	118	283	413
Insurance securitizations	—	56	—	18	—	38
Other structured finance- non-U.S.	401	402	28	29	373	373
Total structured finance- non-U.S.	10,717	14,189	1,736	2,336	8,981	11,853
Total structured finance obligations	$ 53,408	$ 67,593	6,105	8,004	$ 47,303	$ 59,589
Total	$ 394,174	$ 440,909	94,684	120,511	$ 299,490	$ 320,398

Unless otherwise noted, ratings disclosed herein on Assured Guaranty's insured portfolio reflect Assured Guaranty's internal ratings. Assured Guaranty's ratings scale is similar to that used by the NRSROs; however, the ratings in these financial statements may not be the same as those assigned by any such rating agency. For example, the super senior category, which is not generally used by rating agencies, is used by Assured Guaranty in instances where Assured Guaranty's AAA-rated exposure on its internal rating scale (which does not take into account Assured Guaranty's financial guaranty) has additional credit enhancement due to either (1) the existence of another security rated AAA that is subordinated to Assured Guaranty's exposure or (2) Assured Guaranty's exposure benefiting from a different form of credit enhancement that would pay any claims first in the event that any of the exposures incurs a loss, and such credit enhancement, in management's opinion, causes Assured Guaranty's attachment point to be materially above the AAA attachment point.

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2012

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**
					(dollars in millions)					
Super senior	$ —	—%	$ —	—%	$ 8,658	22.6%	$ 2,493	27.8%	$ 11,151	3.7%
AAA	3,521	1.5%	508	2.2%	15,758	41.1%	4,133	46.0%	23,920	8.0%
AA	82,798	36.2%	789	3.4%	6,833	17.8%	469	5.2%	90,889	30.3%
A	118,867	52.0%	5,946	25.4%	1,155	3.0%	586	6.6%	126,554	42.3%
BBB	21,795	9.5%	14,506	62.0%	215	0.6%	676	7.5%	37,192	12.4%
Below-investment-grade ("BIG")	1,822	0.8%	1,635	7.0%	5,703	14.9%	624	6.9%	9,784	3.3%
Total net par outstanding	$ 228,803	100.0%	$ 23,384	100.0%	$ 38,322	100.0%	$ 8,981	100.0%	$ 299,490	100.0%

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2011

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**	**Net Par Outstanding**	**%**
					(dollars in millions)					
Super senior	$ —	—%	$ —	—%	$ 9,574	20.0%	$ 3,414	28.8%	$ 12,988	4.1%
AAA	3,869	1.6%	1,317	5.4%	20,272	42.5%	5,590	47.2%	31,048	9.7%
AA	91,476	38.7%	949	3.9%	8,937	18.8%	665	5.6%	102,027	31.8%
A	118,922	50.3%	7,290	29.9%	1,045	2.2%	474	4.0%	127,731	39.9%
BBB	20,251	8.6%	13,240	54.3%	346	0.7%	1,126	9.5%	34,963	10.9%
BIG	1,891	0.8%	1,604	6.5%	7,562	15.8%	584	4.9%	11,641	3.6%
Total net par outstanding	$ 236,409	100.0%	$ 24,400	100.0%	$ 47,736	100.0%	$ 11,853	100.0%	$ 320,398	100.0%

Beginning in the first quarter 2012, the Company decided to classify those portions of risks benefiting from reimbursement obligations collateralized by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating. The Company applied this policy to the Bank of America Agreement and the Deutsche Bank Agreement (see Note 6, Expected Loss to be Paid). The Bank of America Agreement was entered into in April 2011 and the reclassification in the first quarter 2012 resulted in a decrease in BIG net par outstanding as of December 31, 2011 of $980 million from that previously reported.

Securities purchased for loss mitigation purposes represented $703 million and $988 million of gross par outstanding as of December 31, 2012 and 2011, respectively. In addition, under the terms of certain credit derivative contracts, the Company has obtained the obligations referenced in such contracts and recorded it in invested assets in the consolidated balance sheets. Such amounts totaled $219 million and $221 million in gross par outstanding as of December 31, 2012 and 2011, respectively.

Actual maturities of insured obligations could differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The expected maturities of structured finance obligations are, in general, considerably shorter than the contractual maturities for such obligations.

Expected Amortization of
Net Par Outstanding of Financial Guaranty Insured Obligations
As of December 31, 2012

Terms to Maturity	Public Finance	Structured Finance	Total
		(in millions)	
0 to 5 years	$ 74,215	$ 39,496	$ 113,711
5 to 10 years	54,154	3,749	57,903
10 to 15 years	49,071	1,238	50,309
15 to 20 years	34,827	1,314	36,141
20 years and above	39,920	1,506	41,426
Total net par outstanding	$ 252,187	$ 47,303	$ 299,490

In addition to amounts shown in the tables above, at December 31, 2012, AGM had outstanding commitments to provide guaranties of $197 million for structured finance and $763 million for public finance obligations, of which up to $336 million can be used together with Assured Guaranty Corp. ("AGC"), an affiliate of the Company. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between January 15, 2013 and February 25, 2017; up to $625 million of public finance commitments will expire by December 31, 2013. All the commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

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

Geographic Distribution of Financial Guaranty Portfolio
As of December 31, 2012

	Number of Risks	Net Par Outstanding	Percent of Total Net Par Outstanding
		(dollars in millions)	
U.S.:			
Public finance:			
California	1,162	$ 34,912	11.7%
Pennsylvania	935	19,634	6.6%
New York	869	18,478	6.2%
Illinois	699	16,025	5.3%
Texas	956	15,105	5.0%
Florida	277	13,409	4.5%
Michigan	597	10,486	3.5%
New Jersey	579	9,916	3.3%
Georgia	129	6,635	2.2%
Washington	249	6,145	2.0%
Other states	3,774	78,058	26.1%
Total U.S. public finance	10,226	228,803	76.4%
Structured finance (multiple states)	343	38,322	12.8%
Total U.S.	10,569	267,125	89.2%
Non-U.S.:			
United Kingdom	81	12,140	4.0%
Australia	21	4,765	1.6%
Canada	11	3,646	1.2%
France	14	1,782	0.6%
Italy	10	1,717	0.6%
Other	61	8,315	2.8%
Total non-U.S.	198	32,365	10.8%
Total	10,767	$ 299,490	100.0%

Economic Exposure to the Selected European Countries

Several European countries are experiencing significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The Company is closely monitoring its exposures in Selected European Countries where it believes heightened uncertainties exist. Published reports have identified countries that may be experiencing reduced demand for their sovereign debt in the current environment. The Company selected these European countries based on these reports and its view that their credit fundamentals are deteriorating. The Company's economic exposure to the Selected European Countries (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following table net of ceded reinsurance.

Net Economic Exposure to Selected European Countries(1)
December 31, 2012

	Hungary	Ireland	Italy	Portugal	Spain (2)	Total
			(in millions)			
Sovereign and sub-sovereign exposure:						
Public finance	$ —	$ —	$ 827	$ 96	$ 219	$ 1,142
Infrastructure finance	324	—	218	—	144	686
Total sovereign and sub-sovereign exposure	324	—	1,045	96	363	1,828
Non-sovereign exposure:						
Regulated utilities	—	—	135	—	7	142
RMBS	211	—	479	—	—	690
Pooled corporate obligations	—	76	59	12	108	255
Total non-sovereign exposure	211	76	673	12	115	1,087
Total	$ 535	$ 76	$ 1,718	$ 108	$ 478	$ 2,915
Total BIG	$ 535	$ 7	$ 207	$ 96	$ 362	$ 1,207

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars, Euros and British pounds sterling. One of the RMBS included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 6, Expected Loss to be Paid.

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. For direct exposure this can be a relatively straight-forward determination as, for example, a debt issue supported by availability payments for a toll road in a particular country. The Company may also assign portions of a risk to more than one geographic location.

The Company has included in the exposure tables above its indirect economic exposure to the Selected European Countries through exposure it provides on pooled corporate obligations. The Company considers economic exposure to a selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. In most instances, the trustees and/or servicers for such transactions provide reports that identify the domicile of the underlying obligors in the pool (and the Company relies on such reports), although occasionally such information is not available to the Company. The Company has reviewed transactions through which it believes it may have indirect exposure to the Selected European Countries that is material to the transaction and included in the tables above the proportion of the insured par equal to the proportion of obligors so identified as being domiciled in a Selected European Country.

The Company no longer guarantees any sovereign bonds of the Selected European Countries. The exposure shown in the "Public Finance Category" is from transactions backed by receivable payments from sub-sovereigns in Italy, Spain and Portugal. Sub-sovereign debt is debt issued by a governmental entity or government backed entity, or supported by such an entity, that is other than direct sovereign debt of the ultimate governing body of the country. As of December 31, 2012, the Company no longer had any direct exposure to Greece. In 2012, the Company paid claims under its guarantees of €146 million in net exposure to the sovereign debt of Greece, paying off in full its liabilities with respect to the Greek sovereign bonds.

The Company understands that Moody's recently had undertaken a review of redenomination risk in selected countries in the Eurozone, including some of the Selected European Countries. No redenomination from the Euro to another currency has yet occurred and it may never occur. Therefore, it is not possible to be certain at this point how a redenomination of an issuer's obligations might be implemented in the future and, in particular, whether any redenomination would extend to the Company's obligations under a related financial guarantee.

Significant Risk Management Activities

The Risk Oversight and Audit Committees of the Board of Directors of AGL oversee the Company's risk management policies and procedures. With input from the board committees, specific risk policies and limits are set by the Portfolio Risk Management Committee, which includes members of senior management and senior Credit and Surveillance officers. The Company's Risk Management function encompasses enterprise risk management, establishing the Company's risk appetite, credit underwriting of new business, surveillance and work-out.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and Surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality.

Work-out personnel are responsible for managing work-out and loss mitigation situations, working with surveillance and legal personnel (as well as outside vendors) as appropriate. They develop strategies for the Company to enforce its contractual rights and remedies and to mitigate its losses, engage in negotiation discussions with transaction participants and, when necessary, manage (along with legal personnel) the Company's litigation proceedings.

Since the onset of the financial crisis, the Company has shifted personnel to loss mitigation and work-out activities and hired new personnel to augment its efforts. Although the Company's loss mitigation efforts may extend to any transaction it has identified as having loss potential, much of the activity has been focused on RMBS.

Surveillance Categories

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

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter.

Credits identified as BIG are subjected to further review to determine the probability of a loss (see Note 6, Expected Loss to be Paid). Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a lifetime loss is expected and whether a claim has been paid. The Company expects “lifetime losses” on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims over the life of that transaction than it ultimately will have reimbursed. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for recording of reserves for financial statement purposes.)

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The three BIG categories are:

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make lifetime losses possible, but for which none are currently expected. Transactions on which claims have been paid but are expected to be fully reimbursed (other than investment grade transactions on which only liquidity claims have been paid) are in this category.

- BIG Category 2: Below-investment-grade transactions for which lifetime losses are expected but for which no claims (other than liquidity claims which is a claim that the Company expects to be reimbursed within one year) have yet been paid.

- BIG Category 3: Below-investment-grade transactions for which lifetime losses are expected and on which claims (other than liquidity claims) have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains.

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of December 31, 2012

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 77	—%
Alt-A first lien	26	285	571	882	1,104	0.3
Option ARM	—	—	525	525	762	0.2
Subprime	78	934	583	1,595	3,313	0.5
Second lien U.S. RMBS:						
Closed end second lien	—	205	98	303	461	0.1
Home equity lines of credit ("HELOCs")	72	—	1,967	2,039	2,464	0.7
Total U.S. RMBS	176	1,424	3,744	5,344	8,181	1.8
Other structured finance	678	216	89	983	39,122	0.3
U.S. public finance	1,633	—	189	1,822	228,803	0.6
Non-U.S. public finance	1,635	—	—	1,635	23,384	0.6
Total	$ 4,122	$ 1,640	$ 4,022	$ 9,784	$ 299,490	3.3%

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of December 31, 2011

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 89	—%
Alt-A first lien	39	434	602	1,075	1,239	0.3
Option ARM	—	99	832	931	1,440	0.3
Subprime (including net interest margin securities)	681	907	131	1,719	3,566	0.5
Second lien U.S. RMBS:						
Closed end second lien	—	450	367	817	967	0.3
HELOCs	409	—	2,061	2,470	3,002	0.8
Total U.S. RMBS	1,129	1,890	3,993	7,012	10,303	2.2
Other structured finance	615	233	286	1,134	49,286	0.3
U.S. public finance	1,739	—	152	1,891	236,409	0.6
Non-U.S. public finance	1,415	189	—	1,604	24,400	0.5
Total	$ 4,898	$ 2,312	$ 4,431	$ 11,641	$ 320,398	3.6%

Below-Investment-Grade Credits
By Category
As of December 31, 2012

	Net Par Outstanding			Number of Risks(2)		
Description	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$ 3,723	$ 399	$ 4,122	71	6	77
Category 2	1,640	—	1,640	21	—	21
Category 3	3,892	130	4,022	50	9	59
Total BIG	$ 9,255	$ 529	$ 9,784	142	15	157

Below-Investment-Grade Credits
By Category
As of December 31, 2011

	Net Par Outstanding			Number of Risks(2)		
Description	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$ 4,637	$ 261	$ 4,898	77	4	81
Category 2	2,312	—	2,312	26	—	26
Category 3	4,070	361	4,431	47	10	57
Total BIG	$ 11,019	$ 622	$ 11,641	150	14	164

(1) Includes net par outstanding for FG VIE.

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

Superstorm Sandy

On October 29, 2012, Superstorm Sandy made landfall in New Jersey and caused significant loss of life and property damage in New Jersey, New York and Connecticut. The Company does not expect any significant losses as a direct result of the superstorm at this time.

4. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives for a discussion of credit derivative revenues.

Accounting Policies

Accounting for financial guaranty contracts that meet the scope exception under derivative accounting guidance are subject to industry specific guidance which prescribes revenue recognition methodologies. Contracts that meet the definition of a derivative are accounted for at fair value and discussed separately in these financial statements. The accounting for contracts that fall under the financial guaranty insurance definition are consistent whether the contract was written on a direct basis, assumed from another financial guarantor under a reinsurance treaty, ceded to another insurer under a reinsurance treaty or acquired in a business combination.

"Unearned premium reserve" or "unearned premium revenue" represents "deferred premium revenue" net of paid claims that have not yet been expensed, or "contra-paid." The following discussion relates to the deferred premium revenue component of the unearned premium reserve, while the contra paid is discussed in Note 7, Financial Guaranty Insurance Losses.

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

- For premiums received upfront on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is equal to the amount of cash received. Upfront premiums typically relate to public finance transactions.

- For premiums received in installments on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is the present value of either (1) contractual premiums due or (2) premiums expected to be collected over the life of the contract. For financial guaranty insurance contracts where the underlying collateral is comprised of homogeneous pools of assets, the expected premiums to be collected over the life of the contract is used to estimate the present value of future premiums. To be considered a homogeneous pool of assets prepayments must be contractually prepayable, the amount of prepayments must be probable, and the timing and amount of prepayments can be reasonably estimated. When the Company makes a significant adjustment to prepayment assumptions, or expected premium collections, it recognizes a prospective change in premium revenues. When the Company adjusts prepayment assumptions, an adjustment is recorded to the deferred premium revenue, with a corresponding adjustment to the premium receivable. For all other contracts, the present value of contractual premiums due is used. Premiums receivable are discounted at the risk-free rate at inception and such discount rate is updated only when significant changes to prepayment assumptions are made.Installment premiums typically relate to structured finance transactions, where the insurance premium rate is determined at the inception of the contract but the insured par is subject to prepayment throughout the life of the deal.

- For financial guaranty insurance contracts acquired in a business combination, deferred premium revenue is equal to the fair value of the insurance contract at the date of acquisition based on what a hypothetical similarly rated financial guaranty insurer would have charged for the contract at that date and not the actual cash flows under the insurance contract. The amount of deferred premium revenue differs significantly from cash collections due primarily to fair value adjustments recorded in connection with a business combination.

The Company recognizes deferred premium revenue as earned premium over the contractual period or expected period of the contract in proportion to the amount of insurance protection provided.

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

Deferred premium revenue ceded to reinsurers is recorded as an asset in the line item "ceded unearned premium reserve". Direct, assumed and ceded premium revenue are presented net in the income statement line item, net earned premiums.

Net earned premiums comprise the following:

Net Earned Premiums

	Year Ended December 31,	
	2012	2011
	(in millions)	
Scheduled net earned premiums	$ 403	$ 569
Acceleration of premium earnings	174	79
Accretion of discount on net premiums receivable	13	13
Total net earned premiums(1)	$ 590	$ 661

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(1) Excludes $150 million and $74 million for the year ended December 31, 2012 and 2011, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of December 31, 2012			As of December 31, 2011		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue	$ 4,016	$ 1,224	$ 2,792	$ 4,607	$ 1,398	$ 3,209
Contra-paid	(150)	(37)	(113)	(92)	(25)	(67)
Total	$ 3,866	$ 1,187	$ 2,679	$ 4,515	$ 1,373	$ 3,142

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(1) Excludes $251 million and $398 million deferred premium revenue and $98 million and $133 million of contra-paid related to FG VIEs as of December 31, 2012 and December 31, 2011, respectively.

Net Deferred Premium Revenue Roll Forward

	Year Ended December 31,	
	2012	2011
	(in millions)	
Balance beginning of period, December 31	$ 3,209	$ 3,941
Premium written, net	51	106
Net premium earned, excluding accretion	(577)	(648)
Commutations of reinsurance contracts	(28)	(20)
Change in expected premium	142	(8)
Consolidation of FG VIEs	(5)	(162)
Balance, end of period, December 31	$ 2,792	$ 3,209

Gross Premium Receivable, Net of Ceding Commissions Roll Forward

	Year Ended December 31,	
	2012	2011
	(in millions)	
Balance beginning of period, December 31	$ 645	$ 729
Premium written, net	143	172
Premium payments received, net	(222)	(256)
Adjustments:		
Changes in the expected term of financial guaranty insurance contracts	50	(3)
Accretion of discount	30	21
Foreign exchange translation	13	(5)
Consolidation of FG VIEs	(5)	(7)
Other adjustments	(1)	(6)
Balance, end of period, December 31(1)(2)	$ 653	$ 645

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(1) Represents elimination of premium receivable related to the consolidation of FG VIEs.

(2) Excludes $16 million and $17 million as of December 31, 2012 and 2011, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 66% and 68% of installment premiums at December 31, 2012 and 2011, respectively, are denominated in currencies other than the U.S. dollar, primarily in Euro and British Pound Sterling.

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

Expected Collections of Gross Premiums Receivable,
Net of Ceding Commissions (Undiscounted)

	December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 23
2013 (April 1 - June 30)	25
2013 (July 1- September 30)	16
2013 (October 1 - December 31)	19
2014	65
2015	62
2016	59
2017	55
2018-2022	210
2023-2027	134
2028-2032	97
After 2032	114
Total	$ 879

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(1) Excludes expected cash collections on FG VIEs of $19 million.

Scheduled Net Earned Premiums
Financial Guaranty Insurance Contracts

	As of December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 87
2013 (April 1 - June 30)	83
2013 (July 1- September 30)	78
2013 (October 1 - December 31)	74
Subtotal 2013	322
2014	273
2015	238
2016	213
2017	188
2018-2022	686
2023-2027	405
2028-2032	233
After 2032	234
Total present value basis(1)	2,792
Discount	142
Total future value	$ 2,934

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(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $251 million.

Selected Information for Policies Paid in Installments

	As of December 31,	
	2012	2011
	(dollars in millions)	
Premiums receivable, net of ceding commission payable	$ 653	$ 645
Gross deferred premium revenue	1,562	1,832
Weighted-average risk-free rate used to discount premiums	3.46%	3.6%
Weighted-average period of premiums receivable (in years)	10.0	10.3

5. Financial Guaranty Insurance Acquisition Costs

Accounting Policy

Policy acquisition costs that are directly related and essential to successful insurance contract acquisition are deferred for contracts accounted for as insurance. Amortization of deferred policy acquisition costs includes the accretion of discount on ceding commission income and expense. Acquisition costs associated with derivative contracts are not deferrable.

In October 2010, the FASB adopted Accounting Standards Update (“Update”) No. 2010-26. The Company adopted this guidance January 1, 2012, with retrospective application. As of January 1, 2011, the effect of retrospective application of Update No. 2010-26 was a reduction to deferred acquisition costs ("DAC") of $10 million and a reduction to retained earnings of $7 million. DAC is netted with deferred ceding commission income and recorded in "other liabilities" on the consolidated balance sheets. There was no impact to cash flow. The Update specifies that certain costs incurred in the successful acquisition of new and renewal insurance contracts should be capitalized. These costs include direct costs of contract acquisition that result directly from and are essential to the contract transaction. These costs include expenses such as ceding commissions and the cost of underwriting personnel. Ceding commission income on ceded reinsurance contracts that are associated with premiums received in installments are calculated at their contractually defined rates and included in deferred ceding commissions, with a corresponding offset to net premiums receivable or reinsurance balances payable. Management uses its judgment in determining the type and amount of cost to be deferred. The Company conducts an annual study to determine which operating costs qualify for deferral. Costs incurred by the insurer for soliciting potential customers, market research, training, administration, unsuccessful acquisition efforts, and product development as well as all overhead type costs are charged to expense as incurred. DAC is amortized in proportion to net earned premiums. When an insured obligation is retired early, the remaining related DAC is expensed at that time.

Effect of Retrospective Application of New Deferred Acquisition Cost Guidance
On Consolidated Statements of Operations

	As Reported Year Ended 2011	Retroactive Application Adjustment	As Revised Year Ended 2011
		(in millions)	
Amortization of DAC	$ (7)	$ (1)	$ (8)
Other operating expenses	86	9	95
Net income (loss)	404	(6)	398

The effect of retrospective application of Update No. 2010-26 was an increase to other liabilities of $20 million as of December 31, 2011.

Rollforward of Deferred Ceding Commissions, Net of DAC
With Retrospective Application of Change in Accounting Principle(1)

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Balance, beginning of period	$ (99)	$ (93)
Costs deferred during the period:		
Ceded and assumed commissions	(29)	(24)
Premium taxes	3	4
Compensation and other acquisition costs	7	6
Total	(19)	(14)
Costs amortized during the period	8	8
Balance, end of period	$ (110)	$ (99)

(1) The balances are included in other liabilities on the consolidated balance sheets.

6. Expected Loss to be Paid

Accounting Policy

The insured portfolio includes policies accounted for under three separate accounting models depending on the characteristics of the contract and the Company's control rights. The Company has paid and expects to pay future losses on policies which fall under each of the three accounting models. The following provides a summarized description of the three accounting models required under GAAP for each type of contract with references to additional information provided throughout this report. The three models are insurance, derivative and VIE consolidation.

However, in order to effectively evaluate and manage the economics and liquidity of the entire insured portfolio, management compiles and analyzes loss information for all policies on a consistent basis because loss payments must be made regardless of accounting model. That is, management monitors and assigns ratings and calculates expected losses in the same manner for all its exposures regardless of form or differing accounting models. Management also considers contract specific characteristics that affect the estimates of expected loss. The discussion of expected loss to be paid within this note encompasses expected losses on all policies in the insured portfolio, whatever the accounting treatment. Net expected loss to be paid in the tables below consists of the present value of future: expected claim and loss and loss adjustment expenses ("LAE") payments, expected recoveries of excess spread in the transaction structures, cessions to reinsurers, and expected recoveries for breaches of representations and warranties ("R&W") and other loss mitigation strategies. Assumptions used in the determination of the net expected loss to be paid presented below, such as delinquency, severity, and discount rates and expected timeframes to recovery in the mortgage market were consistent by sector regardless of the accounting model used.

Accounting Models:

The following is a summary of each of the accounting models prescribed by GAAP with a reference to the notes that describe the accounting polices and required disclosures. This note provides information regarding expected claim payments to be made under all insured contracts regardless of form of execution.

Insurance Accounting

For contracts accounted for as financial guaranty insurance, loss and LAE reserve is recorded only to the extent and for the amount that expected losses to be paid exceed unearned premium reserve. As a result, the Company has expected losses that have not yet been expensed but will be expensed in future periods. Such amounts will be expensed in future periods as deferred premium revenue amortizes into income. Expected loss to be paid is important from a liquidity perspective in that it represents the present value of amounts that the Company expects to pay or recover in future periods. Expected loss to be expensed is important because it presents the Company's projection of incurred losses that will be recognized in future periods as deferred premium revenue amortizes into income. See Note 7, Financial Guaranty Insurance Losses.

Derivative Accounting, at Fair Value

For contracts that do not meet the financial guaranty scope exception in the derivative accounting guidance (primarily due to the fact that the insured is not required to be exposed to the insured risk throughout the life of the contract), the Company records such credit derivative contracts at fair value on the consolidated balance sheet with changes in fair value recorded in the consolidated statement of operations. Expected loss to be paid is an important measure used by management to analyze the net economic loss on credit derivatives. The fair value recorded on the balance sheet represents an exit price in a hypothetical market because the Company does not trade its credit derivative contracts. The fair value is determined using significant Level 3 inputs in an internally developed model while the expected loss to be paid (which represents the present value of expected cash outflows) uses methodologies and assumptions consistent with financial guaranty insurance expected losses to be paid. See Note 8, Fair Value Measurement and Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

VIE Consolidation, at Fair Value

For financial guaranty insurance contracts issued on the debt of variable interest entities over which the Company is deemed to be the primary beneficiary due to its control rights, as defined in accounting literature, the Company consolidates the FG VIE. The Company's expected loss to be paid is reflected in the fair value of the FG VIEs liabilities. The Company carries the assets and liabilities of the FG VIEs at fair value under the fair value option election. Management assesses the losses on the insured debt of the consolidated FG VIEs in the same manner as other financial guaranty insurance and credit derivative contracts. Expected loss to be paid for FG VIEs pursuant to AGM's financial guaranty insurance policies is calculated in a manner consistent with the Company's other financial guaranty insurance contracts.

Expected Loss to be Paid

The expected loss to be paid is equal to the present value of expected future cash outflows for claim and LAE payments, net of inflows for expected salvage and subrogation (i.e. excess spread on the underlying collateral, and estimated and contractual recoveries for breaches of representations and warranties), using current risk-free rates. When the Company becomes entitled to the cash flow from the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment or estimated future claim payment, it reduces the expected loss to be paid on the contract. Net expected loss to be paid is defined as expected loss to be paid, net of amounts ceded to reinsurers.

The current risk-free rate is based on the remaining period of the contract used in the premium revenue recognition calculation (i.e., the contractual or expected period, as applicable). The Company updates the discount rate each quarter and records the effect of such changes in economic loss development. Expected cash outflows and inflows are probability weighted cash flows that reflect the likelihood of all possible outcomes. The Company estimates the expected cash outflows and inflows using management's assumptions about the likelihood of all possible outcomes based on all information available to it. Those assumptions consider the relevant facts and circumstances and are consistent with the information tracked and monitored through the Company's risk-management activities.

Economic Loss Development

Economic loss development represents the change in expected loss to be paid attributable to all factors other than loss and LAE payments. It includes the effects of changes in assumptions based on observed market trends, changes in discount rates, accretion of discount and the economic effects of loss mitigation efforts.

Loss Mitigation

Expected loss to be paid and economic loss development include the effects of loss mitigation strategies and other contractual rights to mitigate losses such as: negotiated and estimated recoveries for breaches of representations and warranties, and purchases of insured debt obligations. Additionally, in certain cases, issuers of insured obligations elected, or the Company and an issuer mutually agreed as part of a negotiation, to deliver the underlying collateral or insured obligation to the Company. In circumstances where the Company has acquired its own insured obligations that have expected losses, either as part of loss mitigation strategy or via delivery of underlying collateral, expected loss to be paid is reduced by the proportionate share of the insured obligation that was purchased. The difference between the purchase price of the obligation and the fair value excluding the value of the Company's insurance, is treated as a paid loss for both purchased bonds and delivered collateral or insured obligations. Assets that are purchased or put to the Company are recorded in the investment portfolio, at fair value, excluding the value of the Company's insurance or credit derivative contract. See Note 11, Investments and Cash and Note 8, Fair Value Measurement.

Loss Estimation Process

The Company's loss reserve committees estimate expected loss to be paid for all contracts. Surveillance personnel present analyses related to potential losses to the Company's loss reserve committees for consideration in estimating the expected loss to be paid. Such analyses include the consideration of various scenarios with potential probabilities assigned to them. Depending upon the nature of the risk, the Company's view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments and sector-driven loss severity assumptions or judgmental assessments. In the case of its assumed business, the Company may conduct its own analysis as just described or, depending on the Company's view of the potential size of any loss and the information available to the Company, the Company may use loss estimates provided by ceding insurers. The Company's loss reserve committees review and refresh the estimate of expected loss to be paid each quarter. The Company's estimate of ultimate loss on a policy is subject to significant uncertainty over the life of the insured transaction due to the potential for significant variability in credit performance as a result of economic, fiscal and financial market variability over the long duration of most contracts. The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management.

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives, or FG VIEs, by sector before and after the benefit for estimated and contractual recoveries for breaches of R&W. The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 3.28% as of December 31, 2012 and 0.0% to 3.27% as of December 31, 2011.

Net Expected Loss to be Paid,
Before Recoveries for Breaches of R&W
Roll Forward by Sector
Year Ended December 31, 2012

	Net Expected Loss to be Paid as of December 31, 2011(2)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2012(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 274	$ 43	$ (36)	$ 281
Option ARM	754	92	(507)	339
Subprime	256	44	(31)	269
Total first lien	1,284	179	(574)	889
Second lien:				
Closed end second lien	86	(8)	(12)	66
HELOCs	76	61	(140)	(3)
Total second lien	162	53	(152)	63
Total U.S. RMBS	1,446	232	(726)	952
Other structured finance	62	(37)	3	28
U.S. public finance	(35)	15	(38)	(58)
Non-U.S. public finance	38	195	(195)	38
Total	$ 1,511	$ 405	$ (956)	$ 960

Net Expected Loss to be Paid,
Before Recoveries for Breaches of R&W
Roll Forward by Sector
Year Ended December 31, 2011

	Net Expected Loss to be Paid as of December 31, 2010	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2011(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 213	$ 122	$ (61)	$ 274
Option ARM	751	442	(439)	754
Subprime	207	61	(12)	256
Total first lien	1,171	625	(512)	1,284
Second lien:				
Closed end second lien	190	(65)	(39)	86
HELOCs	117	192	(233)	76
Total second lien	307	127	(272)	162
Total U.S. RMBS	1,478	752	(784)	1,446
Other structured finance	72	(9)	(1)	62
U.S. public finance	8	3	(46)	(35)
Non-U.S. public finance	1	37	—	38
Total	$ 1,559	$ 783	$ (831)	$ 1,511

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

(2) Includes expected LAE to be paid for mitigating claim liabilities of $19 million as of December 31, 2012 and $21 million as of December 31, 2011. The Company paid $30 million and $29 million in LAE for the years ended December 31, 2012 and 2011, respectively.

Net Expected Recoveries from
Breaches of R&W Rollforward
Year Ended December 31, 2012

	Future Net R&W Benefit as of December 31, 2011	R&W Development and Accretion of Discount During 2012	R&W Recovered During 2012(1)	Future Net R&W Benefit as of December 31, 2012(2)
		(in millions)		
Alt-A first lien	$ 181	$ 19	(68)	$ 132
Option ARM	619	78	(216)	481
Subprime	101	6	—	107
Closed end second lien	118	3	(6)	115
HELOC	151	35	(61)	125
Total	$ 1,170	$ 141	$ (351)	$ 960

Net Expected Recoveries from
Breaches of R&W Rollforward
Year Ended December 31, 2011

	Future Net R&W Benefit at December 31, 2010	R&W Development and Accretion of Discount During 2011	R&W Recovered During 2011(1)	Future Net R&W Benefit at December 31, 2011
		(in millions)		
Alt-A first lien	$ 68	$ 113	—	$ 181
Option ARM	291	395	(67)	619
Subprime	27	74	—	101
Closed end second lien	98	28	(8)	118
HELOC	738	101	(688)	151
Total	$ 1,222	$ 711	$ (763)	$ 1,170

(1) Gross amounts recovered are $383 million and $956 million for year ended December 31, 2012 and 2011, respectively.

(2) Includes excess spread that the Company will receive as salvage as a result of a settlement agreement with a R&W provider.

Net Expected Loss to be Paid,
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Year Ended December 31, 2012

	Net Expected Loss to be Paid as of December 31, 2011	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2012
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 93	$ 24	$ 32	$ 149
Option ARM	135	14	(291)	(142)
Subprime	155	38	(31)	162
Total first lien	383	76	(290)	169
Second lien:				
Closed end second lien	(32)	(11)	(6)	(49)
HELOCs	(75)	26	(79)	(128)
Total second lien	(107)	15	(85)	(177)
Total U.S. RMBS	276	91	(375)	(8)
Other structured finance	62	(37)	3	28
U.S. public finance	(35)	15	(38)	(58)
Non-U.S. public finance	38	195	(195)	38
Total	$ 341	$ 264	$ (605)	$ 0

Net Expected Loss to be Paid,
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Year Ended December 31, 2011

	Net Expected Loss to be Paid as of December 31, 2010	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2011
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 145	$ 9	$ (61)	$ 93
Option ARM	460	47	(372)	135
Subprime	180	(13)	(12)	155
Total first lien	785	43	(445)	383
Second lien:				
Closed end second lien	92	(93)	(31)	(32)
HELOCs	(621)	91	455	(75)
Total second lien	(529)	(2)	424	(107)
Total U.S. RMBS	256	41	(21)	276
Other structured finance	72	(9)	(1)	62
U.S. public finance	8	3	(46)	(35)
Non-U.S. public finance	1	37	—	38
Total	$ 337	$ 72	$ (68)	$ 341

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

The following tables present the present value of net expected loss to be paid for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 131	$ 18	$ —	$ 149
Option ARM	(106)	(36)	—	(142)
Subprime	112	50	—	162
Total first lien	137	32	—	169
Second lien:				
Closed end second lien	(62)	23	(10)	(49)
HELOCs	39	(167)	—	(128)
Total second lien	(23)	(144)	(10)	(177)
Total U.S. RMBS	114	(112)	(10)	(8)
Other structured finance	23	—	5	28
U.S. public finance	(58)	—	—	(58)
Non-U.S. public finance	38	—	—	38
Total	$ 117	$ (112)	$ (5)	$ 0

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2011

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 103	$ (10)	$ —	$ 93
Option ARM	111	24	—	135
Subprime	88	42	25	155
Total first lien	302	56	25	383
Second lien:				
Closed end second lien	(59)	33	(6)	(32)
HELOCs	75	(150)	—	(75)
Total second lien	16	(117)	(6)	(107)
Total U.S. RMBS	318	(61)	19	276
Other structured finance	42	—	20	62
U.S. public finance	(34)	—	(1)	(35)
Non-U.S. public finance	38	—	—	38
Total	$ 364	$ (61)	$ 38	$ 341

(1) Refer to Note 10, Consolidation of Variable Interest Entities.

The following tables present the net economic loss development for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Economic Loss Development
By Accounting Model
Year Ended December 31, 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 25	$ (1)	$ 0	$ 24
Option ARM	13	1	0	14
Subprime	29	9	—	38
Total first lien	67	9	—	76
Second lien:				
Closed end second lien	(3)	(8)	—	(11)
HELOCs	7	19	—	26
Total second lien	4	11	—	15
Total U.S. RMBS	71	20	—	91
Other structured finance	(23)	—	(14)	(37)
U.S. public finance	(9)	—	24	15
Non-U.S.Public finance	220	—	(25)	195
Total	$ 259	$ 20	$ (15)	$ 264

Net Economic Loss Development
By Accounting Model
Year Ended December 31, 2011

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 10	$ (1)	$ —	$ 9
Option ARM	(38)	85	—	47
Subprime	(43)	33	(3)	(13)
Total first lien	(71)	117	(3)	43
Second lien:				
Closed end second lien	(106)	36	(23)	(93)
HELOCs	172	(81)	—	91
Total second lien	66	(45)	(23)	(2)
Total U.S. RMBS	(5)	72	(26)	41
Other structured finance	18	—	(27)	(9)
U.S. public finance	4	—	(1)	3
Non-U.S.Public finance	37	—	—	37
Total	$ 54	$ 72	$ (54)	$ 72

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(1) Refer to Note 10, Consolidation of Variable Interest Entities.

(2) Refer to Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates. For transactions where the Company projects it will receive recoveries from providers of R&W, it projects the amount of recoveries and either establishes a recovery for claims already paid or reduces its projected claim payments accordingly.

The further behind a mortgage borrower falls in making payments, the more likely it is that he or she will default. The rate at which borrowers from a particular delinquency category (number of monthly payments behind) eventually default is referred to as the "liquidation rate." Liquidation rates may be derived from observed roll rates, which are the rates at which loans progress from one delinquency category to the next and eventually to default and liquidation. The Company applies liquidation rates to the mortgage loan collateral in each delinquency category and makes certain timing assumptions to project near-term mortgage collateral defaults from loans that are currently delinquent.

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

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. Further detail regarding the assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio may be found below in the sections *"U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien"* and *"U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime."*

The Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit from the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access or believes it will attain access to the underlying mortgage loan files. Where the Company has an agreement with an R&W provider (e.g., the Bank of America Agreement or the Deutsche Bank Agreement) or where it is in advanced discussions on a potential agreement, that credit is based on the agreement or potential agreement. In second lien RMBS transactions where there is no agreement or advanced discussions, this credit is based on a percentage of actual repurchase rates achieved across those transactions where material repurchases have been made. In certain scenarios included in the probability weighted R&W estimates for first lien RMBS transactions where there is no agreement or advanced discussions, this credit is estimated by reducing collateral losses projected by the Company to reflect a percentage of the recoveries the Company believes it will achieve, based on a percentage of actual repurchase rates achieved or based on the Company's two largest settlements with Bank of America Agreement and Deutsche Bank Agreement. The first lien approach is different from the second lien approach because the Company's first lien transactions have multiple tranches and a more complicated method is required to correctly allocate credit to each tranche. In each case, the credit is a function of the projected lifetime collateral losses in the collateral pool, so an increase in projected collateral losses generally increases the R&W credit calculated by the Company for the RMBS issuer. Further detail regarding how the Company calculates these credits may be found under *"Breaches of Representations and Warranties"* below.

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

The ultimate performance of the Company's RMBS transactions remains highly uncertain, may differ from the Company's projections and may be subject to considerable volatility due to the influence of many factors, including the level and timing of loan defaults, changes in housing prices, results from the Company's loss mitigation activities and other variables. The Company will continue to monitor the performance of its RMBS exposures and will adjust its RMBS loss projection assumptions and scenarios based on actual performance and management's view of future performance.

Year-End 2012 Compared to Year-End 2011 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will eventually improve. Each quarter the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as whether those changes are normal fluctuations or part of a trend. Based on such observations, the Company chose to use essentially the same assumptions and scenarios to project RMBS loss as of December 31, 2012 as it used as of December 31, 2011, except that as compared to December 31, 2011:

- in its most optimistic scenario, it reduced by three months the period it assumed it would take the mortgage market to recover; and

- in its most pessimistic scenario, it increased by three months the period it assumed it would take the mortgage market to recover.

The Company's use of essentially the same assumptions and scenarios to project RMBS losses as of December 31, 2012 as at December 31, 2011 was consistent with its view at December 31, 2012 that the housing and mortgage market recovery is occurring at a slower pace than it anticipated at December 31, 2011. The Company's changes during 2012 to the period it would take the mortgage market to recover in its most optimistic scenario and its most pessimistic scenario allowed it to consider a wider range of possibilities for the speed of the recovery. Since the Company's projections for each RMBS transaction are based on the delinquency performance of the loans in that individual RMBS transaction, improvement or deterioration in that aspect of a transaction's performance impacts the projections for that transaction. The methodology and assumptions the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "- U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and " - U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

Year-End 2011 Compared to Year-End 2010 U.S. RMBS Loss Projections

During 2011 the Company made a judgment as to whether to change the assumptions it used to make RMBS loss projections based on its observation of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observed changes, it made a judgment as whether those changes were normal fluctuations or part of a trend. Based on such observations, the Company chose to use essentially the same assumptions and scenarios to project RMBS loss as of December 31, 2011 as it used as of December 31, 2010, except that as compared to December 31, 2010:

- based on its observation of the slow mortgage market recovery, the Company increased its base case expected period for reaching the final conditional default rate in second lien transactions and adjusted the probability weightings it applied to second lien scenarios from year-end 2010 to reflect the changes to those scenarios;

- also based on its observation of the slow mortgage market recovery the Company added a more stressful first lien scenario at year-end 2011 reflecting an even slower potential recovery in the housing and mortgage markets, making what had prior to that been a stress scenario its base scenario;

- based on its observation of increased loss severity rates, the Company increased its projected loss severity rates in various of its first lien scenarios; and

- based on its observation of liquidation rates, the Company decreased the liquidation rates it applied to non-performing loans.

The Company's use of essentially the same assumptions and scenarios to project RMBS losses as of December 31, 2011 as at December 31, 2010 was consistent with its view at December 31, 2011 that the housing and mortgage market recovery was occurring at a slower pace than it anticipated at December 31, 2010. Since the Company's projections for each RMBS transaction are based on the delinquency performance of the loans in that individual RMBS transaction, improvement or deterioration in that aspect of a transaction's performance impacts the projections for that transaction. The methodology and assumptions the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "– U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and " – U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

U.S. Second Lien RMBS Loss Projections: HELOCs and Closed End Second Lien

The Company insures two types of second lien RMBS: those secured by HELOCs and those secured by closed end second lien mortgages. HELOCs are revolving lines of credit generally secured by a second lien on a one to four family home. A mortgage for a fixed amount secured by a second lien on a one to four family home is generally referred to as a closed end second lien. Second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral. The Company has material exposure to second lien mortgage loans originated and serviced by a number of parties, but the Company’s most significant second lien exposure is to HELOCs originated and serviced by Countrywide, a subsidiary of Bank of America. See “—Breaches of Representations and Warranties.”

The delinquency performance of HELOC and closed end second lien exposures included in transactions insured by the Company began to deteriorate in 2007, and such transactions continue to perform below the Company’s original underwriting expectations. While insured securities benefit from structural protections within the transactions designed to absorb collateral losses in excess of previous historically high levels, in many second lien RMBS projected losses now exceed those structural protections.

The Company believes the primary variables affecting its expected losses in second lien RMBS transactions are the amount and timing of future losses in the collateral pool supporting the transactions and the amount of loans repurchased for breaches of R&W (or agreements with R&W providers related to such obligations). Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as conditional prepayment rate ("CPR") of the collateral); the interest rate environment; and assumptions about the draw rate and loss severity. These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company's assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

The following table shows the range of key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
Second Lien RMBS(1)

HELOC key assumptions	**As of December 31, 2012**	**As of December 31, 2011**
Plateau CDR	3.8% - 15.9%	4.0% - 27.4%
Final CDR trended down to	0.4% - 3.2%	0.4% - 3.2%
Expected period until final CDR	36 months	36 months
Initial CPR	2.9% - 14.6%	1.4% - 25.8%
Final CPR	10%	10%
Loss severity	98%	98%
Initial draw rate	0.0% - 4.8%	0.0% - 15.3%

Closed end second lien key assumptions	**As of December 31, 2012**	**As of December 31, 2011**
Plateau CDR	10.6% - 20.7%	17.9% - 29.5%
Final CDR trended down to	3.5% - 8.6%	3.5% - 8.6%
Expected period until final CDR	36 months	36 months
Initial CPR	2.3% - 5.0%	2.2% - 5.1%
Final CPR	10%	10%
Loss severity	98%	98%

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(1) Represents variables for most heavily weighted scenario (the "base case").

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (*i.e.*, 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding twelve months' liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a CDR. The first four months' CDR is calculated by applying the liquidation rates to the current period past due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the CDR is calculated using the average 30-59 day past due balances for the prior three months. The fifth month CDR is then used as the basis for the plateau period that follows the embedded five months of losses.

As of December 31, 2012, for the base case scenario, the CDR (the "plateau CDR") was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. In the base case scenario, the time over which the CDR trends down to its final CDR is 30 months. Therefore, the total stress period for second lien transactions is 36 months, comprising five months of delinquent data, a one month plateau period and 30 months of decrease to the steady state CDR. This is the same as December 31, 2011, but 12 months longer than the total stress period of 24 months (comprising five months of delinquent data, a one month plateau period and 18 months of decrease to the steady state CDR) it used for December 31, 2010. The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as December 31, 2011 and December 31, 2010.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (which is a function of the CDR and the loan balance over time) as well as the amount of excess spread (which is the excess of the interest paid by the borrowers on the underlying loan over the amount of interest and expenses owed on the insured obligations). In the base case, the current CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the CPR at December 31, 2011 and December 31, 2010. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). For HELOC transactions, the draw rate is assumed to decline from the current level to a final draw rate over a period of three months. The final draw rates were assumed to range from 0.0% to 2.4%.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate the assumptions affecting its modeling results.

As of December 31, 2012, the Company's base case assumed a one month CDR plateau and a 30 month ramp-down (for a total stress period of 36 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of December 31, 2011. Increasing the CDR plateau to four months and increasing the ramp-down by three months to 33-months (for a total stress period of 42 months) would increase the expected loss by approximately $36 million for HELOC transactions and $2 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 21 months (for a total stress period of 27 months) would decrease the expected loss by approximately $37 million for HELOC transactions and $2 million for closed-end second lien transactions. The length of the total stress period the Company used in its pessimistic scenario December 31, 2012 was three months longer than the total stress period it used at December 31, 2011 and 15 months longer than the total stress period it used at December 31, 2010. On the other hand, the total stress period the Company used in its optimistic scenario at December 31, 2012 was three months shorter than the total stress period it used at December 31, 2011 but nine months longer than the total stress period it used at December 31, 2010.

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

First lien RMBS are generally categorized in accordance with the characteristics of the first lien mortgage loans on one-to-four family homes supporting the transactions. The collateral supporting "subprime RMBS" transactions consists of first-lien residential mortgage loans made to subprime borrowers. A "subprime borrower" is one considered to be a higher risk credit based on credit scores or other risk characteristics. Another type of RMBS transaction is generally referred to as "Alt-A first lien." The collateral supporting such transactions consists of first-lien residential mortgage loans made to "prime" quality borrowers who lack certain ancillary characteristics that would make them prime. When more than 66% of the loans originally included in the pool are mortgage loans with an option to make a minimum payment that has the potential to amortize the loan negatively (*i.e.*, increase the amount of principal owed), the transaction is referred to as an "Option ARM." Finally, transactions may be composed primarily of loans made to prime borrowers. First lien RMBS sometimes include a portion of loan collateral that differs in priority from the majority of the collateral.

The performance of the Company's first lien RMBS exposures began to deteriorate in 2007 and such transactions, continue to perform below the Company's original underwriting expectations. The Company currently projects first lien collateral losses many times those expected at the time of underwriting. While insured securities benefited from structural protections within the transactions designed to absorb some of the collateral losses, in many first lien RMBS transactions, projected losses exceed those structural protections.

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are delinquent or in foreclosure or where the loan has been foreclosed and the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various delinquency categories. The Company arrived at its liquidation rates based on data purchased from a third party, and assumptions about how delays in the foreclosure process may ultimately affect the rate at which loans are liquidated. The liquidation rate is a standard industry measure that is used to estimate the number of loans in a given aging category that will default within a specified time period. The Company projects these liquidations to occur over two years. For both year-end 2012 and year-end 2011 the Company reviewed the data supplied by the third-party provider. Based on its review of that data, the Company maintained the same liquidation assumptions at December 31, 2012 as it had used at December 31, 2011, but these were updated from December 31, 2010. The following table shows liquidation assumptions for various delinquency categories.

First Lien Liquidation Rates

	December 31, 2012	December 31, 2011
30 - 59 Days Delinquent		
Alt-A and Prime	35%	35%
Option ARM	50	50
Subprime	30	30
60 - 89 Days Delinquent		
Alt-A and Prime	55	55
Option ARM	65	65
Subprime	45	45
90 + Days Delinquent		
Alt-A and Prime	65	65
Option ARM	75	75
Subprime	60	60
Bankruptcy		
Alt-A and Prime	55	55
Option ARM	70	70
Subprime	50	50
Foreclosure		
Alt-A and Prime	85	85
Option ARM	85	85
Subprime	80	80
Real Estate Owned		
All	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans, it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (*i.e*., the CDR plateau), which, if applied for each of the next 24 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 24-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for

36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 24 months represent defaults that can be attributed to loans that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 24 month period represent defaults attributable to borrowers that are currently performing. The CDR trend the Company used in its base case for December 31, 2012 was the same as it used for December 31, 2011 but had small differences from the one it used for December 31, 2010 (for example, for December 31, 2010 the intermediate CDR was calculated as 15% of the plateau CDR).

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historic high levels, and the Company is assuming that these high levels generally will continue for another year (in the case of subprime loans, the Company assumes the unprecedented 90% loss severity rate will continue for six months then drop to 80% for six months before following the ramp described below). The Company determines its initial loss severity based on actual recent experience. The Company's loss severity assumptions for December 31, 2012 were the same as it used for December 31, 2011 but, as shown in the table below, higher than the loss severity assumptions it used for December 31, 2010. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning in June 2013, and in the base case scenario, decline over two years to 40%.

The following table shows the range of key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS(1)

	As of December 31, 2012	As of December 31, 2011
Alt-A First Lien		
Plateau CDR	6.8% - 23.2%	5.7% - 41.3%
Intermediate CDR	1.4% - 4.6%	1.1% - 8.3%
Final CDR	0.3% - 1.2%	0.3% - 2.1%
Initial loss severity	65%	65%
Initial CPR	0.0% - 14.3%	0.0% - 15.2%
Final CPR	15%	15%
Option ARM		
Plateau CDR	7.0% - 26.1%	11.7% - 31.5%
Intermediate CDR	1.4% - 5.2%	2.3% - 6.3%
Final CDR	0.4% - 1.3%	0.6% - 1.6%
Initial loss severity	65%	65%
Initial CPR	0.4% - 3.8%	0.3% - 10.8%
Final CPR	15%	15%
Subprime		
Plateau CDR	7.3% - 21.2%	10.3% - 29.9%
Intermediate CDR	1.5% - 4.2%	2.1% - 6.0%
Final CDR	0.5% - 1.3%	0.5% - 1.5%
Initial loss severity	90%	90%
Initial CPR	0.0% - 9.2%	0.0% - 10.6%
Final CPR	15%	15%

(1) Represents variables for most heavily weighted scenario (the "base case").

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the CPR follows a similar pattern to that of the conditional default rate.

The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be either 10% or 15% depending on the scenario run. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those it used for December 31, 2011 and December 31, 2010.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the current conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of December 31, 2012. For December 31, 2012 the Company used the same five scenarios and weightings as it used for December 31, 2011 except that for December 31, 2012 it assumed in the most stressful scenario that the recovery would occur three months more slowly and in the most optimistic scenario that it would occur three months more quickly than it had assumed would be the case for December 31, 2011. For December 31, 2010 the Company used only four scenarios, and there were some other differences in the assumptions used for the December 31, 2010 as compared to those used for December 31, 2012. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended three months (to be 27 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over four rather than two years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately $20 million for Alt-A first liens, $15 million for Option ARM and $96 million for subprime transactions. In an even more stressful scenario where loss severities were assumed to rise and then recover over eight years and the initial ramp-down of the CDR was assumed to occur over 15 months (rather than 12 months as of December 31, 2011) and other assumptions were the same as the other stress scenario), expected loss to be paid would increase from current projections by approximately $56 million for Alt-A first liens, $34 million for Option ARM and $149 million for subprime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 12 months and was assumed to recover to 40% over two years, expected loss to be paid would decrease from current projections by approximately $3 million for Alt-A first lien, $26 million for Option ARM and $27 million for subprime transactions. In an even less stressful scenario where the conditional default rate plateau was three months shorter (21 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the CDR over nine months rather than 12 months as at December 31, 2011) expected loss to be paid would decrease from current projections by approximately $22 million for Alt-A first lien, $55 million for Option ARM and $56 million for subprime transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W, that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these requirements. The Company uses internal resources as well as third party forensic underwriting firms and legal firms to pursue breaches of R&W. If a provider of R&W refuses to honor its repurchase obligations, the Company may choose to initiate litigation. See "-Recovery Litigation" below.

The Company's success in pursuing R&W claims against a number of counterparties that provided R&W on a loan by loan basis has permitted the Company to pursue reimbursement agreements with R&W providers. Such agreements provide the Company with many of the benefits of pursuing the R&W claims but without the expense and uncertainty of pursuing the R&W claims on a loan by loan basis.

The Company may also employ other strategies as appropriate to avoid or mitigate losses in U.S. RMBS or other areas, including pursuing litigation in areas other than RMBS or entering into other arrangements to alleviate or reduce all or a portion of certain risks.

The Company is pursuing reimbursements for breaches of R&W regarding loan characteristics. Performance of the collateral underlying certain first and second lien securitizations has substantially differed from the Company's original expectations. The Company has employed several loan file diligence firms and law firms as well as devoted internal resources to review the mortgage files surrounding many of the defaulted loans. The Company's success in these efforts has resulted in several negotiated agreements in respect of the Company's R&W claims, including one on April 14, 2011 with Bank of America and one on May 8, 2012 with Deutsche Bank AG.

On April 14, 2011, Assured Guaranty reached a comprehensive agreement with Bank of America Corporation and its subsidiaries, including Countrywide Financial Corporation and its subsidiaries (collectively, “Bank of America”), regarding their liabilities with respect to 29 RMBS transactions insured by Assured Guaranty, including claims relating to reimbursement for breaches of R&W and historical loan servicing issues ("Bank of America Agreement"). Of the 29 RMBS transactions, eight were second lien transactions and 21 were first lien transactions, all of which were financial guaranty insurance except for one first lien in credit derivative form. The Bank of America Agreement covers Bank of America-sponsored securitizations that AGM has insured, as well as certain other securitizations containing concentrations of Countrywide-originated loans that AGM has insured. The AGM-insured transactions covered by the Bank of America Agreement have a gross par outstanding of $2.5 billion ($2.2 billion net par outstanding) as of December 31, 2012.

Bank of America paid $1,043 million (of which $822 million was related to AGM-insured transactions) in 2011 and $57 million in March 2012 (of which $45 million is related to AGM-insured transactions) in respect of Assured Guaranty insured second lien transactions. In consideration of the $1.1 billion, Assured Guaranty has agreed to release its claims for the repurchase of mortgage loans underlying the eight second lien transactions (i.e., Assured Guaranty will retain the risk of future insured losses without further offset for R&W claims against Bank of America).

In addition, Bank of America will reimburse Assured Guaranty 80% of claims Assured Guaranty pays on certain first lien transactions, until aggregate collateral losses on such RMBS transactions reach $6.6 billion. As of December 31, 2012, collateral losses for covered first lien transactions were $3.1 billion (of which $2.8 billion was related to AGM). Assured Guaranty estimates that cumulative projected collateral losses for the covered first lien transactions will be $5.1 billion. Assured Guaranty accounts for the 80% loss sharing agreement with Bank of America as subrogation. As Assured Guaranty calculates expected losses for these first lien transactions, such expected losses will be offset by an R&W benefit from Bank of America for 80% of these amounts. As of December 31, 2012, Bank of America had placed $316 million of eligible assets in trust in order to collateralize the reimbursement obligation relating to the first lien transactions. The amount of assets required to be posted may increase or decrease from time to time, as determined by rating agency requirements. A portion of the covered transactions are insured by the Company. As of December 31, 2012, and before cessions to reinsurers, AGM had collected $291 million, and had invoiced for an additional $17 million in claims paid in December 2012, and expected to collect an additional $254 million, on a discounted basis, for the covered first lien transactions under the Bank of America Agreement.

On May 8, 2012, Assured Guaranty reached a settlement with Deutsche Bank AG and certain of its affiliates (collectively, “Deutsche Bank”), resolving claims related to certain RMBS transactions issued, underwritten or sponsored by Deutsche Bank that were insured by Assured Guaranty under financial guaranty insurance policies and to certain RMBS exposures in re-securitization transactions as to which AGC provides credit protection through CDS. As part of the settlement agreement (the “Deutsche Bank Agreement”), Assured Guaranty settled its litigation against Deutsche Bank on three RMBS transactions.

Assured Guaranty received a cash payment of $166 million from Deutsche Bank upon signing of the Deutsche Bank Agreement, a portion of which partially reimbursed Assured Guaranty for past losses on certain transactions. Assured Guaranty and Deutsche Bank also entered into loss sharing arrangements covering future RMBS related losses, which are described below. Under the Deutsche Bank Agreement, Deutsche Bank AG placed eligible assets in trust in order to collateralize the obligations of a reinsurance affiliate under the loss-sharing arrangements. The Deutsche Bank reinsurance affiliate may be required to post additional collateral in the future to satisfy rating agency requirements. As of December 31, 2012, the balance of the assets held in trust of $44 million was sufficient to fully collateralize Deutsche Bank's obligations, based on the Company's estimate of expected loss for the transactions covered under the agreement.

The settlement includes six AGM and two AGC RMBS transactions (“Covered Transactions”) insured through financial guaranty insurance policies. The Covered Transactions are backed by first lien and second lien mortgage loans. Under the Deutsche Bank Agreement, the Deutsche Bank reinsurance affiliate will reimburse 80% of Assured Guaranty’s future losses on the Covered Transactions until Assured Guaranty’s aggregate losses (including those to date that are partially reimbursed by the $166 million cash payment) reach $319 million. Assured Guaranty currently projects that in the base case the Covered Transactions will not generate aggregate losses in excess of $319 million. In the event aggregate losses exceed $389 million, the Deutsche Bank reinsurance affiliate is required to resume reimbursement at the rate of 85% of Assured Guaranty’s losses in excess of $389 million until such losses reach $600 million. The six AGM Covered Transactions represented $438 million of gross par outstanding ($323 million on a net basis) as of December 31, 2012. AGM and AGC will be reimbursed under the Deutsche Bank Agreement for their respective future losses on the Covered Transactions as they pay claims on such Covered Transactions, and Assured Guaranty quarterly will allocate such reimbursements between the six insurers pro rata based on the cumulative amounts, net of recoveries, paid to date by each insurer with respect to the Covered Transactions.

As of December 31, 2012 and before cessions to reinsurers, the Company collected $4 million and had invoiced for an additional $2 million in claims paid in the fourth quarter 2012.

The settlement does not include AGM's CDS with Deutsche Bank. The parties have agreed to continue efforts to resolve CDS-related claims.

In the fourth quarter of 2012, AGM reached agreement with another R&W provider in an RMBS securitization transaction to repurchase underlying loans in that transaction. Such amount was applied by the securities administrator to the transaction's flow of funds and is available to support the R&W benefit on this transaction, as of December 31, 2012 of $81 million.

The Company has included in its net expected loss estimates as of December 31, 2012 an estimated benefit from loan repurchases related to breaches of R&W of $960 million, which includes $470 million from agreements with and judgments against R&W providers and $490 million in transactions where the Company does not yet have such an agreement or judgment. (Included in $470 million is a credit for amounts awarded in a judgment subject to appeal). Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have no effect on the amount of the Company's exposure. See "Recovery Litigation" below for a description of the related legal proceedings the Company has commenced.

The Company's success in pursuing breaches of R&W is based upon a detailed review of loan files. The Company reviewed approximately 28,300 second lien and 6,000 first lien loan files (representing approximately $2,173 million and $2,044 million, respectively, of loans) in transactions as to which it eventually reached agreements or won judgment. For the RMBS transactions as to which the Company had not settled its claims or won a judgment for breaches of R&W as of December 31, 2012, the Company had performed a detailed review of approximately 2,800 second lien and 20,800 first lien loan files, representing approximately $203 million in second lien and $6,575 million in first lien outstanding par of loans underlying insured transactions. In the majority of its loan file reviews, the Company identified breaches of one or more R&W regarding the characteristics of the loans, such as misrepresentation of income or employment of the borrower, occupancy, undisclosed debt and non-compliance with underwriting guidelines at loan origination.

Through December 31, 2012 (but including judgments and settlements reached through February 28, 2013) the Company has caused entities providing R&Ws to pay or agree to pay (or has won a judgment requiring them to pay) approximately $2.2 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided a financial guaranty. Of this, $1.8 billion are payments made or to be made pursuant to agreements with or judgments against R&W providers and approximately $375 million are amounts paid into the relevant RMBS financial guaranty transactions pursuant to the transaction documents in the regular course.

The $1.8 billion of payments made or to be made by R&W providers under agreements with the Company or a judgment against them includes $1.3 billion that has already been received by the Company, as well as $496 million the Company projects receiving in the future pursuant to such currently existing agreements or judgment. Because much of that $496 million is projected to be received through loss-sharing arrangements, the exact amount the Company will receive will depend on actual losses experienced by the covered transactions. This amount is included in the Company's calculated credit for R&W recoveries, described below.

The $375 million paid, by R&W providers were paid in the regular course into the relevant RMBS transactions in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions. However, such payments do reduce collateral pool losses and so usually reduce the Company's expected losses.

The Company did not incorporate any gain contingencies or damages paid from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized.

The calculation of expected recovery from breaches of R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future.

U.S. RMBS Risks with R&W Benefit

	Number of Risks(1) as of		Debt Service as of	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
	(dollars in millions)			
Alt-A first lien	10	11	$ 1,023	$ 1,261
Option ARM	7	10	604	1,240
Subprime	5	5	810	892
Closed-end second lien	2	2	120	219
HELOC(2)	5	12	443	2,171
Total	29	40	$ 3,000	$ 5,783

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments.

(2) The decline in number of HELOC risks and Debt Service relates to the final payment from Bank of America for covered HELOC transactions.

The following table provides a breakdown of the development and accretion amount in the roll forward of estimated recoveries associated with alleged breaches of R&W.

	Year Ended December 31,	
	2012	2011
	(in millions)	
Inclusion or removal of deals with breaches of R&W during period	$ 2	$ 80
Change in recovery assumptions as the result of additional file review and recovery success	40	229
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	63	(46)
Results of settlements/judgments	29	433
Accretion of discount on balance	7	15
Total	$ 141	$ 711

The Company assumes that recoveries on second lien transactions that were not subject to the Deutsche Bank Agreement will occur in two to four years from the balance sheet date depending on the scenarios and that recoveries on transactions backed by Alt-A first lien, Option ARM and Subprime loans will occur as claims are paid over the life of the transactions.

The quality of servicing of the mortgage loans underlying an RMBS transaction influences collateral performance and ultimately the amount (if any) of the Company's insured losses. The Company has established a group to mitigate RMBS losses by influencing mortgage servicing, including, if possible, causing the transfer of servicing or establishing special servicing arrangements. “Special servicing” is an industry term referencing more intense servicing applied to delinquent loans aimed at mitigating losses. Special servicing arrangements provide incentives to a servicer to achieve better performance on the mortgage loans it services. As a result of the Assured Guaranty’s efforts, as of February 28, 2013 the servicing of approximately $3.0 billion of mortgage loans had been transferred to a new servicer and another $1.7 billion of mortgage loans were subject to special servicing arrangements. The December 31, 2012 net insured par of the transactions subject to a servicing transfer was $2.7 billion and the net insured par of the transactions subject to a special servicing arrangement was $0.9 billion.

Selected U.S. Public Finance Transactions

U.S. municipalities and related entities have been under increasing pressure over the last few quarters, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. The

Company expects that bondholder rights will be enforced. However, given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code are: Jefferson County, Alabama and Stockton, California. The City Council of Harrisburg, Pennsylvania had also filed a purported bankruptcy petition, which was later dismissed by the bankruptcy court; a receiver for the City of Harrisburg was appointed by the Commonwealth Court of Pennsylvania on December 2, 2011.

The Company has net exposure to Jefferson County, Alabama of $286 million as of December 31, 2012. On November 9, 2011, Jefferson County filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Part of the Company's net Jefferson County exposure relates to $125 million in sewer revenue exposure. The sewer revenue warrants are secured by a pledge of the net revenues of the sewer system. The bankruptcy court has affirmed that the net revenues constitute a "special revenue" under Chapter 9. Therefore, the lien on net revenues of the sewer system survives the bankruptcy filing and such net revenues are not subject to the automatic stay during the pendency of Jefferson County's bankruptcy case. BNY Mellon, as trustee, had brought a lawsuit regarding the amount of net revenues to which it is entitled. Since its bankruptcy filing, Jefferson County had been withholding estimated bankruptcy-related legal expenses and an amount representing a monthly reserve for future expenditures and depreciation and amortization from the monthly payments it had been making to the trustee from sewer revenues for Debt Service. On June 29, 2012, the Bankruptcy Court ruled that "Operating Expenses" as determined under the bond indenture do not include (1) a reserve for depreciation, amortization, or future expenditures, or (2) an estimate for professional fees and expenses, such that, after payment of Operating Expenses (as defined in the indenture), monies remaining in the Revenue Account created under the bond indenture must be distributed in accordance with the waterfall set forth in the indenture without withholding any monies for depreciation, amortization, reserves, or estimated expenditures that are the subject of this litigation. Whether sufficient net revenues will be available for the payment of regularly scheduled debt service ultimately depends on the bankruptcy court's valuation of the sewer revenue stream. The Company's remaining net exposure of $161 million to Jefferson County relates to obligations that are secured by, or payable from, certain taxes that may have the benefit of a statutory lien or a lien on "special revenues" or other collateral.

On June 28, 2012, the City of Stockton, California filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to Stockton's general fund is $64 million, consisting of pension obligation bonds. As of December 31, 2012, the Company had paid $4 million in net claims.

The Company has $130 million of net par exposure to The City of Harrisburg, Pennsylvania, of which $69 million is BIG. The Company has paid $11 million in net claims as of December 31, 2012, and expects a full recovery.

The Company has $23 million remaining in net par exposure to bonds secured by the excess free cash flow of the Foxwoods Casino, run by the Mashantucket Pequot Tribe. The Company had paid $74 million in net claims as of December 31, 2012, and expects full recovery of such amount.

The Company projects that its total future expected net recovery across its troubled U.S. public finance credits (after projected recoveries of claims already paid) will be $58 million as of December 31, 2012, up from $35 million as of December 31, 2011. This increase was due primarily to the increase in expected recoveries on Foxwoods Casino.

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish regions where a Spanish sovereign default causes the regions also to default. The Company's gross exposure to these credits is €435 million and its exposure net of reinsurance is €274 million. During 2012, the Company downgraded most of these exposures to the BB category due to concerns that these regions would not pay under their contractual obligations. As a result the Company estimated a net expected loss of $31 million compared to none as of December 31, 2011. During 2012 the Company paid $183 million in net claims in respect of the €314 million (€146 million net) Greek sovereign bonds it had guaranteed, and no longer has any direct financial guaranty exposure to Greece. Information regarding the Company's exposure to other Selected European Countries may be found under Note 3, Outstanding Exposure, –Economic Exposure to the Selected European Countries.

Manufactured Housing

The Company insures a total of $217 million net par of securities backed by manufactured housing loans, a total of $128 million rated BIG. The Company has expected loss to be paid of $21 million as of December 31, 2012 compared to $18 million as of December 31, 2011.

Infrastructure Finance

The Company has exposure to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued; the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. For the three largest transactions with significant refinancing risk, the Company may be exposed to, and subsequently recover, payments aggregating $1.4 billion. These transactions generally involve long-term infrastructure projects that are financed by bonds that mature prior to the expiration of the project concession. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, the Company expected it to be refinanced in the market at or prior to its maturity. Due to market dislocation and increased credit spreads, the Company may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments may take a long time and is uncertain. The claim payments are anticipated to occur substantially between 2014 and 2017, while the recoveries could take 20-45 years, depending on the transaction and the performance of the underlying collateral.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM has lawsuits pending against a number of providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages. In all the lawsuits, AGM has alleged breaches of R&W in respect of the underlying loans in the transactions, and failure to cure or repurchase defective loans identified by AGM to such persons. In addition, in the lawsuits against DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) and UBS Real Estate Securities Inc. ("UBS"), AGM has alleged breaches of contract in procuring falsely inflated shadow ratings (a condition to the issuance by AGM of its policies) by providing false and misleading information to the rating agencies:

- **Flagstar**: AGM has sued Flagstar Bank, FSB, Flagstar Capital Markets Corporation and Flagstar ABS, LLC in the United States District Court for the Southern District of New York on the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 second lien transactions. On February 5, 2013, the court granted judgment in favor of AGM on its claims for breach of contract plus contractual interest and attorneys' fees and costs to be determined. On April 1, 2013, the court issued a final judgment awarding AGM damages of $90.7 million and pre-judgment interest of $15.9 million, for a total of $106.5 million. The court deferred ruling on AGM's requests for attorneys' fees and expenses until the resolution of any appeal by Flagstar of the final judgment. On April 10, 2013, Flagstar Bank filed a notice of appeal indicating that it appeals both the February 5, 2013 order and the April 1, 2013 final judgment.

- **Deutsche Bank**: AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. in the Supreme Court of the State of New York on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

- **ResCap**: AGM has sued GMAC Mortgage, LLC (formerly GMAC Mortgage Corporation; Residential Asset Mortgage Products, Inc.; Ally Bank (formerly GMAC Bank); Residential Funding Company, LLC (formerly Residential Funding Corporation); Residential Capital, LLC (formerly Residential Capital Corporation, "ResCap"); Ally Financial (formerly GMAC, LLC); and Residential Funding Mortgage Securities II, Inc. in the United States District Court for the Southern District of New York on the GMAC RFC Home Equity Loan-Backed Notes, Series 2006-HSA3 and GMAC Home Equity Loan-Backed Notes, Series 2004-HE3 second lien transactions. On May 14, 2012, ResCap and several of its affiliates (the “Debtors”) filed for Chapter 11 protection with the U.S. Bankruptcy Court. The automatic stay of Bankruptcy Code Section 362 (a) stays lawsuits (such as the suit brought by AGM) against the Debtors and AGM, the Debtors and the non-Debtor affiliates have filed a stipulation with the court agreeing to extend the stay to the non-Debtor affiliates until April 30, 2013.

- **Credit Suisse**: AGM and its affiliate AGC have sued DLJ and Credit Suisse in the Supreme Court of the State of New York on first lien U.S. RMBS transactions insured by them. The ones insured by AGM are: CSAB Mortgage-Backed Pass Through Certificates, Series 2006-2; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-3; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-4; and CMSC Mortgage-Backed Pass Through Certificates, Series 2007-3. On December 6, 2011, DLJ and Credit Suisse filed a motion to dismiss the cause of action asserting breach of the document containing the condition precedent regarding the rating of the securities and claims for recissionary damages and other relief in the complaint, and on October 11, 2012, the Supreme Court of the State of New York granted the motion to dismiss. AGM and AGC intend to appeal the dismissal of certain of its claims. The causes of action against DLJ for breach of R&W and breach of its repurchase obligations remain.

- **UBS**: AGM has sued UBS in the Supreme Court of the State of New York on the MASTR Adjustable Rate Mortgages Trust 2006-OA2, MASTR Adjustable Rate Mortgages Trust 2007-1 and MASTR Adjustable Rate Mortgages Trust 2007-3 first lien transactions. The case was later removed to the United States District Court for the Southern District of New York. In April 2012, UBS filed a motion to dismiss the complaint and in August 2012, the court rejected the motion to dismiss as to AGM's claims of breach of R&W and for recissory damages. It also upheld AGM's breach of warranty claim related to the shadow ratings issued with respect to the transactions. The motion to dismiss was granted against AGM's claims for breach of the repurchase obligation, which the court held could only be enforced by the trustee of the applicable trusts, and for declaratory judgments that UBS failed to cure breaches and for reimbursement of all insurance payments made to UBS. On September 28, 2012, at the direction of AGM, the trustee of the trusts filed a breach of contract complaint against UBS on behalf of the applicable trusts.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, “RBS”) in the United States District Court for the Southern District of New York on the Soundview Home Loan Trust 2007-WMC1 transaction. The complaint alleges that RBS made fraudulent misrepresentations to AGM regarding the quality of the underlying mortgage loans in the transaction and that RBS's misrepresentations induced AGM into issuing a financial guaranty insurance policy in respect of the Class II-A-1 certificates issued in the transaction.

AGM also has a lawsuit pending against UBS Securities LLC, as underwriter, as well as several named and unnamed control persons of IndyMac Bank, FSB and related IndyMac entities, that it filed in September 2010 in California state court on the IndyMac IMSC Mortgage Loan Trust, Series 2007-HOA-1a first lien transaction (the "HOA1 Transaction"), seeking damages for alleged violations of state securities laws and breach of contract, among other claims. In addition, on August 9, 2012, AGM filed a complaint in California state court against OneWest Bank, FSB, the servicer of the mortgage loans underlying the HOA1 Transaction and the IndyMac Home Equity Mortgage Loan Asset-Backed Trust, Series 2007-H1 HELOC transaction seeking damages, specific performance and declaratory relief in connection with OneWest failing to properly service the mortgage loans.

Public Finance Transactions

In June 2010, AGM sued JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc. (together, “JPMorgan”), the underwriter of debt issued by Jefferson County, in the Supreme Court of the State of New York alleging that JPMorgan induced AGM to issue its insurance policies in respect of such debt through material and fraudulent misrepresentations and omissions, including concealing that it had secured its position as underwriter and swap provider through bribes to Jefferson County commissioners and others. In December 2010, the court denied JPMorgan’s motion to dismiss. AGM has filed a motion with the Jefferson County bankruptcy court to confirm that continued prosecution of the lawsuit against JPMorgan will not violate the automatic stay applicable to Jefferson County notwithstanding JPMorgan’s interpleading of Jefferson County into the lawsuit. AGM is continuing its risk remediation efforts for this exposure.

In September 2010, AGM, together with TD Bank, National Association and Manufacturers and Traders Trust Company, as trustees, filed a complaint in the Court of Common Pleas of Dauphin County, Pennsylvania against The Harrisburg Authority, The City of Harrisburg, Pennsylvania, and the Treasurer of the City in connection with certain Resource Recovery Facility bonds and notes issued by The Harrisburg Authority, alleging, among other claims, breach of contract by both The Harrisburg Authority and The City of Harrisburg, and seeking remedies including an order of mandamus compelling the City to satisfy its obligations on the defaulted bonds and notes and the appointment of a receiver for The Harrisburg Authority. Acting on its own, the City Council of Harrisburg filed a purported bankruptcy petition for the City in October 2011, which petition and a subsequent appeal were dismissed by the bankruptcy court in November 2011. The City Council appealed the dismissal of the appeal and such appeal was dismissed as untimely both by the District Court and the Third Circuit Court of Appeals. As a result of the dismissal, the actions brought by AGM and the trustees against The City of Harrisburg and The Harrisburg Authority are no longer stayed. A receiver for The City of Harrisburg (the “City Receiver”) was appointed by the Commonwealth Court of Pennsylvania in December 2011. The City Receiver filed a motion to intervene in the mandamus action and action for the appointment of a receiver for the resource recovery facility. In March 2012, the Court of Common Pleas of Dauphin County, Pennsylvania issued an order granting the motion for the appointment of a receiver for the resource recovery facility, which order has been appealed by The Harrisburg Authority.

7. Financial Guaranty Insurance Losses

Accounting Policies

Loss and LAE Reserve

Loss and LAE reserve reported on the balance sheet relates only to direct and assumed reinsurance contracts that are accounted for as insurance, substantially all of which are financial guaranty insurance contracts. The corresponding reserve ceded to reinsurers is reported as reinsurance recoverable on unpaid losses. As discussed in Note 8, Fair Value Measurement, contracts that meet the definition of a derivative, as well as consolidated FG VIE assets and liabilities, are recorded separately at fair value.

Under financial guaranty insurance accounting, the sum of unearned premium reserve (deferred premium revenue, less claim payments that have not yet been expensed or "contra-paid"), and loss and LAE reserve represents the Company's stand-ready obligation. At contract inception, the entire stand-ready obligation is represented by unearned premium reserve. A loss and LAE reserve for an insurance contract is only recorded when the expected loss to be paid plus contra-paid (“total losses”) exceed the deferred premium revenue on a contract by contract basis.

When a claim payment is made on a contract it first reduces any recorded loss and LAE reserve. To the extent a loss and LAE reserve is not recorded on a contract, which occurs when total losses are less than deferred premium revenue, or to the extent loss and LAE reserve is not sufficient to cover a claim payment, then such claim payment is recorded as “contra-paid,” which reduces the unearned premium reserve. The contra-paid is recognized in the line item “loss and LAE” in the consolidated statement of operations when and for the amount that total losses exceed the remaining deferred premium revenue on the insurance contract. Loss and LAE in the consolidated statement of operations is presented net of cessions to reinsurers.

Salvage and Subrogation Recoverable

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

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

The Company recognizes the expected recovery of claim payments made by an acquired subsidiary, including recoveries from settlement with R&W providers, prior to the date of acquisition consistent with its policy for recognizing recoveries on all financial guaranty insurance contracts. To the extent that the estimated amount of recoveries increases or decreases, due to changes in facts and circumstances, including the examination of additional loan files and our experience in recovering loans put back to the originator, the Company would recognize a benefit or expense consistent with how changes in the expected recovery of all other claim payments are recorded. The ceded component of salvage and subrogation is recorded in the line item reinsurance balances payable.

Expected Loss to be Expensed

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

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves, net of reinsurance and salvage and subrogation recoverable.

Loss and LAE Reserve (Recovery),
Net of Reinsurance and Salvage and Subrogation Recoverable
Insurance Contracts

	As of December 31, 2012			As of December 31, 2011		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net
	(in millions)					
U.S. RMBS:						
First lien:						
Alt-A first lien	$ 52	$ —	$ 52	$ 31	$ 55	$ (24)
Option ARM	29	213	(184)	109	123	(14)
Subprime	78	—	78	42	—	42
Total first lien	159	213	(54)	182	178	4
Second lien:						
Closed-end second lien	—	71	(71)	0	68	(68)
HELOC	—	169	(169)	—	151	(151)
Total second lien	—	240	(240)	0	219	(219)
Total U.S. RMBS	159	453	(294)	182	397	(215)
Other structured finance	10	—	10	40	—	40
U.S. public finance	16	86	(70)	11	56	(45)
Non-U.S. public finance	23	—	23	28	—	28
Subtotal	208	539	(331)	261	453	(192)
Effect of consolidating FG VIEs	(53)	(217)	164	(43)	(191)	148
Total (1)	$ 155	$ 322	$ (167)	$ 218	$ 262	$ (44)

(1) See "Components of Net Reserves (Salvage)" table for loss and LAE reserve and salvage and subrogation recoverable components.

The following table reconciles the loss and LAE reserve and salvage and subrogation components on the consolidated balance sheet to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)
Insurance Contracts

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Loss and LAE reserve	$ 230	$ 297
Reinsurance recoverable on unpaid losses	(75)	(79)
Subtotal	155	218
Salvage and subrogation recoverable	(383)	(316)
Salvage and subrogation payable(1)	61	54
Subtotal	(322)	(262)
Financial guaranty net reserves (salvage)	$ (167)	$ (44)

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

Balance Sheet Classification of
Net Expected Recoveries for Breaches of R&W

	As of December 31, 2012			As of December 31, 2011		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)
	(in millions)					
Salvage and subrogation recoverable	$ 393	$ (170)	$ 223	$ 293	$ (131)	$ 162
Loss and LAE reserve	455	(11)	444	706	(31)	675

(1) The remaining benefit for R&W is not recorded on the balance sheet until the expected loss, net of R&W, exceeds unearned premium reserve.

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) for transactions with a net expected recovery, the addition of claim payments that have been made (and therefore are not included in expected loss to be paid) that are expected to be recovered in the future (and therefore have reduced expected loss to be paid), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

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

	As of December 31, 2012
	(in millions)
Net expected loss to be paid	$ 5
Less: net expected loss to be paid for FG VIEs	(112)
Total	117
Contra-paid, net	113
Salvage and subrogation recoverable, net of reinsurance	322
Loss and LAE reserve, net of reinsurance	(155)
Net expected loss to be expensed (1)	$ 397

(1) Excludes $150 million as of December 31, 2012 related to consolidated FG VIEs.

The following table provides a schedule of the expected timing of net expected losses to be expensed. The amount and timing of actual loss and LAE may differ from the estimates shown below due to factors such as refundings, accelerations, commutations, changes in expected lives and updates to loss estimates. A loss and LAE reserve is only recorded for the amount by which expected loss to be expensed exceeds deferred premium revenue determined on a contract-by-contract basis. This table excludes amounts related to consolidated FG VIEs, which are eliminated in consolidation.

Net Expected Loss to be Expensed
Insurance Contracts

	As of December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 18
2013 (April 1 - June 30)	18
2013 (July 1- September 30)	16
2013 (October 1 - December 31)	14
Subtotal 2013	66
2014	43
2015	37
2016	32
2017	32
2018-2022	108
2023-2027	46
2028-2032	20
After 2032	13
Total present value basis(1)	397
Discount	95
Total future value	$ 492

(1) Consolidation of FG VIEs resulted in reductions of $150 million in net expected loss to be expensed.

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

Loss and LAE Reported
on the Consolidated Statements of Operations

	Year Ended December 31,	
	2012	2011
	(in millions)	
U.S. RMBS:		
First lien:		
Alt-A first lien	$ 47	$ 47
Option ARM	112	242
Subprime	40	(9)
Total first lien	199	280
Second lien:		
Closed-end second lien	35	6
HELOC	29	117
Total second lien	64	123
Total U.S. RMBS	263	403
Other structured finance	(21)	25
U.S. public finance	25	14
Non-U.S. public finance	182	29
Subtotal	449	471
Effect of consolidating FG VIEs	(52)	(89)
Total loss and LAE	$ 397	$ 382

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
December 31, 2012

	BIG Categories								
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded	Total BIG, Net	Effect of Consolidating VIEs	Total
	(dollars in millions)								
Number of risks(1)	71	(66)	21	(21)	50	(50)	142	—	142
Remaining weighted-average contract period (in years)	9.5	9.6	9.3	15.6	5.3	6.8	7.4	—	7.4
Outstanding exposure:									
Principal	$ 6,004	$ (2,281)	$ 1,820	$ (180)	$ 4,680	$ (788)	$ 9,255	$ —	$ 9,255
Interest	2,583	(893)	982	(179)	1,157	(240)	3,410	—	3,410
Total(2)	$ 8,587	$ (3,174)	$ 2,802	$ (359)	$ 5,837	$ (1,028)	$ 12,665	$ —	$ 12,665
Expected cash outflows (inflows)	$ 1,535	$ (900)	$ 733	$ (64)	$ 1,827	$ (250)	$ 2,881	$ (617)	$ 2,264
Potential recoveries(3)	(1,586)	883	(475)	22	(1,818)	209	(2,765)	713	(2,052)
Subtotal	(51)	(17)	258	(42)	9	(41)	116	96	212
Discount	(2)	6	(78)	15	(59)	7	(111)	16	(95)
Present value of expected cash flows	$ (53)	$ (11)	$ 180	$ (27)	$ (50)	$ (34)	$ 5	$ 112	$ 117
Deferred premium revenue	$ 93	$ (36)	$ 211	$ (17)	$ 728	$ (122)	$ 857	$ (244)	$ 613
Reserves (salvage)(4)	$ (100)	$ 6	$ 49	$ (15)	$ (266)	$ (5)	$ (331)	$ 164	$ (167)

Financial Guaranty Insurance
BIG Transaction Loss Summary
December 31, 2011

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	77	(73)	26	(26)	47	(47)	150	—	150
Remaining weighted-average contract period (in years)	7.9	9.5	12.3	20.6	6.2	6.6	7.5	—	7.5
Outstanding exposure:									
Principal	$ 6,721	$ (2,084)	$ 2,727	$ (415)	$ 4,914	$ (844)	$ 11,019	$ —	$ 11,019
Interest	2,269	(732)	2,002	(575)	1,337	(234)	4,067	—	4,067
Total(2)	$ 8,990	$ (2,816)	$ 4,729	$ (990)	$ 6,251	$ (1,078)	$ 15,086	$ —	$ 15,086
Expected cash outflows (inflows)	$ 1,590	$ (871)	$ 1,470	$ (141)	$ 1,749	$ (165)	$ 3,632	$ (877)	$ 2,755
Potential recoveries(3)	(1,657)	882	(910)	45	(1,690)	122	(3,208)	892	(2,316)
Subtotal	(67)	11	560	(96)	59	(43)	424	15	439
Discount	17	(6)	(180)	37	8	3	(121)	46	(75)
Present value of expected cash flows	$ (50)	$ 5	$ 380	$ (59)	$ 67	$ (40)	$ 303	$ 61	$ 364
Deferred premium revenue	$ 250	$ (91)	$ 265	$ (15)	$ 962	$ (169)	$ 1,202	$ (386)	$ 816
Reserves (salvage)(4)	$ (92)	$ 14	$ 201	$ (49)	$ (276)	$ 10	$ (192)	$ 148	$ (44)

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes estimated future recoveries for breaches of R&W as well as excess spread, and draws on HELOCs.

(4) See table "Components of net reserves (salvage)."

Ratings Impact on Financial Guaranty Business

A downgrade of the Company may result in increased claims under financial guaranties issued by the Company if the insured obligors were unable to pay.

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. The claim payments would be subject to recovery from the municipal obligor. As a result of the January 2013 Moody's downgrade of the financial strength rating of AGM, if the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an amount not exceeding $109 million in respect of such termination payments. Taking into consideration whether the rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding $258 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of December 31, 2012, AGM had insured approximately $8.2 billion net par of VRDOs, of which approximately $338 million of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company’s internal rating. As of the date of this filing, the Company has not been notified that a bank has terminated a liquidity facility as a result of the January 2013 Moody's downgrade, nor has there been a failed remarketing of the AGM VRDOs, although in some cases, VRDOs insured by AGM have remarketed at higher interest rates. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

8. Fair Value Measurement

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

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party’s proprietary pricing models. In addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company’s credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company’s creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During 2012, no changes were made to the Company’s valuation models that had or are expected to have, a material impact on the Company’s consolidated balance sheets or statements of operations and comprehensive income.

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

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

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

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

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

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1 and Level 2. The committed capital securities ("CCS") were transferred to Level 3 in the fair value hierarchy in the third quarter 2011 because the Company was no longer able to obtain the same level of pricing information as in past quarters. There were no transfers in or out of Level 3 during 2012.

In May 2011, the FASB issued new guidance that develops common requirements for measuring fair value and for disclosing information about fair value measurements to improve the comparability of financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. The new guidance clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value, and requires additional disclosures about fair value measurements. The amendments were adopted in the first quarter of 2012. The Company did not have an impact on its financial position and results of operations as a result of these amendments.

Measured and Carried at Fair Value

Fixed Maturity Securities and Short-term Investments

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news. The market inputs used in the pricing evaluation, listed in the approximate order of priority include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently. The extent of the use of each input is dependent on the asset class and the market conditions. Given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur. The vast majority of fixed maturities are classified as Level 2.

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

Prices determined based upon model processes where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. At December 31, 2012, the Company used model processes to price 23 fixed maturity securities, which was 8% or $445 million of the Company's fixed-maturity securities and short-term investments at fair value. Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); house price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

Other invested assets includes certain investments that are carried and measured at fair value on a recurring basis and non-recurring basis, as well as assets not carried at fair value. Within other invested assets, $89 million are carried at fair value on a recurring basis as of December 31, 2012. These assets primarily comprise certain short-term investments and fixed maturity securities classified as trading and are Level 2 in the fair value hierarchy. Also carried at fair value on a recurring basis are $1 million in notes classified as Level 3 in the fair value hierarchy. The fair value of these notes is determined by calculating the present value of the expected cash flows. The unobservable inputs used in the fair value measurement of the notes are discount rate, prepayment speed and default rate.

Within other invested assets, $7 million are carried at fair value on a non-recurring basis as of December 31, 2012. These assets are comprised of mortgage loans which are classified as Level 3 in the fair value hierarchy as there are significant unobservable inputs used in the valuation of such loans. The non-performing portion of these mortgage loans is valued using an average recovery rate. The performing loans are valued using management's determination of future cash flows arising from these loans, discounted at the rate of return that would be required by a market participant. The unobservable inputs used in the fair value measurement of the mortgage loans are discount rate, recovery on delinquent loans, loss severity, prepayment speed and default rate.

Other Assets

Committed Capital Securities

The fair value of CCS, which is recorded in "other assets" on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGM Committed Preferred Trust Securities (the "AGM CPS Securities") agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 17, Notes Payable and Credit Facilities). The estimated current cost of the Company's CCS depends on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

In the third quarter 2011, these securities were transferred to Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including a broker-dealer quote and the Company's estimate of the term the securities will be outstanding. Prior to the third quarter 2011, the significant market inputs used were observable; therefore, the Company classified this fair value measurement as Level 2. The Company is no longer able to obtain the same level of pricing information as in past quarters.

Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The Company does not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. Such terminations generally are completed for an amount that approximates the present value of future premiums, not at fair value.

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

Due to the lack of quoted prices for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the fair value of the Company's contracts in principal markets. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Management does not believe there is an established market where financial guaranty insured credit derivatives are actively traded. The terms of the protection under an insured financial guaranty credit derivative do not, except for certain rare circumstances, allow the Company to exit its contracts. Management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The Company's models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely and relevant market information.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining net premiums the Company expects to receive or pay for the credit protection under the contract and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay the Company for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual cash flows are the most readily observable inputs since they are based on the CDS contractual terms. These cash flows include premiums to be received or paid under the terms of the contract. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity also affects valuations of the underlying obligations. Market conditions at December 31, 2012 were such that market prices of the Company's CDS contracts were not available. Since market prices were not available, the Company used proprietary valuation models that used both unobservable and observable market data inputs as described under "Assumptions and Inputs" below. These models are primarily developed internally based on market conventions for similar transactions.

Valuation models include management estimates and current market information. Management is also required to make assumptions of how the fair value of credit derivative instruments is affected by current market conditions. Management considers factors such as current prices charged for similar agreements, when available, performance of underlying assets, life of the instrument, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine the fair value may change in the future due to market conditions. Due to the inherent uncertainties of the assumptions used in the valuation models to determine the fair value of these credit derivative products, actual experience may differ from the estimates reflected in the Company's consolidated financial statements and the differences may be material.

Assumptions and Inputs

Listed below are various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts.

- How gross spread is calculated.
- The allocation of gross spread among:
    - the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction ("bank profit");
    - premiums paid to the Company for the Company's credit protection provided ("net spread"); and
    - the cost of CDS protection purchased by the originator to hedge their counterparty credit risk exposure to the Company ("hedge cost").
- The weighted average life which is based on expected remaining contractual cash flows and Debt Service schedules, which are readily observable inputs since they are based on the CDS contractual terms.
- The rates used to discount future expected cash flows.

The expected future premium cash flows for the Company's credit derivatives were discounted at rates ranging from 0.25% to 2.8% at December 31, 2012 and 0.3% to 2.7% at December 31, 2011.

Gross spread is used to ultimately determine the net spread a comparable financial guarantor would charge the Company to transfer its risk at the reporting date. The Company obtains gross spreads on risks assumed from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within the Company's transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resemble the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. These indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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

The following spread hierarchy is utilized in determining which source of gross spread to use, with the rule being to use CDS spreads where available. If not available, the Company either interpolates or extrapolates CDS spreads based on similar transactions or market indices.

- Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available).
- Deals priced or closed during a specific quarter within a specific asset class and specific rating.
- Credit spreads interpolated based upon market indices.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Information by Credit Spread Type

	As of December 31, 2012	As of December 31, 2011
Based on actual collateral specific spreads	0%	0%
Based on market indices	100%	100%
Total	100%	100%

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or management's assessment that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions' current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness.

The premium the Company receives is referred to as the "net spread." The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGM. For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 82%, as of December 31, 2012 and approximately 93% as of December 31, 2011 of the Company's CDS contracts are fair valued using this minimum premium. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGM. This reduces the amount of contractual cash flows AGM can capture as premium for selling its protection.

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

A fair value resulting in a credit derivative asset on protection sold is the result of contractual cash inflows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize a gain representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Example

Following is an example of how changes in gross spreads, the Company's own credit spread and the cost to buy protection on the Company affect the amount of premium the Company can demand for its credit protection. The assumptions used in these examples are hypothetical amounts. Scenario 1 represents the market conditions in effect on the transaction date and Scenario 2 represents market conditions at a subsequent reporting date.

	Scenario 1		Scenario 2	
	bps	% of Total	bps	% of Total
Original gross spread/cash bond price (in bps)	185		500	
Bank profit (in bps)	115	62%	50	10%
Hedge cost (in bps)	30	16%	440	88%
The Company premium received per annum (in bps)	40	22%	10	2%

In Scenario 1, the gross spread is 185 basis points. The bank or deal originator captures 115 basis points of the original gross spread and hedges 10% of its exposure to AGM, when the CDS spread on AGM was 300 basis points (300 basis points × 10% = 30 basis points). Under this scenario the Company received premium of 40 basis points, or 22% of the gross spread.

In Scenario 2, the gross spread is 500 basis points. The bank or deal originator captures 50 basis points of the original gross spread and hedges 25% of its exposure to AGM, when the CDS spread on AGM was 1,760 basis points (1,760 basis points × 25% = 440 basis points). Under this scenario the Company would receive premium of 10 basis points, or 2% of the gross spread. Due to the increased cost to hedge AGM's name, the amount of profit the bank would expect to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

Strengths and Weaknesses of Model

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

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

- The model takes into account the transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.

- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by the Company to be the key parameters that affect fair value of the transaction.

- The model is a consistent approach to valuing positions. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

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

- There is no exit market or actual exit transactions. Therefore the Company’s exit market is a hypothetical one based on the Company’s entry market.

- There is a very limited market in which to validate the reasonableness of the fair values developed by the Company’s model.

- At December 31, 2012 and 2011, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

As of December 31, 2012 these contracts were classified as Level 3 in the fair value hierarchy because there is a reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of non-standard terms and conditions of its credit derivative contracts and of amount of protection purchased on AGM's name.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all FG VIEs assets and liabilities. See Note 10, Consolidation of Variable Interest Entities.

The FG VIEs that are consolidated by the Company issued securities collateralized by HELOCs, first lien and second lien RMBS, subprime automobile loans, and other loans and receivables. The lowest level input that is significant to the fair value measurement of these assets and liabilities in its entirety was a Level 3 input (i.e. unobservable), therefore management classified them as Level 3 in the fair value hierarchy. Prices were generally determined with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach and the third-party's proprietary pricing models. The models to price the FG VIEs' liabilities used, where appropriate, inputs such as estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; house price depreciation/appreciation rates based on macroeconomic forecasts and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the FG VIE tranches insured by the Company, taking into account the timing of the potential default and the Company's own credit rating. These inputs are utilized to project the future cash flows of the security and to evaluate the overall bond profile. The third-party also utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithm's designed to aggregate market color, received by the third-party, on comparable bonds.

Changes in fair value of the FG VIEs' assets and liabilities are included in fair value gains (losses) on FG VIEs within the consolidated statement of operations. Except for net credit impairment that triggers a claim on the financial guaranty contract (i.e. net expected loss to be paid as described in Note 6), the unrealized fair value gains (losses) related to the consolidated FG VIEs will reverse to zero over the terms of these financial instruments.

The fair value of the Company's FG VIE assets is sensitive to changes related to estimated prepayment speeds; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. Significant changes to some of these inputs could materially change the market value of the FG VIE's assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIE asset is most sensitive to changes in the projected collateral losses, where an increase in collateral losses typically leads to a decrease in the fair value of FG VIE assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIE assets. These factors also directly impact the fair value of the Company's FG VIE liabilities.

The fair value of the Company's FG VIE liabilities is also sensitive to changes relating to estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. In addition, the Company's FG VIE liabilities with recourse are also sensitive to changes in the Company's implied credit worthiness. Significant changes to any of these inputs could materially change the timing of expected losses within the insured transaction which is a significant factor in determining the implied benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the tranches of debt issued by the FG VIE that is insured by the Company. In general, extending the timing of expected loss payments by the Company into the future typically leads to a decrease in the value of the Company's insurance and a decrease in the fair value of the Company's FG VIE liabilities with recourse, while a shortening of the timing of expected loss payments by the Company typically leads to an increase in the value of the Company's insurance and an increase in the fair value of the Company's FG VIE liabilities with recourse.

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

The fair value of the Company's financial guaranty contracts accounted for as insurance was based on management's estimate of what a similarly rated financial guaranty insurance company would demand to acquire the Company's in-force book of financial guaranty insurance business. This amount was based on the pricing assumptions management has observed for portfolio transfers that have occurred in the financial guaranty market and included adjustments to the carrying value of unearned premium reserve for stressed losses, ceding commissions and return on capital. The significant inputs were not readily observable. The Company accordingly classified this fair value measurement as Level 3.

Other Invested Assets

Other invested assets primarily consist of a surplus note issued by AGC to AGM (see note 15, Related Party Transactions) and assets acquired in refinancing transactions. The fair value of the surplus note was determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period.

The fair value of the assets acquired in refinancing transactions was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, including LIBOR curve projections and prepayment and default assumptions. The fair value measurement was classified as Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including the discount rates, prepayment and default assumptions, loss severity and recovery on delinquent loans.

Other Assets and Other Liabilities

The Company’s other assets and other liabilities consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.

Notes Payable

The fair value of the notes payable was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, if applicable, including LIBOR curve projections, prepayment and default assumptions, and AGM CDS spreads. The fair value measurement was classified as Level 3 in the fair value hierarchy.

Loan Receivable from Affiliate

The fair value of the Company's loan receivable from affiliate is determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period.

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2012

		Fair Value Hierarchy		
	Fair Value	Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 93	$ —	$ 93	$ —
Obligations of state and political subdivisions	3,503	—	3,491	12
Corporate securities	230	—	230	—
Mortgage-backed securities:				
RMBS	359	—	175	184
Commercial mortgage-backed security ("CMBS")	103	—	103	—
Asset-backed securities	341	—	92	249
Foreign government securities	202	—	202	—
Total fixed maturity securities	4,831	—	4,386	445
Short-term investments	473	308	165	—
Other invested assets (1)	97	—	89	8
Credit derivative assets	131	—	—	131
FG VIEs' assets, at fair value	1,870	—	—	1,870
Other assets(2)	14	—	—	14
Total assets carried at fair value	$ 7,416	$ 308	$ 4,640	$ 2,468
Liabilities:				
Credit derivative liabilities	$ 414	$ —	$ —	$ 414
FG VIEs' liabilities with recourse, at fair value	1,605	—	—	1,605
FG VIEs' liabilities without recourse, at fair value	678	—	—	678
Total liabilities carried at fair value	$ 2,697	$ —	$ —	$ 2,697

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2011

	Fair Value	Fair Value Hierarchy Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 86	$ —	$ 86	$ —
Obligations of state and political subdivisions	3,597	—	3,587	10
Corporate securities	208	—	208	—
Mortgage-backed securities:				
RMBS	344	—	239	105
CMBS	104	—	104	—
Asset-backed securities	335	—	124	211
Foreign government securities	242	—	242	—
Total fixed maturity securities	4,916	—	4,590	326
Short-term investments	412	135	277	—
Other invested assets (1)	44	—	33	11
Credit derivative assets	140	—	—	140
FG VIEs' assets, at fair value	2,057	—	—	2,057
Other assets(2)	22	—	—	22
Total assets carried at fair value	$ 7,591	$ 135	$ 4,900	$ 2,556
Liabilities:				
Credit derivative liabilities	$ 456	$ —	$ —	$ 456
FG VIEs' liabilities with recourse, at fair value	1,926	—	—	1,926
FG VIEs' liabilities without recourse, at fair value	704	—	—	704
Total liabilities carried at fair value	$ 3,086	$ —	$ —	$ 3,086

(1) Includes mortgage loans that are recorded at fair value on a non-recurring basis. At December 31, 2012 and December 31, 2011, such investments were carried at their market value of $7 million and $9 million, respectively.

(2) Includes fair value of CCS.

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during the years ended December 31, 2012 and 2011.

Fair Value Level 3 Rollforward
Recurring Basis
Year Ended December 31, 2012

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
					(in millions)				
Fair value as of December 31, 2011	$ 10	$ 105	$ 211	$ 2	$ 2,057	$ 22	$ (316)	$ (1,926)	$ (704)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	— (2)	13 (2)	27 (2)	0	273 (3)	(8) (4)	52 (6)	(233) (3)	(110) (3)
Other comprehensive income (loss)	1	11	20	(1)	—	—	—	—	—
Purchases	1	95	18	—	—	—	—	—	—
Settlements	—	(40)	(27)	—	(468)	—	(19)	482	136
FG VIE consolidations	—	—	—	—	8	—	—	(10)	—
FG VIE elimination	—	—	—	—	—	—	—	82	—
Fair value as of December 31, 2012	$ 12	$ 184	$ 249	$ 1	$ 1,870	$ 14	$ (283)	$ (1,605)	$ (678)
Change in unrealized gains/(losses) related to financial instruments held as of December 31, 2012	$ 1	$ 3	$ 23	$ (1)	$ 459	$ (8)	$ 38	$ (549)	$ 198

Fair Value Level 3 Rollforward
Recurring Basis
Year Ended December 31, 2011

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2010	$ —	$ 72	$ 165	$ 2	$ 2,692	$ —	$ (411)	$ (2,511)	$ (842)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	— (2)	(31) (2)	(11) (2)	—	(179) (3)	14 (4)	162 (6)	53 (3)	(8) (3)
Other comprehensive income (loss)	1	(76)	33	0	—	—	—	—	—
Purchases	9	216	47	—	—	—	—	—	—
Settlements	—	(24)	(23)	0	(720)	—	(67)	759	209
FG VIE consolidations	—	(52)	—	—	264	—	—	(227)	(63)
Transfers into Level 3	—	—	—	—	—	8	—	—	—
Fair value as of December 31, 2011	$ 10	$ 105	$ 211	$ 2	$ 2,057	$ 22	$ (316)	$ (1,926)	$ (704)
Change in unrealized gains/(losses) related to financial instruments held as of December 31, 2011	$ 0	$ (76)	$ 33	$ (1)	$ 159	$ 14	$ 83	$ 60	$ (69)

(1) Realized and unrealized gains (losses) from changes in values of Level 3 financial instruments represent gains (losses) from changes in values of those financial instruments only for the periods in which the instruments were classified as Level 3.

(2) Included in net realized investment gains (losses) and net investment income.

(3) Included in fair value gains (losses) on FG VIEs.

(4) Recorded in fair value gains (losses) on CCS.

(5) Represents net position of credit derivatives. The consolidated balance sheet presents gross assets and liabilities based on net counterparty exposure.

(6) Reported in net change in fair value of credit derivatives.

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2012

Financial Instrument Description	(in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	$ 12	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	4.9% - 29.7%
			Discount rates	4.6%
			Collateral recovery period	1 month - 11 years
RMBS	184	Discounted cash flow	CPR	1.0% - 6.9%
			CDR	6.2% - 23.0%
			Severity	51.6% - 102.8%
			Yield	3.5% - 12.5%
Asset-backed securities:				
Whole business securitization	63	Discounted cash flow	Annual gross revenue projections (in millions)	$54 - $96
			Value of primary financial guaranty policy	43.8%
			Liquidity discount	5.0% - 20.0%
Investor owned utility	186	Discounted cash flow	Liquidation value (in millions)	$212 - $242
			Years to liquidation	0 years - 3 years
			Discount factor	15.3%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	1.0% - 12.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
FG VIEs' assets, at fair value	1,870	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

Financial Instrument Description	Fair Value as of December 31, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	14	Discounted cash flow	Quotes from third party pricing	$45 - $51
			Term (years)	3 years
Liabilities:				
Credit derivative liabilities, net	(283)	Discounted cash flow	Hedge cost (in bps)	64.2 - 536.2
			Bank profit (in bps)	1.0 - 1,312.9
			Internal floor (in bps)	7.0 - 60.0
			Internal credit rating	AAA - BIG
FG VIEs' liabilities, at fair value	(2,283)	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

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

Fair Value of Financial Instruments

	As of December 31, 2012		As of December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Assets:				
Fixed maturity securities	$ 4,831	$ 4,831	$ 4,916	$ 4,916
Short-term investments	473	473	412	412
Other invested assets	441	548	420	538
Loan receivable from affiliate	83	82	—	—
Credit derivative assets	131	131	140	140
FG VIEs' assets, at fair value	1,870	1,870	2,057	2,057
Other assets	72	72	81	81
Liabilities:				
Financial guaranty insurance contracts(1)	2,091	2,949	2,651	3,392
Note payable	66	72	104	101
Credit derivative liabilities	414	414	456	456
FG VIEs' liabilities with recourse, at fair value	1,605	1,605	1,926	1,926
FG VIEs' liabilities without recourse, at fair value	678	678	704	704
Other liabilities	25	25	8	8

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

9. Financial Guaranty Contracts Accounted for as Credit Derivatives

Accounting Policy

Credit derivatives are recorded at fair value. Changes in fair value are recorded in “net change in fair value of credit derivatives” on the consolidated statement of operations. Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, premiums paid and payable for credit protection the Company has purchased, contractual claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions expense or income and realized gains or losses related to their early termination. Net unrealized gains and losses on credit derivatives represent the adjustments for changes in fair value in excess of realized gains and other settlements. Fair value of credit derivatives is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 8, Fair Value Measurement, for a discussion on the fair value methodology for credit derivatives.

Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS). Until the Company ceased selling credit protection through credit derivative contracts in the beginning of 2009, following the issuance of regulatory guidelines that limited the terms under which the credit protection could be sold, management considered these agreements to be a normal part of its financial guaranty business. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer Protection Act contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future.

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. For example, the Company’s control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, while the Company’s exposure under credit derivatives, like the Company’s exposure under financial guaranty insurance contracts, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty contracts, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. A loss payment is made only upon the occurrence of one or more defined credit events with respect to the referenced securities or loans. A credit event may be a non-payment event such as a failure to pay, bankruptcy or restructuring, as negotiated by the parties to the credit derivative transactions. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. The Company may be required to make a termination payment to its swap counterparty upon such termination. The Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 2.5 years at December 31, 2012 and 2.8 years at December 31, 2011. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives Net Par Outstanding

	As of December 31, 2012				As of December 31, 2011			
Asset Type	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating
				(dollars in millions)				
Pooled corporate obligations:								
Collateralized loan obligations/ collateralized bond obligations	$ 15,614	29.1%	30.4%	AAA	$ 18,606	28.7%	29.4%	AAA
Synthetic investment grade pooled corporate	9,089	21.1	19.2	AAA	11,494	19.7	17.9	AAA
Synthetic high yield pooled corporate	3,616	35.0	30.4	AAA	4,901	35.7	30.3	AA+
Trust preferred securities collateralized debt obligations ("TruPS CDOs")	41	55.1	78.8	AAA	63	56.1	70.5	AAA
Market value CDOs of corporate obligations	1,492	17.0	29.9	AAA	1,492	17.0	32.0	AAA
Total pooled corporate obligations	29,852	26.8	27.0	AAA	36,556	26.4	26.1	AAA
U.S. RMBS:								
Subprime first lien (including net interest margin)	72	—	—	AA	102	—	—	A
Closed end second lien and HELOCs	101	—	—	BBB	127	—	—	BBB
Total U.S. RMBS	173	—	—	A	229	—	—	BBB+
Other	3,269	—	—	A-	4,254	—	—	A
Total	$ 33,294			AAA	$ 41,039			AAA

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure consists of collateralized loan obligation ("CLO") or synthetic pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

The $3.3 billion of exposure in "Other" CDS contracts as of December 31, 2012 comprises numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of December 31, 2012 Net Par Outstanding	As of December 31, 2012 % of Total	As of December 31, 2011 Net Par Outstanding	As of December 31, 2011 % of Total
	(dollars in millions)			
Super Senior	$ 10,488	31.5%	$ 12,342	30.1%
AAA	17,338	52.1	22,814	55.6
AA	1,839	5.5	1,963	4.8
A	1,781	5.3	1,860	4.5
BBB	1,319	4.0	1,438	3.5
BIG	529	1.6	622	1.5
Total credit derivative net par outstanding	$ 33,294	100.0%	$ 41,039	100.0%

Net Change in Fair Value of Credit Derivatives

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

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Net credit derivative premiums received and receivable	$ 49	$ 89
Net ceding commissions (paid and payable) received and receivable	1	3
Realized gains on credit derivatives	50	92
Net credit derivative losses (paid and payable) recovered and recoverable	(39)	(22)
Total realized gains (losses) and other settlements on credit derivatives	11	70
Net unrealized gains (losses) on credit derivatives	41	92
Net change in fair value of credit derivatives	$ 52	$ 162

In years ended December 31, 2012 and 2011, CDS contracts totaling $1.7 billion and $5.2 billion in net par were terminated, resulting in accelerations of credit derivative revenue of $0.5 million in 2012 and $14 million in 2011.

Changes in the fair value of credit derivatives occur primarily because of changes in interest rates, credit spreads, notional amounts, credit ratings of the referenced entities, expected terms, realized gains (losses) and other settlements, and the issuing company's own credit rating, credit spreads and other market factors. Except for net estimated credit impairments (i.e., net expected loss to be paid as discussed in Note 6), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Net Change in Unrealized Gains (Losses) on Credit Derivatives By Sector

Asset Type	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Pooled corporate obligations:		
CLOs/Collateralized bond obligations	$ (1)	$ 3
Synthetic investment grade pooled corporate	19	16
Synthetic high yield pooled corporate	20	(1)
TruPS CDOs	1	(1)
Market value CDOs of corporate obligations	0	0
Total pooled corporate obligations	39	17
U.S. RMBS:		
Alt-A first lien	0	—
Subprime first lien (including net interest margin)	24	6
Closed end second lien and HELOCs	5	11
Total U.S. RMBS	29	17
Other	(27)	58
Total	$ 41	$ 92

In 2012, unrealized fair value gains were generated primarily in the high yield and investment grade synthetic pooled corporate sectors, as well as the subprime first lien sector. The gains in all three sectors were a result of a significant run-off of par outstanding as the transactions in these sectors approach maturity, as well as the expiration of several large transactions. The unrealized gains were partially offset by unrealized losses in the Other sector. The unrealized losses in Other were a result of the decreased cost to buy protection in AGM's name as the market cost of AGM's credit protection decreased during the period. Several transactions were pricing above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGM, which management refers to as the CDS spread on AGM, decreased the implied spreads that the Company would expect to receive on these transactions increased.

In 2011, unrealized fair value gains were generated primarily in the Other sector due to narrower implied net spreads. The unrealized gain in Other was primarily attributable to price improvements on a XXX life securitization transaction, as well as the run off of par outstanding on several policies. The narrower implied net spreads were primarily a result of the increased cost to buy protection in AGM's name as the market cost of AGM's credit protection increased. Several transactions were pricing above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGM, which management refers to as the CDS spread on AGM, increased the implied spreads that the Company would expect to receive on these transactions decreased.

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

Five Year CDS Spread on AGM

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Quoted price of CDS contract (in basis points)	536	778	650

Components of Credit Derivative Assets (Liabilities)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Credit derivative assets	$ 131	$ 140
Credit derivative liabilities	(414)	(456)
Net fair value of credit derivatives	$ (283)	$ (316)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Fair value of credit derivatives before effect of AGM credit spread	$ (627)	$ (1,109)
Plus: Effect of AGM credit spread	344	793
Net fair value of credit derivatives	$ (283)	$ (316)

The $0.6 billion liability as of December 31, 2012, which represents the fair value of CDS contracts before considering the implications of AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets, and ratings downgrades. The asset classes that remain most affected are pooled corporate obligations. Comparing December 31, 2012 to December 31, 2011, there was a narrowing of general market spreads as well as a run-off in net par outstanding, resulting in a gain of approximately $482 million, before taking into account AGM's credit spreads.

Management believes that the trading level of AGM's credit spreads are due to the correlation between AGM's risk profile and the current risk profile of the broader financial markets and to increased demand for credit protection against AGM as the result of its financial guaranty volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, Trust- Preferred CDO, and CLO markets as well as continuing market concerns over the most recent vintages of subprime RMBS.

The following table presents the fair value and the present value of expected claim payments or recoveries (i.e. net expected loss to be paid as described in Note 6) for contracts accounted for as derivatives.

Net Fair Value and Expected Losses of Credit Derivatives by Sector

Asset Type	Fair Value of Credit Derivative Asset (Liability), net		Present Value of Expected Claim (Payments) Recoveries (1)	
	As of December 31, 2012	As of December 31, 2011	As of December 31, 2012	As of December 31, 2011
		(in millions)		
Pooled corporate obligations:				
CLOs/Collateralized bond obligations	$ (2)	$ 0	$ —	$ —
Synthetic investment grade pooled corporate	(6)	(25)	—	—
Synthetic high yield pooled corporate	3	(16)	—	(5)
TruPS CDOs	0	(1)	—	—
Market value CDOs of corporate obligations	0	0	—	—
Total pooled corporate obligations	(5)	(42)	—	(5)
U.S. RMBS:				
Option ARM and Alt-A first lien	0	0	—	—
Subprime first lien (including net interest margin)	0	(18)	—	(25)
Closed end second lien and HELOCs	(10)	(15)	10	7
Total U.S. RMBS	(10)	(33)	10	(18)
Other	(268)	(241)	(4)	(14)
Total	$ (283)	$ (316)	$ 6	$ (37)

(1) Represents amount in excess of the present value of future installment fees to be received of $1 million as of December 31, 2012 and $2 million as of December 31, 2011. There is no R&W benefit on credit derivatives as of December 31, 2012 and 2011.

Sensitivity to Changes in Credit Spread

The following table summarizes the estimated change in fair values on the net balance of the Company's credit derivative positions assuming immediate parallel shifts in credit spreads on AGM and on the risks that it assumes.

Effect of Changes in Credit Spread
As of December 31, 2012

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax)	Estimated Change in Gain/(Loss) (Pre-Tax)
	(in millions)	
100% widening in spreads	$ (537)	$ (254)
50% widening in spreads	(408)	(125)
25% widening in spreads	(343)	(60)
10% widening in spreads	(304)	(21)
Base Scenario	(283)	—
10% narrowing in spreads	(264)	19
25% narrowing in spreads	(243)	40
50% narrowing in spreads	(209)	74

(1) Includes the effects of spreads on both the underlying asset classes and the Company’s own credit spread.

10. Consolidation of Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGM does not sponsor any VIEs when underwriting third party financial guaranty insurance or credit derivative transactions, nor does it act as the servicer or collateral manager for any VIE obligations that it insures. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

AGM is not primarily liable for the debt obligations issued by the VIEs they insure and would only be required to make payments on these debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. AGM's creditors do not have any rights with regard to the assets of the VIEs. Proceeds from sales, maturities, prepayments and interest from VIE assets may only be used to pay Debt Service on VIE liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and receivable, and claims paid and expected to be paid by AGM under the financial guaranty insurance contract. The Company's estimate of expected loss to be paid for FG VIEs is included in Note 6, Expected Loss to be Paid.

Accounting Policy

For all years presented, the Company has evaluated whether it was the primary beneficiary or control party of its VIEs. If the Company concludes that it is the primary beneficiary it is required to consolidate the entire VIE in the Company's financial statements. The accounting rules governing the criteria for determining the primary beneficiary or control party of VIEs changed effective January 1, 2010.

Effective January 1, 2010, GAAP requires the Company to perform an analysis to determine whether its variable interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both 1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and 2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. This guidance requires an ongoing reassessment of whether the Company is the primary beneficiary of a VIE.

As part of the terms of its financial guaranty contracts, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company obtains protective rights under its insurance contracts that give the Company additional controls over a VIE if there is either deterioration of deal performance or in the financial health of the deal servicer. The Company is deemed to be the control party under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the Company's protective rights that could make it the control party have not been triggered, then it does not consolidate the VIE. As of December 31, 2012, the Company had issued financial guaranty contracts for approximately 600 VIEs that it did not consolidate.

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

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

Consolidated FG VIEs

Number of FG VIEs Consolidated

	Year Ended December 31,	
	2012	2011
Beginning of the year	26	24
Consolidated(1)	1	6
Matured	(2)	(4)
End of the year	25	26

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(1) Net gain on consolidation and deconsolidation was $5 million in 2012 and $40 million in 2011 and recorded in “fair value gains (losses) on FG VIEs” in the consolidated statement of operations.

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately $654 million. The aggregate unpaid principal of the FG VIEs' assets was approximately $1,987 million greater than the aggregate fair value at December 31, 2012. The change in the instrument-specific credit risk of the FG VIEs' assets for 2012 was a gain of $320 million. The change in the instrument-specific credit risk of the FG VIEs’ assets for 2011 were losses of $565 million.

The aggregate unpaid principal balance was approximately $1,569 million greater than the aggregate fair value of the FG VIEs’ liabilities as of December 31, 2012.

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

Consolidated FG VIEs
By Type of Collateral

	As of December 31, 2012			As of December 31, 2011		
	Number of FG VIEs	Assets	Liabilities	Number of FG VIEs	Assets	Liabilities
			(dollars in millions)			
With recourse:						
HELOCs	8	$ 525	$ 786	8	$ 573	$ 908
First liens:						
Alt-A first lien	4	131	113	4	128	124
Option ARM	2	42	169	2	50	244
Subprime	6	392	485	5	387	473
Closed-end second lien	3	28	13	3	59	21
Automobile loans	2	39	39	4	156	156
Total with recourse	25	1,157	1,605	26	1,353	1,926
Without recourse	—	713	678	—	704	704
Total	25	$ 1,870	$ 2,283	26	$ 2,057	$ 2,630

Gross Unpaid Principal for FG VIEs' Liabilities
With Recourse

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Gross unpaid principal for FG VIEs' liabilities with recourse	$ 2,087	$ 3,030

Contractual Maturity Schedule of FG VIE Liabilities with Recourse

Contractual Maturity	As of December 31, 2012
	(in millions)
2013	$ —
2014	39
2015	—
2016	—
2017	—
Thereafter	2,048
Total	$ 2,087

The consolidation of FG VIEs has a significant effect on net income and shareholder's equity due to (1) changes in fair value gains (losses) on FG VIE assets and liabilities, (2) the elimination of premiums and losses related to the AGM FG VIE liabilities with recourse and (3) the elimination of investment balances related to the Company's purchase of AGM insured FG VIE debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

Effect of Consolidating FG VIEs on Net Income and Shareholder's Equity

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Net earned premiums	$ (150)	$ (74)
Net investment income	(11)	(6)
Net realized investment gains (losses)	4	12
Fair value gains (losses) on FG VIEs	115	(61)
Loss and LAE	52	89
Total pretax effect on net income	10	(40)
Less: tax provision (benefit)	3	(14)
Total effect on net income (loss)	$ 7	$ (26)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Total (decrease) increase on shareholder’s equity	$ (321)	$ (325)

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs’ assets and liabilities. For the year ended December 31, 2012, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of $115 million. The majority of this gain, approximately $59 million, is a result of a R&W settlement with Deutsche Bank that closed during the second quarter 2012. While prices continued to appreciate during the period on the Company's FG VIE assets and liabilities, the remainder of the gains were primarily driven by large principal paydowns made on the Company's FG VIEs.

Year ended December 31, 2011 pre-tax fair value losses on consolidated FG VIEs of $61 million were driven by the unrealized loss on consolidation of six new VIEs, as well as two existing transactions in which the fair value of the underlying collateral depreciated, while the price of the wrapped senior bonds was largely unchanged from the prior year.

Non-Consolidated VIEs

To date, the Company's analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, they are not consolidated in the consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 3, Outstanding Exposure.

11. Investments and Cash

Accounting Policy

The vast majority of the Company's investment portfolio is fixed maturity and short-term investments, classified as available-for-sale at the time of purchase (approximately 97% based on fair value at December 31, 2012), and therefore carried at fair value. Changes in fair value for other than temporarily impaired ("OTTI") securities are bifurcated between credit losses and non-credit changes in fair value. Credit losses on other-than-temporary impairment securities are recorded in the statement of operations and the non-credit component of OTTI securities are recorded in OCI. For securities where the Company has the intent to sell, declines in fair value are recorded in the consolidated statements of operations. OTTI credit losses adjust the amortized cost of impaired securities and that amortized cost basis is not increased for any subsequent recoveries in fair value. However, the amortized cost basis is adjusted for accretion and amortization using the effective interest method with a corresponding entry recorded in net investment income.

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

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

The Company purchased securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses ("loss mitigation bonds"). These securities were purchased at a discount and are accounted for excluding the effects of the Company's insurance on the securities.

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

Other invested assets include assets acquired in refinancing transactions which are primarily comprised of franchise loans that are evaluated for impairment by assessing the probability of collecting expected cash flows. Any impairment is recorded in the consolidated statement of operations and any subsequent increases in expected cash flow are recorded as an increase in yield over the remaining life of the loans. Other invested assets also include trading securities and a surplus note issued by AGC to AGM (see Note 15, Related Party Transactions). Trading securities are recorded on a trade date basis and carried at fair value. Unrealized gains and losses on trading securities are reflected in net income. The surplus note is being held to maturity.

Cash consists of cash on hand and demand deposits. As a result of the lag in reporting, FG VIEs and short term investments reported on the consolidated balance sheet does not reflect cash outflow to the holders of the debt issued by the FG VIEs for claim payments made by the Company to the consolidated FG VIEs until the subsequent reporting period.

Assessment for Other-Than Temporary Impairments

Once an OTTI has occurred, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date.

If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI is separated into (1) the amount representing the credit loss and (2) the amount related to all other factors.

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

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

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

The Company's assessment of a decline in value included management's current assessment of the factors noted above. The Company also seeks advice from its outside investment managers. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

Investment Portfolio

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Net investment income increased primarily due to higher income earned on loss mitigation bonds. Income earned on the general portfolio excluding loss mitigation bonds declined slightly due to lower reinvestment rates. Accrued investment income on fixed maturity, short-term investments and assets acquired in refinancing transactions was $52 million and $55 million as of December 31, 2012 and 2011, respectively.

Net Investment Income

	Year Ended December 31,	
	2012	2011
	(in millions)	
Income from fixed maturity securities	$ 215	$ 200
Income from short-term investments	0	0
Interest income from notes receivable from affiliates (See Note 15, Related Party Transactions)	17	15
Interest from assets acquired in refinancing transactions	5	5
Gross investment income	237	220
Investment expenses	(4)	(4)
Net investment income	$ 233	$ 216

Net Realized Investment Gains (Losses)

	Year Ended December 31,	
	2012	2011
	(in millions)	
Realized gains on investment portfolio	$ 23	$ 25
Realized losses on investment portfolio	(23)	(5)
OTTI:		
Intent to sell	0	(1)
Credit component of OTTI securities	(5)	(37)
OTTI	(5)	(38)
Net realized investment gains (losses)	$ (5)	$ (18)

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

Roll Forward of Credit Losses in the Investment Portfolio

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Balance, beginning of period	$ 31	$ 7
Additions for credit losses on securities for which an OTTI was not previously recognized	2	25
Eliminations of securities issued by FG VIEs	—	(13)
Additions for credit losses on securities for which an OTTI was previously recognized	3	12
Balance, end of period	$ 36	$ 31

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2012

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI (2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
				(dollars in millions)			
Fixed maturity securities:							
U.S. government and agencies	2%	$ 86	$ 8	$ 0	$ 94	$ —	AA+
Obligations of state and political subdivisions	65	3,197	306	0	3,503	6	AA
Corporate securities	4	215	15	0	230	—	AA-
Mortgage-backed securities(4):							
RMBS	8	398	13	(53)	358	(37)	BBB-
CMBS	2	97	6	—	103	—	AAA
Asset-backed securities	6	288	54	—	342	41	BIG
Foreign government securities	3	192	9	0	201	1	AAA
Total fixed maturity securities	90	4,473	411	(53)	4,831	11	AA-
Short-term investments	10	473	0	—	473	—	AAA
Total investment portfolio	100%	$ 4,946	$ 411	$ (53)	$ 5,304	$ 11	AA-

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2011

Investment Category	Percent of Total(1)		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value		AOCI Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
							(dollars in millions)					
Fixed maturity securities:												
U.S. government and agencies	1%	$	78	$	8	$	—	$	86	$	—	AA+
Obligations of state and political subdivisions	66		3,357		240		0		3,597		4	AA
Corporate securities	4		200		9		(1)		208		—	AA-
Mortgage-backed securities(4):												
RMBS	8		392		11		(59)		344		(38)	A-
CMBS	2		101		3		—		104		—	AAA
Asset-backed securities	6		302		33		—		335		29	BIG
Foreign government securities	5		244		4		(6)		242		—	AAA
Total fixed maturity securities	92		4,674		308		(66)		4,916		(5)	AA-
Short-term investments	8		412		—		—		412		—	AAA
Total investment portfolio	100%	$	5,086	$	308	$	(66)	$	5,328	$	(5)	AA-

(1) Based on amortized cost.

(2) Accumulated OCI ("AOCI").

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

(4) Government‑agency obligations were approximately 38% of mortgage backed securities as of December 31, 2012 and 52% as of December 31, 2011 based on fair value.

The Company continues to receive sufficient information to value its investments and has not had to modify its valuation approach due to the current market conditions. As of December 31, 2012, amounts, net of tax, in AOCI included a net unrealized gain of $7 million for securities for which the Company had recognized OTTI and a net unrealized gain of $225 million for securities for which the Company had not recognized OTTI. As of December 31, 2011, amounts, net of tax, in AOCI included a net unrealized loss of $4 million for securities for which the Company had recognized OTTI and a net unrealized gain of $160 million for securities for which the Company had not recognized OTTI.

The Company's investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories. This is a high quality portfolio of municipal securities with an average rating of AA as of December 31, 2012 and 2011. Securities rated lower than A-/A3 by S&P or Moody's are not eligible to be purchased for the Company's portfolio unless acquired for loss mitigation or risk management strategies.

The following tables present the fair value of the Company's available-for-sale municipal bond portfolio as of December 31, 2012 and December 31, 2011 by state, excluding $350 million and $237 million of pre-refunded bonds, respectively. The credit ratings are based on the underlying ratings and do not include any benefit from bond insurance.

Fair Value of Available-for-Sale Municipal Bond Portfolio by State
As of December 31, 2012

State	State General Obligation	Local General Obligation	Revenue	Fair Value	Amortized Cost	Average Credit Rating
			(in millions)			
Texas	$ 47	$ 191	$ 200	$ 438	$ 401	AA
New York	13	21	396	430	399	AA
Florida	34	36	173	243	216	AA-
California	20	27	196	243	215	AA-
Illinois	—	63	130	193	173	A+
Washington	11	39	89	139	126	AA
Arizona	—	8	113	121	110	AA
Michigan	—	29	84	113	102	AA-
Massachusetts	20	4	82	106	95	AA
Pennsylvania	29	32	32	93	86	A+
All others	134	132	768	1,034	949	AA-
Total	$ 308	$ 582	$ 2,263	$ 3,153	$ 2,872	AA-

Fair Value of Available-for-Sale Municipal Bond Portfolio by State
As of December 31, 2011

State	State General Obligation	Local General Obligation	Revenue	Fair Value	Amortized Cost	Average Credit Rating
			(in millions)			
New York	$ 12	$ 24	$ 446	$ 482	$ 453	AA
Texas	47	220	195	462	432	AA
Florida	34	35	176	245	225	AA
Illinois	3	66	159	228	213	AA
California	19	13	170	202	182	AA
Washington	11	53	83	147	136	AA
Michigan	—	37	86	123	116	AA
Arizona	—	8	115	123	116	AA
Massachusetts	21	—	83	104	96	AA
Ohio	—	32	61	93	86	AA
All others	173	203	775	1,151	1,076	AA
Total	$ 320	$ 691	$ 2,349	$ 3,360	$ 3,131	AA

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

Revenue Sources

Type	As of December 31, 2012 Fair Value	As of December 31, 2012 Amortized Cost	As of December 31, 2011 Fair Value	As of December 31, 2011 Amortized Cost
	(in millions)			
Transportation	$ 472	$ 421	$ 510	$ 474
Tax backed	437	400	518	484
Municipal utilities	390	355	369	342
Water and sewer	298	274	299	281
Healthcare	253	229	257	242
Higher education	247	225	195	182
All others	166	156	201	191
Total	$ 2,263	$ 2,060	$ 2,349	$ 2,196

The Company's investment portfolio is managed by four outside managers. As municipal investments are a material portion of the Company's overall investment portfolio, the Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. Each of the portfolio managers perform independent analysis on every municipal security they purchase for the Company's portfolio. The Company meets with each of its portfolio managers quarterly and reviews all investments with a change in credit rating as well as any investments on the manager's watch list of securities with the potential for downgrade.

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

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2012

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
U.S. government and agencies	$ 12	$ 0	$ —	$ —	$ 12	$ 0
Obligations of state and political subdivisions	17	0	—	—	17	0
Corporate securities	5	0	—	—	5	0
Mortgage-backed securities:						
RMBS	76	(17)	97	(36)	173	(53)
Foreign government securities	6	0	—	—	6	0
Total	$ 116	$ (17)	$ 97	$ (36)	$ 213	$ (53)
Number of securities		16		10		26
Number of securities with OTTI		5		4		9

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2011

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
Obligations of state and political subdivisions	$ 6	$ 0	$ 10	$ 0	$ 16	$ 0
Corporate securities	16	(1)	—	—	16	(1)
Mortgage-backed securities:						
RMBS	81	(40)	30	(19)	111	(59)
Foreign government securities	141	(6)	—	—	141	(6)
Total	$ 244	$ (47)	$ 40	$ (19)	$ 284	$ (66)
Number of securities		26		10		36
Number of securities with OTTI		4		3		7

Of the securities in an unrealized loss position for 12 months or more as of December 31, 2012, six securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of December 31, 2012 was $35 million. The Company has determined that the unrealized losses recorded as of December 31, 2012 are yield related and not specific to issuer credit, therefore not OTTI.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of December 31, 2012 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of December 31, 2012

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	$ 123	$ 124
Due after one year through five years	493	522
Due after five years through 10 years	1,405	1,547
Due after 10 years	1,957	2,177
Mortgage-backed securities:		
RMBS	398	358
CMBS	97	103
Total	$ 4,473	$ 4,831

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts for the benefit of reinsured companies, which amounted to $21 million and $21 million as of December 31, 2012 and December 31, 2011, respectively. In addition, to fulfill state licensing requirements, the Company has placed on deposit eligible securities of $15 million and $15 million as of December 31, 2012 and December 31, 2011, respectively, for the protection of policyholders. In connection with an excess of loss reinsurance facility, $17 million were released from the trust to the reinsurers in the first quarter of 2013. See Note 14, Reinsurance and other Monoline Exposures.

No investments of the Company were non-income producing for the years ended December 31, 2012, and 2011.

Loss Mitigation Assets

One of the Company's strategies for mitigating losses has been to purchase insured securities that have expected losses at discounted prices. The Company may also obtain the obligations referenced in CDS transactions that have triggered the insured's obligation to put these bonds to AGM.

Prior to its acquisition, AGM had also purchased assets of certain insured obligations that had triggered rights under the financial guaranty contracts. The Company has rights under certain of its financial guaranty insurance policies and indentures that allow it to accelerate the insured notes and pay claims under its insurance policies upon the occurrence of predefined events of default. To mitigate financial guaranty insurance losses, the Company had elected to purchase the outstanding insured obligation or its underlying collateral. Generally, refinancing vehicles reimburse AGM in whole for its claims payments in exchange for assignments of certain of AGM's rights against the trusts. The refinancing vehicles obtained their funds from the proceeds of AGM-insured GICs issued in the ordinary course of business by former subsidiaries of AGMH that had engaged in its former financial products business (the "Financial Products Companies"). The refinancing vehicles are consolidated with the Company. The accretable yield on the securitized loans was $150 million and $141 million at December 31, 2012 and 2011, respectively.

Loss Mitigation Assets
Carrying Value

	As of December 31,	
	2012	2011
	(in millions)	
Fixed maturity securities:		
Obligations of state and political subdivisions	$ 12	$ 9
RMBS	184	105
Asset-backed securities	249	211
Other invested assets:		
Assets acquired in refinancing transactions	72	107
Other	1	2
Total	$ 518	$ 434

12. Insurance Company Regulatory Requirements

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

The Company prepares statutory financial statements in accordance with accounting practices prescribed or permitted by the National Association of Insurance Commissioners (“NAIC”) and their respective insurance departments. Prescribed statutory accounting practices are set forth in the NAIC Accounting Practices and Procedures Manual. The Company has no permitted accounting practices on a statutory basis.

GAAP differs in certain significant respects from statutory accounting practices, applicable to U.S. insurance companies that are prescribed or permitted by insurance regulatory authorities. The principal differences result from the following statutory accounting practices:

- upfront premiums are earned when related principal and interest have expired rather than earned over the expected period of coverage;
- acquisition costs are charged to operations as incurred rather than over the period that related premiums are earned;

- a contingency reserve is computed based on the following statutory requirements:

    1) for all policies written prior to July 1, 1989, an amount equal to 50% of cumulative earned premiums less permitted reductions, plus

    2) for all policies written on or after July 1, 1989, an amount equal to the greater of 50% of premiums written for each category of insured obligation or a designated percentage of principal guaranteed for that category. These amounts are provided each quarter as either 1/60th or 1/80th of the total required for each category, less permitted reductions;

- certain assets designated as “non-admitted assets” are charged directly to statutory surplus but are reflected as assets under GAAP;

- the amount of deferred tax assets that may be admitted is subject to an adjusted surplus threshold and is generally limited to the lesser of those assets the Company expects to realize within three years of the balance sheet date or fifteen percent of the Company's adjusted surplus. This realization period and surplus percentage is subject to change based on the amount of adjusted surplus;

- insured CDS are accounted for as insurance contracts rather than as derivative contracts recorded at fair value;

- bonds are generally carried at amortized cost rather than fair value;

- VIEs and refinancing vehicles are not consolidated;

- push-down acquisition accounting is not applicable under statutory accounting practices;

- present value of expected losses are discounted at 5% and recorded without consideration of the deferred premium revenue as opposed to discounted at the risk free rate at the end of each reporting period and only to the extent they exceed deferred premium revenue;

- present value of installment premiums are not recorded on the balance sheets.

Insurance Regulatory Amounts Reported

	Policyholders' Surplus As of December 31,		Net Income (Loss) Year Ended December 31,	
	2012	2011	2012	2011
	(in millions)			
Assured Guaranty Municipal Corp (Consolidated)(1)	$ 1,785	$ 1,227	$ 256	$ 632
Assured Guaranty Municipal Corp (Stand-alone)	1,780	1,209	203	399

(1) Amounts represent the Company's statutory basis amounts on a consolidated basis with all its domestic and foreign subsidiaries.

Dividend Restrictions and Capital Requirements

AGM is a New York domiciled insurance company. Based on AGM’s statutory statements filed for the year ended December 31, 2012, the maximum amount available for payment of dividends by AGM without regulatory approval over the 12 months following December 31, 2012, is approximately $178 million. Also in connection with the acquisition of AGMH on July 1, 2009 ("AGMH Acquisition"), the Company committed to the New York Department of Financial Services that AGM would not pay any dividends for a period of two years from the Acquisition Date without written approval of the New York Department of Financial Services.

Dividends Paid
By Insurance Company

	Year Ended December 31,	
	2012	2011
	(in millions)	
Dividends paid by AGM to AGMH	30	—

13. Income Taxes

Accounting Policy

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

Non-interest-bearing tax and loss bonds are purchased to prepay the tax benefit that results from deducting contingency reserves as provided under Internal Revenue Code Section 832(e). The Company records the purchase of tax and loss bonds in deferred taxes.

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

Provision for Income Taxes

The Company's Bermuda subsidiary, Assured Guaranty (Bermuda) Ltd. (formerly Financial Security Assurance International Ltd. (“AGBM”)), is not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, AGBM will be exempt from taxation in Bermuda until March 28, 2035. The Company's U.S. and United Kingdom (“U.K.”) subsidiary are subject to income taxes imposed by U.S. and U.K. authorities and file applicable tax returns.

In conjunction with AGL's purchase of AGMH on July 1, 2009, AGM and its insurance company subsidiaries have joined the consolidated federal tax group of AGUS. A new tax sharing agreement was entered into effective July 1, 2009 whereby each company in the Assured Guaranty US Holdings Inc. ("AGUS") consolidated tax group pays or receives its proportionate share of the consolidated federal tax burden for the group as if each company filed on a separate return basis with current period credit for net losses.

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

Effective Tax Rate Reconciliation

	Year Ended December 31,	
	2012	2011
	(in millions)	
Expected tax provision (benefit) at statutory rate	$ 204	$ 192
Tax-exempt interest	(42)	(43)
True-up from tax return filings	0	(2)
Change in liability for uncertain tax positions	—	—
Other	2	2
Total provision (benefit) for income taxes	$ 164	$ 149
Effective tax rate	28.2%	27.2%

Components of Net Deferred Tax Assets

	As of December 31,	
	2012	2011
	(in millions)	
Deferred tax assets:		
Unrealized losses on credit derivative financial instruments, net	$ 98	$ 132
Unearned premium reserve, net	143	356
Losses and LAE reserves	19	—
Tax and loss bonds	6	45
Deferred ceding commission income	38	41
Foreign tax credits	30	30
FG VIEs	145	175
Investment in foreign subsidiary	30	29
Investment basis difference	72	27
Other	3	10
Total deferred income tax assets	584	845
Deferred tax liabilities:		
Contingency reserves	6	45
Losses and LAE reserves	—	62
Unrealized appreciation on investments	125	84
Market discount	33	—
Other	11	23
Total deferred income tax liabilities	175	214
Net deferred income tax asset	$ 409	$ 631

As of December 31, 2012, the Company had foreign tax credits carried forward of $30 million which expire in 2018 through 2021. Internal Revenue Code limits the amounts of foreign tax credits the Company may utilize each year. Management believes sufficient future taxable income exists to realize the full benefit of these foreign tax credits.

Valuation Allowance

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

Audits

AGUS has open tax years with the U.S. Internal Revenue Service ("IRS") for 2009 forward and is currently under audit for the 2009 tax year. The IRS concluded its field work with respect to tax years 2006 through 2008 without adjustment. On February 20, 2013 the IRS notified AGUS that the Joint Committee on Taxation completed its review and has accepted the results of the IRS examination without exception. AGMH and subsidiaries have separate open tax years with the IRS of 2008 through the July 1, 2009 when they joined the AGUS consolidated group. AGMH and subsidiaries are under audit for 2008 while members of the Dexia Holdings Inc. consolidated tax group. The Company is indemnified by Dexia for any potential liability associated with this audit of any periods prior to the AGMH Acquisition. The Company's U.K. subsidiary is not currently under examination and have open tax years of 2010 forward.

Uncertain Tax Positions

The following table provides a reconciliation of the beginning and ending balances of the total liability for unrecognized tax benefits. The Company does not believe it is reasonably possible that this amount will change significantly in the next twelve months.

	2012	2011
	(in millions)	
Balance as of January 1,	$ 5	$ 5
True-up from tax return filings	—	—
Increase in unrecognized tax benefits as a result of position taken during the current period	—	—
Balance as of December 31,	5	$ 5

The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2012, the Company has accrued $1 million of interest.

The total amount of unrecognized tax benefits as at December 31, 2012, that would affect the effective tax rate, if recognized, is $5 million.

Tax Treatment of CDS

The Company treats the guaranty it provides on CDS as insurance contracts for tax purposes and as such a taxable loss does not occur until the Company expects to make a loss payment to the buyer of credit protection based upon the occurrence of one or more specified credit events with respect to the contractually referenced obligation or entity. The Company holds its CDS to maturity, at which time any unrealized fair value loss in excess of credit-related losses would revert to zero. The tax treatment of CDS is an unsettled area of the law. The uncertainty relates to the IRS determination of the income or potential loss associated with CDS as either subject to capital gain (loss) or ordinary income (loss) treatment. In treating CDS as insurance contracts the Company treats both the receipt of premium and payment of losses as ordinary income and believes it is more likely than not that any CDS credit related losses will be treated as ordinary by the IRS. To the extent the IRS takes the view that the losses are capital losses in the future and the Company incurred actual losses associated with the CDS, the Company would need sufficient taxable income of the same character within the carryback and carryforward period available under the tax law.

14. Reinsurance and Other Monoline Exposures

AGM assumes exposure on insured obligations (“Assumed Business”) and cedes portions of its exposure on obligations it has insured (“Ceded Business”) in exchange for premiums, net of ceding commissions.

Accounting Policy

For business assumed and ceded, the accounting model of the underlying direct financial guaranty contract dictates the accounting model used for the reinsurance contract (except for those eliminated as FG VIEs). For any assumed or ceded financial guaranty insurance premiums and losses, the accounting model described in Note 4 is followed, and for assumed and ceded credit derivative premiums and losses, the accounting model in Note 6 is followed.

Ceded and Assumed Business

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

Over the past several years, the Company has entered into several commutations in order to reassume previously ceded books of business from BIG financial guaranty companies and its other reinsurers. The Company also has cancelled assumed reinsurance contracts. These commutations of ceded and cancellations of Assumed Business resulted in gains of $82 million and $32 million for the years ended December 31, 2012 and 2011, respectively, which were recorded in “other income.” While certain Ceded Business has been reassumed, the Company still has significant Ceded Business with third parties.

Net Effect of Commutations of Ceded and Cancellations of Assumed Reinsurance Contracts

	Year Ended December 31,	
	2012	2011
	(in millions)	
Increase (decrease) in net unearned premium reserve	$ 109	$ (12)
Increase (decrease) in net par outstanding	19,173	(270)

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

Effect of Reinsurance on Statement of Operations

	Year Ended December 31,	
	2012	2011
	(in millions)	
Premiums Written:		
Direct	$ 194	$ 170
Ceded	(1)	(71)
Net	$ 193	$ 99
Premiums Earned:		
Direct	$ 809	$ 871
Assumed	1	0
Ceded	(220)	(210)
Net	$ 590	$ 661
Loss and LAE:		
Direct	$ 583	$ 510
Ceded	(186)	(128)
Net	$ 397	$ 382

Reinsurer Exposure

In addition to assumed and ceded reinsurance arrangements, the Company may also have exposure to some financial guaranty reinsurers (i.e., monolines) in other areas. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monolines. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. Another area of exposure is in the investment portfolio where the Company holds fixed maturity securities that are wrapped by monolines and whose value may decline based on the rating of the monoline. At December 31, 2012, based on fair value, the Company had $562 million of fixed maturity securities in its investment portfolio wrapped by National Public Finance Guarantee Corporation, $392 million by Ambac Assurance Corporation ("Ambac"), $84 million by AGC, and $25 million by other guarantors.

Exposure by Reinsurer

Reinsurer	Ratings as of April 22, 2013		Par Outstanding as of December 31, 2012		
	Moody's Reinsurer Rating	S&P Reinsurer Rating	Ceded Par Outstanding(1)	Second-to-Pay Insured Par Outstanding	Assumed Par Outstanding
			(dollars in millions)		
Affiliated Companies	(2)	(2)	$ 64,923	$ 503	$ 26
Non-Affiliated Companies:					
Tokio	Aa3(3)	AA-(3)	8,395	—	933
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	WR(4)	WR	7,672	—	24
Radian	Ba1	B+	5,097	40	—
Syncora Guarantee Inc.	WR	WR	4,156	727	—
Mitsui Sumitomo Insurance Co. Ltd.	A1	A+(3)	2,243	—	—
ACA Financial Guaranty Corp.	NR	WR	810	5	—
Swiss Reinsurance Co.	A1	AA-	430	—	—
CIFG Assurance North America Inc. ("CIFG")	WR	WR	65	119	—
MBIA Inc.	(5)	(5)	—	7,834	—
Ambac	WR	WR	—	3,464	—
Financial Guaranty Insurance Co.	WR	WR	—	1,209	—
Other	Various	Various	893	—	1
Non-Affiliated Companies			29,761	13,398	958
Total			$ 94,684	$ 13,901	$ 984

(1) Includes $3,633 million in ceded par outstanding related to insured credit derivatives.

(2) As of the date of this document, the affiliates of AGM are Assured Guaranty Re Ltd. and its subsidiaries ("AG Re"), rated Baa1 (stable) by Moody's and AA- (stable) by S&P, and AGC and its subsidiaries, rated A3 (stable) by Moody's and AA- (stable) by S&P.

(3) The Company has structural collateral agreements satisfying the triple-A credit requirement of S&P and/or Moody's.

(4) Represents "Withdrawn Rating."

(5) MBIA Inc. includes various subsidiaries which are rated BB, CCC and WR by S&P and Caa2, B3, Baa2, WR and NR by Moody's.

Ceded Par Outstanding by Reinsurer and Credit Rating
As of December 31, 2012

Reinsurer	Super Senior	AAA	AA	A	BBB	BIG	Total
				(in millions)			
Affiliated Companies	$ 68	$ 1,391	$ 21,277	$ 30,697	$ 10,304	$ 1,186	$ 64,923
Tokio	313	1,072	1,421	2,457	2,412	720	8,395
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	52	420	3,098	2,515	1,277	310	7,672
Radian	10	256	374	2,342	1,737	378	5,097
Syncora Guarantee Inc.	—	—	241	761	2,495	659	4,156
Mitsui Sumitomo Insurance Co. Ltd.	7	151	713	865	449	58	2,243
ACA Financial Guaranty Corp.	—	—	474	325	11	—	810
Swiss Reinsurance Co.	—	8	7	261	111	43	430
CIFG	—	—	—	—	—	65	65
Other	—	—	114	741	38	—	893
Total	$ 450	$ 3,298	$ 27,719	$ 40,964	$ 18,834	$ 3,419	$ 94,684

In accordance with U.S. statutory accounting requirements and U.S. insurance laws and regulations, in order for the Company to receive credit for liabilities ceded to reinsurers domiciled outside of the U.S., such reinsurers must secure their liabilities to the Company. All of the unauthorized reinsurers in the table above post collateral for the benefit of the Company in an amount at least equal to the sum of their ceded unearned premium reserve, loss reserves and contingency reserves all calculated on a statutory basis of accounting. CIFG and Radian are authorized reinsurers. Radian's collateral equals or exceeds its ceded statutory loss reserves and CIFG's collateral covers a substantial portion of its ceded statutory loss reserves. Collateral may be in the form of letters of credit or trust accounts. The total collateral posted by all non-affiliated reinsurers as of December 31, 2012 is approximately $977 million.

Second-to-Pay
Insured Par Outstanding by Rating
As of December 31, 2012(1)

	Public Finance				Structured Finance				
	AA	A	BBB	BIG	AAA	AA	A	BIG	Total
					(in millions)				
Affiliated Companies	$ 77	$ —	$ —	$ —	$ —	$ 426	$ —	$ —	$ 503
Radian	—	13	16	11	—	—	—	—	40
Syncora Guarantee Inc.	—	114	312	214	84	—	3	—	727
ACA Financial Guaranty Corp	3	—	2	—	—	—	—	—	5
CIFG	5	17	52	45	—	—	—	—	119
MBIA Inc.	1,941	2,971	1,403	—	—	1,308	—	211	7,834
Ambac	966	1,772	195	207	15	53	1	255	3,464
Financial Guaranty Insurance Co.	26	651	3	241	248	—	—	40	1,209
Total	$ 3,018	$ 5,538	$ 1,983	$ 718	$ 347	$ 1,787	$ 4	$ 506	$ 13,901

(1) Assured Guaranty's internal rating.

Amounts Due (To) From Reinsurers

	As of December 31, 2012	
	Ceded Premium, net of Commissions	Ceded Expected Loss and LAE
	(in millions)	
Affiliated Companies	$ (63)	$ 20
Tokio	(27)	37
American Overseas Reinsurance Company Ltd.	(10)	3
Radian	(20)	(4)
Syncora Guarantee Inc.	(43)	1
Mitsui Sumitomo Insurance Co. Ltd.	(5)	9
Swiss Reinsurance Co.	(3)	2
CIFG	—	3
Other	(59)	—
Total	$ (230)	$ 71

Excess of Loss Reinsurance Facility

On January 22, 2012, AGC and AGM entered into an aggregate excess of loss reinsurance facility, effective as of January 1, 2012. The facility cover losses occurring from January 1, 2013 through December 31, 2020. It terminates on January 1, 2014 unless AGC and AGM choose to extend it. The facility covers U.S. public finance credits insured or reinsured by AGC and AGM as of September 30, 2011, excluding credits that were rated non-investment grade as of December 31, 2011 by Moody's or S&P or internally by AGC or AGM and subject to certain per credit limits. The facility attaches when AGC's or AGM's net losses (net of AGC's and AGM other reinsurance, other than pooling reinsurance provided to AGM by AGM's subsidiaries and net of recoveries) exceed in the aggregate $2 billion and covers a portion of the next $600 million of losses, with the reinsurers assuming pro rata in the aggregate $435 million of the $600 million of losses and AGC and AGM jointly retaining the remaining $165 million of losses. The reinsurers are required to be rated at least AA-(Stable Outlook) through December 31, 2014 or to post collateral sufficient to provide AGM and AGC with the same reinsurance credit as reinsurers rated AA-. AGM and AGC are obligated to pay the reinsurers their share of recoveries relating to losses during the coverage period in the covered portfolio. This obligation is secured by a pledge of the recoveries, which will be deposited into a trust for the benefit of the reinsurers. The Company has paid approximately $17 million of premiums during 2012. The remaining $17 million of premium was released from the trust to the reinsurers in the first quarter of 2013.

Re-Assumption Agreement with Radian Asset Assurance Inc.

On January 24, 2012, AGM entered into an agreement under which it reassumed $12.9 billion of par it had previously ceded to Radian. AGM has received a payment of $86 million from Radian for the re-assumption, which consists 96% of public finance exposure and 4% of structured finance credits. Additionally, the Company projected it will receive an incremental $1.9 million, on a present value basis of future installment premiums. The reassumed portfolio is composed entirely of selected credits that meet the Company's underwriting standards.

Tokio Marine & Nichido Fire Insurance Co., Ltd. Agreement

Effective as of March 1, 2012, AGM and Tokio entered into a Commutation, Reassumption and Release Agreement for a portfolio consisting of approximately $6.2 billion principal amount of U.S. public finance exposures outstanding as of February 29, 2012. Tokio paid AGM the statutory unearned premium outstanding as of February 29, 2012 plus a commutation premium.

15. Related Party Transactions

Guarantees or Contingencies for Related Parties

AGM has executed a net worth maintenance agreement on behalf of Assured Guaranty Municipal Insurance Company

(“AGMIC”) pursuant to which the Company agrees to maintain AGMIC's policyholders' surplus of $66 million as determined under the laws of New York. AGM has entered into a net worth maintenance agreement with AGBM pursuant to which AGM agrees to cause AGBM to maintain the minimum shareholders' equity required under the laws of Bermuda for AGBM to maintain its insurance license. However, under both of these net worth maintenance agreements, any contributions by AGM for such purpose shall not: (a) exceed 35% of AGM's policyholders' surplus on an accumulated basis as determined under the laws of the State of New York, (b) not have the effect of jeopardizing AGM's insurer financial strength rating from Moody's or S&P, and (c) be in compliance with Section 1505 of the New York Insurance Law. AGM has entered into an amended and restated net worth maintenance agreement with AGE pursuant to which the Company agrees to maintain AGE's capital resources at least equal to 110% of the minimum capital requirement as determined under the laws of the United Kingdom or required by the U.K. insurance regulator; provided that any such contributions by AGM shall not: (a) exceed 35% of AGM's policyholders' surplus on an accumulated basis as determined under the laws of the State of New York and (b) be in compliance with Section 1505 of the New York Insurance Law. AGM did not make any contributions under any of these net worth maintenance agreements with AGE in 2012 and 2011.

Management, Service Contracts or Cost Sharing Arrangements

Under a Service Agreement between AGC and AGM dated January 1, 2010, AGC provides insurance and certain support services, including actuarial, claims handling, surveillance, legal, corporate secretarial, information technology, human resources, accounting, tax, financial reporting and investment planning services to AGM. Also under the Service Agreement, AGM makes available office space and equipment to certain of its affiliates. Costs and expenses under the Service Agreement are allocated directly, where possible, and where not possible, allocated between companies according to: employee headcount multiplied by the percentage of employee time allocated to each company.

See Note 18, Employee Benefit Plans for expenses related to Long-Term Compensation Plans of AGL which are allocated to AGM. For the years ended December 31, 2012 and 2011, the Company was allocated expenses of $64 million and $55 million, respectively, under these affiliate expense sharing agreements. The increase in the expenses that AGC allocated to affiliates was a result of an updated time study. The primary driver was an increase in expenses allocated to AGM which guaranteed the majority of new business in 2012.

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

Amounts Due (To) From Affiliated Companies

	As of December 31,	
	2012	2011
	(in millions)	
Affiliated companies		
Assured Guaranty Corp.	$ (36)	$ (16)
Assured Guaranty Finance Overseas Ltd.	(1)	(2)
Assured Guaranty Ltd.	(1)	(1)
Other	(3)	(1)
Total	$ (41)	$ (20)

Assured Guaranty Re Ltd.

The Company cedes business to AG Re under certain reinsurance agreements. The following table summarizes the affiliated components of each balance sheet item, where applicable.

	As of December 31,	
	2012	2011
	(in millions)	
Assets:		
Ceded unearned premium reserve (1)	644	679
Reinsurance recoverable on unpaid losses	19	12
Reinsurance recoverable on paid losses(2)	1	8
Profit commission receivable (2)	3	5
Net credit derivative assets	45	41
Liabilities:		
Ceded premium payable, net of ceding commission	63	69
Ceded salvage and subrogation recoverable	17	13
Ceded funds held	36	22
Other liabilities (3)	118	106

(1) Includes $11 million and $5 million of ceded contra-paid on losses at December 31, 2012 and December 31, 2011, respectively.

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

(3) Represents deferred ceding commissions.

The table below summarizes ceded activity to AG Re reflected in the consolidated statement of operations.

	Year Ended December 31,	
	2012	2011
	(in millions)	
Revenues:		
Net earned premiums	(92)	(90)
Profit commission income	3	5
Realized gains and other settlements on credit derivatives	(1)	(2)
Net unrealized gains (losses) on credit derivatives	3	(4)
Expenses:		
Loss and loss adjustment expenses (recoveries)	(58)	(26)
Commissions incurred (earned)	(7)	(7)

Other Invested Assets

Surplus Note from AGC

On December 18, 2009, AGC issued a surplus note with a principal amount of $300.0 million to AGM. This note carries a simple interest rate of 5.0% per annum and matures on December 31, 2029. Principal is payable at the option of AGC prior to the final maturity of the note in 2029 and interest is payable on the note annually in arrears as of December 31 of each year, commencing December 31, 2010. Payments of principal and interest are subject to AGC having policyholders' surplus in excess of statutory minimum requirements after such payment and to prior written approval by the Maryland Insurance Administration. AGM recognized $15 million of interest income in each of the years ended December 31, 2012 and 2011. AGM also received $15 million of interest from AGC in each of the years ended December 31, 2012 and 2011. There was no principal paydown on the surplus note by AGC.

Loan Receivable from Affiliate

Loan to Assured Guaranty US Holdings Inc.

In May 2012, AGBM entered into a five-year loan agreement with AGUS which authorizes borrowings up to $172.5 million. On May 31, 2012, AGUS borrowed $82.5 million under such agreement. Interest is accruing on the unpaid principal amount of the loan at a rate of six-month LIBOR plus 3% per annum. The entire outstanding principal balance of the loan, together with all accrued and unpaid interest, will be due and payable on the fifth anniversary of the date the loan is made. AGM recognized $2 million of interest income during the year ended December 31, 2012.

Capital Contribution from AGMH

In the third quarter of 2008, AGM issued a non-interest bearing surplus note with no term to AGMH in exchange for $300 million which, due to the terms of the agreement, is recorded as capital. Principal on the surplus note may be paid at any time at the option of the Company, subject to prior approval of the New York Superintendent and in compliance with the conditions to such payments as contained in the New York Insurance Laws. The Company repaid $50 million in principal on these surplus notes in 2012 and $50 million in 2011. As of December 31, 2012, an aggregate principal of $125 million remains outstanding on the surplus note. In March 2013, AGM obtained approval from the New York Department of Financial Services to repay an additional $25 million of principal of the surplus note.

16. Commitments and Contingencies

Leases

Effective June 2004, the Company entered into a 21-year sublease agreement with Deutsche Bank AG for office space at 31 West 52nd Street, New York, New York. The Company moved to this space in June 2005. The lease contains scheduled rent increases every five years after the 19-month rent-free period, as well as lease incentives for initial construction costs of up to $6 million, as defined in the sublease. The lease contains provisions for rent increases related to increases in the building's operating expenses. The lease also contains a renewal option for an additional ten-year period, and an option to rent additional office space at various points in the future, in each case at then-current market rents. Rent expense was $5.0 million in 2012 and $4.9 million in 2011.

Future Minimum Rental Payments

Year	(in millions)
2013	$ 8.5
2014	7.4
2015	7.1
2016	7.5
2017	7.6
Thereafter	66.3
Total	$ 104.4

Legal Proceedings

Litigation

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

In addition, in the ordinary course of its business, the Company asserts claims in legal proceedings against third parties to recover losses paid in prior periods. For example, as described in the "Recovery Litigation" section within Note 6, Expected Loss to be Paid, as of the date of this filing, AGM has filed complaints against certain sponsors and underwriters of RMBS securities that AGM had insured, alleging, among other claims, that such persons had breached R&W in the transaction documents, failed to cure or repurchase defective loans and/or violated state securities laws. The amounts, if any, the Company will recover in proceedings to recover losses are uncertain, and recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or year could be material to the Company's results of operations in that particular quarter or year.

Proceedings Relating to the Company's Financial Guaranty Business

AGM and AGMH receive subpoenas *duces tecum* and interrogatories from regulators from time to time.

In August 2008, a number of financial institutions and other parties, including AGM and other bond insurers, were named as defendants in a civil action brought in the circuit court of Jefferson County, Alabama relating to the County's problems meeting its sewer debt obligations: *Charles E. Wilson vs. JPMorgan Chase & Co et al* (filed the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00, a putative class action. The action was brought on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleges conspiracy and fraud in connection with the issuance of the County's debt. The complaint in this lawsuit seeks equitable relief, unspecified monetary damages, interest, attorneys' fees and other costs. On January, 13, 2011, the circuit court issued an order denying a motion by the bond insurers and other defendants to dismiss the action. Defendants, including the bond insurers, have petitioned the Alabama Supreme Court for a writ of mandamus to the circuit court vacating such order and directing the dismissal with prejudice of plaintiffs' claims for lack of standing. On January 23, 2012, the Alabama Supreme Court entered a stay pending the resolution of the Jefferson County bankruptcy. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from this lawsuit.

Beginning in July 2008, AGM and various other financial guarantors were named in complaints filed in the Superior Court for the State of California, City and County of San Francisco. Since that time, plaintiffs' counsel has filed amended complaints against AGM and AGC and added additional plaintiffs. As of the date of this filing, the plaintiffs with complaints against AGM and AGC, among other financial guaranty insurers, are: (a) *City of Los Angeles, acting by and through the Los Angeles Department of Water and Power*; (b) *City of Sacramento*; (c) *City of Los Angeles*; (d) *City of Oakland*; (e) *City of Riverside*; (f) *City of Stockton*; (g) *County of Alameda*; (h) *Contra Costa County*; (i) *County of San Mateo*; (j) *Los Angeles World Airports;* (k) *City of Richmond;* (l) *Redwood City;* (m) *East Bay Municipal Utility District;* (n) *Sacramento Suburban Water District;* (o) *City of San Jose;* (p) *County of Tulare;* (q) *The Regents of the University of California;* (r) *The Redevelopment Agency of the City of Riverside;* (s) *The Public Financing Authority of the City of Riverside;* (t) *The Jewish Community Center of San Francisco;* (u) *The San Jose Redevelopment Agency;* (v) *The Redevelopment Agency of the City of Stockton;* (w) *The Public Financing Authority of the City of Stockton;* and (x) *The Olympic Club*. Complaints filed by the City and County of San Francisco and the Sacramento Municipal Utility District were subsequently dismissed as to AGM and AGC. These complaints allege that the financial guaranty insurer defendants (i) participated in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance, (ii) participated in risky financial transactions in other lines of business that damaged each insurer's financial condition (thereby undermining the value of each of their guaranties), and (iii) failed to adequately disclose the impact of those transactions on their financial condition. In addition to their antitrust claims, various plaintiffs in these actions assert claims for breach of the covenant of good faith and fair dealing, fraud, unjust enrichment, negligence, and negligent misrepresentation. At hearings held in July and October 2011 relating to AGM, AGC and the other defendants' demurrer, the court overruled the demurrer on the following claims: breach of contract, violation of California's antitrust statute and of its unfair business practices law, and fraud. The remaining claims were dismissed. On December 2, 2011, AGM, AGC and the other bond insurer defendants filed an anti-SLAPP ("Strategic Lawsuit Against Public Participation") motion to strike the complaints under California's Code of Civil Procedure. On May 1, 2012, the court ruled in favor of the bond insurer defendants on the first prong of the anti-SLAPP motion as to the causes of action arising from the alleged conspiracy, but denied the motion as to those causes of action based on transaction specific representations and omissions about the bond insurer defendants' credit ratings and financial health. The court held hearings on the second prong of the anti-SLAPP motion on March 21, 2013 and April 22, 2013. At the March 21, 2013 hearing, the court issued an oral ruling that, under the second prong of the anti-SLAPP motion, there has been no showing of an antitrust act claim against the defendants. At the April 22, 2013 hearing the court issued another oral ruling that, under the second prong of the anti-SLAPP motion, plaintiffs had offered sufficient evidence of a claim under California's Unfair Competition Law and denied defendants' motion to strike. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from these lawsuits.

On November 19, 2012, Lehman Brothers Holdings Inc. ("LBHI") and Lehman Brothers Special Financing Inc. ("LBSF") commenced an adversary complaint and claim objection in the United States Bankruptcy Court for the Southern District of New York against Credit Protection Trust 283 ("CPT 283"), FSA Administrative Services, LLC, as trustee for CPT 283, and AGM, in connection with CPT 283's termination of a CDS between LBSF and CPT 283. CPT 283 terminated the CDS as a consequence of LBSF failing to make a scheduled payment owed to CPT 283, which termination occurred after LBHI filed for bankruptcy but before LBSF filed for bankruptcy. The CDS provided that CPT 283 was entitled to receive from LBSF a termination payment in that circumstance of approximately $43.8 million (representing the economic equivalent of the future fixed payments CPT 283 would have been entitled to receive from LBSF had the CDS not been terminated), and CPT 283 filed proofs of claim against LBSF and LBHI (as LBSF's credit support provider) for such amount. LBHI and LBSF seek to disallow and expunge (as impermissible and unenforceable penalties) CPT 283's proofs of claim against LBHI and LBSF and recover approximately $67.3 million, which LBHI and LBSF allege was the mark-to-market value of the CDS to LBSF (less unpaid amounts) on the day CPT 283 terminated the CDS, plus interest, attorney's fees, costs and other expenses. On the same day, LBHI and LBSF also commenced an adversary complaint and claim objection against Credit Protection Trust 207 ("CPT 207"), FSA Administrative Services, LLC, as trustee for CPT 207, and AGM, in connection with CPT 207's termination of a CDS between LBSF and CPT 207. Similarly, the CDS provided that CPT 207 was entitled to receive from LBSF a termination payment in that circumstance of $492,555. LBHI and LBSF seek to disallow and expunge CPT 207's proofs of claim against LBHI and LBSF and recover approximately $1.5 million. AGM believes the terminations of the CDS and the calculation of the termination payment amounts were consistent with the terms of the ISDA master agreements between the parties. The Company cannot reasonably estimate the possible loss, if any, that may arise from this lawsuit.

Proceedings Related to AGMH's Former Financial Products Business

The following is a description of legal proceedings involving AGMH's former financial products business. Although Assured Guaranty did not acquire AGMH's former financial products business, which included AGMH's former GIC business, medium term notes business and portions of the leveraged lease businesses, certain legal proceedings relating to those businesses are against entities that Assured Guaranty did acquire. While Dexia SA and Dexia Crédit Local S.A. ("DCL"), jointly and severally, have agreed to indemnify Assured Guaranty against liability arising out of the proceedings described below in the "—Proceedings Related to AGMH's Former Financial Products Business" section, such indemnification might not be sufficient to fully hold Assured Guaranty harmless against any injunctive relief or civil or criminal sanction that is imposed against AGMH or its subsidiaries.

Governmental Investigations into Former Financial Products Business

AGMH and/or AGM have received subpoenas *duces tecum* and interrogatories or civil investigative demands from the Attorneys General of the States of Connecticut, Florida, Illinois, Massachusetts, Missouri, New York, Texas and West Virginia relating to their investigations of alleged bid rigging of municipal GICs. AGMH is responding to such requests. AGMH may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future. In addition,

- AGMH received a subpoena from the Antitrust Division of the Department of Justice in November 2006 issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives;

- AGM received a subpoena from the Securities and Exchange Commission ("SEC") in November 2006 related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives; and

- AGMH received a “Wells Notice” from the staff of the Philadelphia Regional Office of the SEC in February 2008 relating to the investigation concerning the bidding of municipal GICs and other municipal derivatives. The Wells Notice indicates that the SEC staff is considering recommending that the SEC authorize the staff to bring a civil injunctive action and/or institute administrative proceedings against AGMH, alleging violations of Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

Pursuant to the subpoenas, AGMH has furnished to the Department of Justice and SEC records and other information with respect to AGMH’s municipal GIC business. The ultimate loss that may arise from these investigations remains uncertain.

In July 2010, a former employee of AGM who had been involved in AGMH's former financial products business was indicted along with two other persons with whom he had worked at Financial Guaranty Insurance Company. Such former employee and the other two persons were convicted on fraud conspiracy counts. They have appealed the convictions.

Lawsuits Relating to Former Financial Products Business

During 2008, nine putative class action lawsuits were filed in federal court alleging federal antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. These cases have been coordinated and consolidated for pretrial proceedings in the U.S. District Court for the Southern District of New York as *MDL 1950, In re Municipal Derivatives Antitrust Litigation,* Case No. 1:08-cv-2516 ("MDL 1950").

Five of these cases named both AGMH and AGM: (a) *Hinds County, Mississippi v. Wachovia Bank, N.A.*; (b) *Fairfax County, Virginia v. Wachovia Bank, N.A.*; (c) *Central Bucks School District, Pennsylvania v. Wachovia Bank, N.A.*; (d) *Mayor and City Council of Baltimore, Maryland v. Wachovia Bank, N.A.*; and (e) *Washington County, Tennessee v. Wachovia Bank, N.A.* In April 2009, the MDL 1950 court granted the defendants' motion to dismiss on the federal claims, but granted leave for the plaintiffs to file a second amended complaint. In June 2009, interim lead plaintiffs' counsel filed a Second Consolidated Amended Class Action Complaint; although the Second Consolidated Amended Class Action Complaint currently describes some of AGMH's and AGM's activities, it does not name those entities as defendants. In March 2010, the MDL 1950 court denied the named defendants' motions to dismiss the Second Consolidated Amended Class Action Complaint. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

Four of the cases named AGMH (but not AGM) and also alleged that the defendants violated California state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the cities or municipalities of competition in the awarding of GICs and ultimately resulting in the cities paying higher fees for these products: (f) *City of Oakland, California v. AIG Financial Products Corp.*; (g) *County of Alameda, California v. AIG Financial Products Corp.*; (h) *City of Fresno, California v. AIG Financial Products Corp.*; and (i) *Fresno County Financing Authority v. AIG Financial Products Corp*. When the four plaintiffs filed a consolidated complaint in September 2009, the plaintiffs did not name AGMH as a defendant. However, the complaint does describe some of AGMH's and AGM's activities. The consolidated complaint generally seeks unspecified monetary damages, interest, attorneys' fees and other costs. In April 2010, the MDL 1950 court granted in part and denied in part the named defendants' motions to dismiss this consolidated complaint.

In 2008, AGMH and AGM also were named in five non-class action lawsuits originally filed in the California Superior Courts alleging violations of California law related to the municipal derivatives industry: (a) *City of Los Angeles, California v. Bank of America, N.A.*; (b) *City of Stockton, California v. Bank of America, N.A.*; (c) *County of San Diego, California v. Bank of America, N.A.*; (d) *County of San Mateo, California v. Bank of America, N.A.*; and (e) *County of Contra Costa, California v. Bank of America, N.A.* Amended complaints in these actions were filed in September 2009, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. These cases have been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings.

In late 2009, AGM and AGUS, among other defendants, were named in six additional non-class action cases filed in federal court, which also have been coordinated and consolidated for pretrial proceedings with MDL 1950: (f) City of Riverside, California v. Bank of America, N.A.; (g) Sacramento Municipal Utility District v. Bank of America, N.A.; (h) Los Angeles World Airports v. Bank of America, N.A.; (i) Redevelopment Agency of the City of Stockton v. Bank of America, N.A.; (j) Sacramento Suburban Water District v. Bank of America, N.A.; and (k) County of Tulare, California v. Bank of America, N.A.

The MDL 1950 court denied AGM and AGUS's motions to dismiss these eleven complaints in April 2010. Amended complaints were filed in May 2010. On October 29, 2010, AGM and AGUS were voluntarily dismissed with prejudice from the

Sacramento Municipal Utility District case only. The complaints in these lawsuits generally seek or sought unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from the remaining lawsuits.

In May 2010, AGM and AGUS, among other defendants, were named in five additional non-class action cases filed in federal court in California: (a) City of Richmond, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (b) City of Redwood City, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (c) Redevelopment Agency of the City and County of San Francisco, California v. Bank of America, N.A. (filed on May 21, 2010, N.D. California); (d) East Bay Municipal Utility District, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); and (e) City of San Jose and the San Jose Redevelopment Agency, California v. Bank of America, N.A (filed on May 18, 2010, N.D. California). These cases have also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In September 2010, AGM and AGUS, among other defendants, were named in a sixth additional non-class action filed in federal court in New York, but which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Active Retirement Community, Inc. d/b/a Jefferson's Ferry v. Bank of America, N.A. (filed on September 21, 2010, E.D. New York), which has also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In December 2010, AGM and AGUS, among other defendants, were named in a seventh additional non-class action filed in federal court in the Central District of California, Los Angeles Unified School District v. Bank of America, N.A., and in an eighth additional non-class action filed in federal court in the Southern District of New York, Kendal on Hudson, Inc. v. Bank of America, N.A. These cases also have been consolidated with MDL 1950 for pretrial proceedings. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from these lawsuits.

In January 2011, AGM and AGUS, among other defendants, were named in an additional non-class action case filed in federal court in New York, which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Peconic Landing at Southold, Inc. v. Bank of America, N.A. This case has been consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from this lawsuit.

In September 2009, the Attorney General of the State of West Virginia filed a lawsuit (Circuit Ct. Mason County, W. Va.) against Bank of America, N.A. alleging West Virginia state antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. An amended complaint in this action was filed in June 2010, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. This case has been removed to federal court as well as transferred to the S.D.N.Y. and consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks civil penalties, unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

17. Notes Payable and Credit Facilities

Notes Payable

Notes Payable represents debt issued by VIEs consolidated by AGM to one of the Financial Products Companies that were transferred to Dexia Holdings prior to the AGMH Acquisition. The funds borrowed were used to finance the purchase of the underlying obligations of AGM-insured obligations which had breached triggers allowing AGM to exercise its right to accelerate payment of a claim in order to mitigate loss. The assets purchased are classified as assets acquired in refinancing transactions and recorded in “other invested assets.” The terms of the notes payable match the terms of the assets acquired in refinancing transactions. On the Acquisition Date, the fair value of these notes payable was $164.4 million, including a premium of $9.5 million that is being amortized over the term of the debt.

The principal and carrying values of the Company's notes payable are presented in the table below.

Principal and Carrying Amounts of Notes Payable

	As of December 31,			
	2012		2011	
	Principal	Carrying Value	Principal	Carrying Value
	(in millions)			
Notes Payable	$ 61	$ 66	$ 97	$ 104

The Company recorded $7 million and $6 million of interest expense on the notes payable for the years ended December 31, 2012, and December 31, 2011, respectively.

Expected Maturity Schedule of Notes Payable

Expected Withdrawal Date	Principal Amount
	(in millions)
2013	$ 22
2014	10
2015	10
2016	6
2017	13
Thereafter	0
Total	$ 61

Recourse Credit Facilities

2009 Strip Coverage Facility

In connection with the AGMH Acquisition, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. The liquidity risk to AGM related to the strip policy portion of the leveraged lease business is mitigated by the strip coverage facility described below.

In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds). The tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the “strip coverage”) from its own sources. AGM issued financial guaranty insurance policies (known as “strip policies”) that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. AGM can then seek reimbursement of its strip policy payments from the tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

One event that may lead to an early termination of a lease is the downgrade of AGM, as the strip coverage provider, or the downgrade of the equity payment undertaker within the transaction, in each case, generally to a financial strength rating below double-A. Upon such downgrade, the tax exempt entity is generally obligated to find a replacement credit enhancer within a specified period of time; failure to find a replacement could result in a lease default, and failure to cure the default within a specified period of time could lead to an early termination of the lease and a demand by the lessor for a termination payment from the tax exempt entity. However, even in the event of an early termination of the lease, there would not necessarily be an automatic draw on AGM’s policy, as this would only occur to the extent the tax-exempt entity does not make the required termination payment.

As a result of the January 2013 Moody's downgrade of AGM, all the leveraged lease transactions in which AGM acts as strip coverage provider are currently breaching a ratings trigger related to AGM. If early termination of the leases were to occur and the tax-exempt entities do not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of approximately $1.7 billion as of December 31, 2012. To date, none of the leveraged lease transactions that involve AGM has experienced an early termination due to a lease default and a claim on the AGM guaranty. It is difficult to determine the probability that the Company will have to pay strip provider claims or the likely aggregate amount of such claims. At December 31, 2012, approximately $947 million of cumulative strip par exposure had been terminated since 2008 on a consensual basis. The consensual terminations have resulted in no claims on AGM.

On July 1, 2009, AGM and DCL, acting through its New York Branch ("Dexia Crédit Local (NY)"), entered into a credit facility (the "Strip Coverage Facility"). Under the Strip Coverage Facility, Dexia Crédit Local (NY) agreed to make loans to AGM to finance all draws made by lessors on AGM strip policies that were outstanding as of November 13, 2008, up to the commitment amount. The commitment amount of the Strip Coverage Facility was $1 billion at closing of the AGMH Acquisition but is scheduled to amortize over time. As of December 31, 2012, the maximum commitment amount of the Strip Coverage Facility has amortized to $960 million. It may also be reduced in 2014 to $750 million, if AGM does not have a specified consolidated net worth at that time.

Fundings under this facility are subject to certain conditions precedent, and their repayment is collateralized by a security interest that AGM granted to Dexia Crédit Local (NY) in amounts that AGM recovers—from the tax-exempt entity, or from asset sale proceeds—following its payment of strip policy claims. The Strip Coverage Facility will terminate upon the earliest to occur of an AGM change of control, the reduction of the commitment amount to $0, and January 31, 2042.

The Strip Coverage Facility's financial covenants require that AGM and its subsidiaries maintain a maximum debt-to-capital ratio of 30% and maintain a minimum net worth of 75% of consolidated net worth as of July 1, 2009, plus, starting July 1, 2014, (i) 25% of the aggregate consolidated net income (or loss) for the period beginning July 1, 2009 and ending on June 30, 2014 or, (2) zero, if the commitment amount has been reduced to $750 million as described above. The Company is in compliance with all financial covenants as of December 31, 2012.

The Strip Coverage Facility contains restrictions on AGM, including, among other things, in respect of its ability to incur debt, permit liens, pay dividends or make distributions, dissolve or become party to a merger or consolidation. Most of these restrictions are subject to exceptions. The Strip Coverage Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, bankruptcy or insolvency proceedings and cross-default to other debt agreements.

As of December 31, 2012, no amounts were outstanding under this facility, nor have there been any borrowings during the life of this facility.

AGM CPS Securities

In June 2003, $200 million of "AGM CPS Securities", money market preferred trust securities, were issued by trusts created for the primary purpose of issuing the AGM CPS Securities, investing the proceeds in high-quality commercial paper and selling put options to AGM, allowing AGM to issue the trusts non-cumulative redeemable perpetual preferred stock (the "AGM Preferred Stock") of AGM in exchange for cash. There are four trusts, each with an initial aggregate face amount of $50 million. These trusts hold auctions every 28 days, at which time investors submit bid orders to purchase AGM CPS Securities. If AGM were to exercise a put option, the applicable trust would transfer the portion of the proceeds attributable to principal received upon maturity of its assets, net of expenses, to AGM in exchange for AGM Preferred Stock. AGM pays a floating put premium to the trusts, which represents the difference between the commercial paper yield and the winning auction rate (plus all fees and expenses of the trust). If an auction does not attract sufficient clearing bids, however, the auction rate is subject to a maximum rate of one-month LIBOR plus 200 basis points for the next succeeding distribution period. Beginning in August 2007, the AGM CPS Securities required the maximum rate for each of the relevant trusts. AGM continues to have the ability to exercise its put option and cause the related trusts to purchase AGM Preferred Stock. The trusts provide AGM access to new capital at its sole discretion through the exercise of the put options. As of December 31, 2012 the put option had not been exercised. The Company does not consider itself to be the primary beneficiary of the trusts. See Note 8, Fair Value Measurement, –Other Assets–Committed Capital Securities, for a fair value measurement discussion.

18. Employee Benefit Plans

Accounting Policy

AGM participates in AGL's long term incentive plans. AGL follows the fair value recognition provisions for share based compensation expense. The Company is allocated its proportionate share of all compensation expense based on time studies conducted annually.

Assured Guaranty Ltd. 2004 Long-Term Incentive Plan

Under the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan, as amended (the "Incentive Plan"), the number of common shares that may be delivered under the Incentive Plan may not exceed 10,970,000. In the event of certain transactions affecting AGL's common shares, the number or type of shares subject to the Incentive Plan, the number and type of shares subject to outstanding awards under the Incentive Plan, and the exercise price of awards under the Incentive Plan, may be adjusted.

The Incentive Plan authorizes the grant of incentive stock options, non-qualified stock options, stock appreciation rights, and full value awards that are based on AGL's common shares. The grant of full value awards may be in return for a participant's previously performed services, or in return for the participant surrendering other compensation that may be due, or may be contingent on the achievement of performance or other objectives during a specified period, or may be subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals relating to completion of service by the participant, or achievement of performance or other objectives. Awards under the Incentive Plan may accelerate and become vested upon a change in control of AGL.

The Incentive Plan is administered by a committee of the Board of Directors of AGL. The Compensation Committee of the Board serves as this committee except as otherwise determined by the Board. The Board may amend or terminate the Incentive Plan. As of December 31, 2012, 2,565,007 common shares of AGL were available for grant under the Incentive Plan.

The Company recognized expenses of $3 million and $2 million for the years ended December 31, 2012 and 2011, respectively, under the Incentive Plan.

Stock Options

Nonqualified or incentive stock options may be granted to employees and directors of Assured Guaranty. Stock options are generally granted once a year with exercise prices equal to the closing price on the date of grant. To date, AGL has only issued nonqualified stock options. All stock options, except for performance stock options, granted to employees vest in equal annual installments over a three-year period and expire seven years or ten years from the date of grant. None of AGL's options, except for performance stock options, have a performance or market condition.

Performance Stock Options

Beginning in 2012, the Company has granted performance stock options under the Incentive Plan. These awards are non-qualified stock options with exercise prices equal to the closing price on the date of grant. These awards vest in full or on a pro-rata basis on the third anniversary of the grant date, if certain target hurdle prices are met. These awards expire seven years from the date of grant.

Restricted Stock Awards

Restricted stock awards are valued based on the closing price of the underlying shares at the date of grant. These Restricted stock awards to employees generally vest in equal annual installments over a four-year period.

Restricted Stock Units

Restricted stock units are valued based on the closing price of the underlying shares at the date of grant. Restricted stock units generally vest in equal installments over a four-year period.

Performance Restricted Stock Units

Beginning in 2012, the Company has granted performance restricted stock units under the Incentive Plan. These awards vest in full or on a pro-rata basis on the third anniversary of grant date, if certain target hurdle prices are met.

Employee Stock Purchase Plan

Assured Guaranty established the AGL Employee Stock Purchase Plan ("Stock Purchase Plan") in accordance with Internal Revenue Code Section 423, and participation is available to all eligible employees. Maximum annual purchases by participants are limited to the number of whole shares that can be purchased by an amount equal to 10% of the participant's compensation or, if less, shares having a value of $25,000. Participants may purchase shares at a purchase price equal to 85% of the lesser of the fair market value of the stock on the first day or the last day of the subscription period. The Company recorded $0.1 million and $0.1 million in share-based compensation, after the effects of DAC, under the Stock Purchase Plan during the years ended December 31, 2012 and 2011, respectively.

Cash-Based Compensation

Performance Retention Plan

Assured Guaranty has established the Assured Guaranty Ltd. Performance Retention Plan (“PRP”) which permits the grant of cash based awards to selected employees. PRP awards may be treated as nonqualified deferred compensation subject to the rules of Internal Revenue Code Section 409A. The PRP is a sub-plan under the Company's Long-Term Incentive Plan (enabling awards under the plan to be performance based compensation exempt from the $1 million limit on tax deductible compensation).

Assured Guaranty granted a limited number of PRP awards in 2007, which vested after four years of continued employment (or if earlier, on employment termination, if the participant's termination occured as a result of death, disability, or retirement). Participants received the designated award in a single lump sum in 2011.

Generally, each PRP award is divided into three installments, with 25% of the award allocated to a performance period that includes the year of the award and the next year, 25% of the award allocated to a performance period that includes the year of the award and the next two years, and 50% of the award allocated to a performance period that includes the year of the award and the next three years. Each installment of an award vests if the participant remains employed through the end of the performance period for that installment. Awards may vest upon the occurrence of other events as set forth in the plan documents. Payment for each performance period is made at the end of that performance period. One half of each installment is increased or decreased in proportion to the increase or decrease of per share adjusted book value during the performance period, and one half of each installment is increased or decreased in proportion to the operating return on equity during the performance period. As of December 31, 2012, a limited number of awards had cliff vesting in five years. Operating return on equity and adjusted book value are defined in each PRP award agreement.

A payment otherwise subject to the $1 million limit on tax deductible compensation, will not be made unless performance satisfies a minimum threshold.

The Company recognized performance retention plan expenses of $6 million and $3 million for the year ended December 31, 2012 and 2011, respectively, representing its proportionate share of the Assured Guaranty expense.

Defined Contribution Plans

Employees receive employer contributions into the AGC Employee Retirement Plan (“AGC ERP”) based on a fixed percentage of the employee's compensation and are eligible to make employee contributions and to receive matching employer contributions based on a percentage of compensation up to limits prescribed by Internal Revenue Code Section 401(k). The Company recognized defined contribution expenses of $4 million and $4 million for the years ended December 31, 2012 and 2011, respectively.

Employees receive employer contributions into the AGC Supplemental Executive Retirement Plan based on a fixed percentage of the employee's compensation and are eligible to make employee contributions and to receive matching employer contributions based on a percentage of compensation.

19. Other Comprehensive Income

Year Ended December 31, 2012

	Net Unrealized Gains (Losses) on Investments	Total Accumulated Other Comprehensive Income
	(in millions)	
Balance, December, 2011	$ 156	$ 156
Other comprehensive income (loss)	76	76
Balance, December 31, 2012	$ 232	$ 232

Year Ended December 31, 2011

	Net Unrealized Gains (Losses) on Investments	Total Accumulated Other Comprehensive Income
	(in millions)	
Balance, December 31, 2010	$ 14	$ 14
Other comprehensive income (loss)	142	142
Balance, December 31, 2011	$ 156	$ 156

APPENDIX 4

INTERIM FINANCIAL STATEMENTS OF ASSURED GUARANTY MUNICIPAL CORP.

Exhibit 99.2

Assured Guaranty Municipal Corp.

Consolidated Financial Statements

June 30, 2013

ASSURED GUARANTY MUNICIPAL CORP.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Assured Guaranty Municipal Corp.

Consolidated Balance Sheets (Unaudited)

(dollars in millions except per share and share amounts)

	As of June 30, 2013	As of December 31, 2012
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of $4,683 and $4,473)	$ 4,847	$ 4,831
Short-term investments, at fair value	623	473
Other invested assets	395	444
Total investment portfolio	5,865	5,748
Loan receivable from affiliate	83	83
Cash	63	47
Premiums receivable, net of ceding commissions payable	593	653
Ceded unearned premium reserve	1,111	1,187
Reinsurance recoverable on unpaid losses	81	75
Salvage and subrogation recoverable	240	383
Credit derivative assets	114	131
Deferred tax asset, net	384	409
Financial guaranty variable interest entities’ assets, at fair value	1,784	1,870
Other assets	128	127
Total assets	**$ 10,446**	**$ 10,713**
Liabilities and shareholder's equity		
Unearned premium reserve	$ 3,557	$ 3,866
Loss and loss adjustment expense reserve	225	230
Reinsurance balances payable, net	255	292
Notes payable	53	66
Credit derivative liabilities	424	414
Financial guaranty variable interest entities’ liabilities with recourse, at fair value	1,422	1,605
Financial guaranty variable interest entities’ liabilities without recourse, at fair value	717	678
Other liabilities	388	343
Total liabilities	**7,041**	**7,494**
Commitments and contingencies (See Note 14)		
Preferred stock ($1,000 par value, 5,000.1 shares authorized; 0 shares issued and outstanding)	—	—
Common stock ($45,455 par value, 330 shares authorized; issued and outstanding)	15	15
Additional paid-in capital	1,067	1,092
Retained earnings	2,216	1,880
Accumulated other comprehensive income, net of tax of $58 and $125	107	232
Total shareholder's equity	**3,405**	**3,219**
Total liabilities and shareholder's equity	**$ 10,446**	**$ 10,713**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Operations (Unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues				
Net earned premiums	$ 109	$ 156	$ 285	$ 290
Net investment income	56	59	112	113
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(13)	—	(14)	0
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(10)	0	(7)	2
Other net realized investment gains (losses)	1	(9)	(3)	(6)
Net realized investment gains (losses)	(2)	(9)	(10)	(8)
Net change in fair value of credit derivatives:				
Realized gains and other settlements	18	(6)	29	(7)
Net unrealized gains (losses)	45	53	(22)	24
Net change in fair value of credit derivatives	63	47	7	17
Fair value gain (loss) on committed capital securities	(1)	2	(4)	(3)
Fair value gains (losses) on financial guaranty variable interest entities	147	65	222	30
Other income	(9)	13	(25)	96
Total revenues	363	333	587	535
Expenses				
Loss and loss adjustment expenses	33	76	4	266
Amortization of deferred ceding commissions	(19)	(1)	(22)	(2)
Interest expense	2	3	3	4
Other operating expenses	25	24	55	54
Total expenses	41	102	40	322
Income (loss) before income taxes	322	231	547	213
Provision (benefit) for income taxes:				
Current	17	(16)	81	18
Deferred	86	86	92	36
Total provision (benefit) for income taxes	103	70	173	54
Net income (loss)	**$ 219**	**$ 161**	**$ 374**	**$ 159**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Comprehensive Income (Unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income (loss)	**$ 219**	**$ 161**	**$ 374**	**$ 159**
Unrealized holding gains (losses) arising during the period:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $(43), $0, $(55) and $7	(81)	0	(103)	14
Investments with other-than-temporary impairment, net of tax provision (benefit) of $(5), $1, $(16) and $2	(11)	2	(30)	4
Unrealized holding gains (losses) arising during the period, net of tax	(92)	2	(133)	18
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(1), $(5), $(4) and $(6)	(3)	(10)	(8)	(11)
Other comprehensive income (loss)	(89)	12	(125)	29
Comprehensive income (loss)	**$ 130**	**$ 173**	**$ 249**	**$ 188**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Shareholder's Equity (unaudited)

For the Six Months Ended June 30, 2013

(dollars in millions, except share data)

	Common Stock					
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity
Balance at December 31, 2012	330	$ 15	$ 1,092	$ 1,880	$ 232	$ 3,219
Net income	—	—	—	374	—	374
Dividends	—	—	—	(38)	—	(38)
Other comprehensive loss	—	—	—	—	(125)	(125)
Return of capital	—	—	(25)	—	—	(25)
Balance at June 30, 2013	**330**	**$ 15**	**$ 1,067**	**$ 2,216**	**$ 107**	**$ 3,405**

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

Assured Guaranty Municipal Corp.

Consolidated Statements of Cash Flows (Unaudited)

(in millions)

	Six Months Ended June 30,	
	2013	2012
Net cash flows provided by (used in) operating activities	$ 271	$ 274
Investing activities		
Fixed maturity securities:		
Purchases	(426)	(326)
Sales	44	185
Maturities	186	214
Net sales (purchases) of short-term investments	(150)	(77)
Net proceeds from paydowns on financial guaranty variable interest entities' assets	402	242
Loan to affiliate	—	(83)
Other investments	12	26
Net cash flows provided by (used in) investing activities	**68**	**181**
Financing activities		
Dividends paid	(38)	(30)
Repayment of notes payable	(13)	(23)
Net paydowns of financial guaranty variable interest entities' liabilities	(244)	(331)
Return of capital	(25)	(50)
Net cash flows provided by (used in) financing activities	**(320)**	**(434)**
Effect of exchange rate changes	(3)	(3)
Increase (decrease) in cash	**16**	**18**
Cash at beginning of period	47	59
Cash at end of period	**$ 63**	**$ 77**
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$ 23	$ (95)
Interest	$ 3	$ 5

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

1. Business and Basis of Presentation

Business

Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("AGM," or together with its direct and indirect owned subsidiaries, the "Company"), a New York domiciled insurance company, is a wholly owned subsidiary of Assured Guaranty Municipal Holdings Inc. ("AGMH"). AGMH is an indirect and wholly owned subsidiary of Assured Guaranty Ltd. ("AGL" and, together with its subsidiaries, "Assured Guaranty"). AGL is a Bermuda based holding company that provides, through its operating subsidiaries, credit protection products to the United States ("U.S.") and international public finance (including infrastructure) and structured finance markets.

The Company applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The Company markets its credit protection products directly to issuers and underwriters of public finance securities as well as to investors in such obligations. The Company guarantees obligations issued in many countries, although its principal focus is on the U.S., as well as Europe and Australia. The Company had previously offered insurance and reinsurance in the global structured finance market, but has not done so since mid-2008.

Financial guaranty insurance policies provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest ("Debt Service") when due. Upon an obligor's default on scheduled principal or interest payments due on the obligation, the Company is required under the financial guaranty policy to pay the principal or interest shortfall. The Company has issued financial guaranty insurance policies on public finance obligations and, prior to mid-2008, structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets such as residential or commercial mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value. While AGM has ceased insuring new originations of asset-backed securities, a significant portfolio of such obligations remains outstanding and its wholly owned subsidiary Assured Guaranty (Europe) Ltd. ("AGE") provides financial guarantees in both the international public finance and structured finance markets.

In the past, the Company had sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives. Financial guaranty contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company's obligation to make loss payments are similar to those for financial guaranty insurance contracts and only occurs upon one or more defined credit events such as failure to pay or bankruptcy, in each case, as defined within the transaction documents, with respect to one or more third party referenced securities or loans. Financial guaranty contracts accounted for as credit derivatives are primarily comprised of credit default swaps ("CDS"). The Company's credit derivative transactions are governed by International Swaps and Derivative Association, Inc. ("ISDA") documentation. The Company has not entered into any new CDS in order to sell credit protection since the beginning of 2009, when regulatory guidelines were issued that limited the terms under which such protection could be sold. The capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), also contributed to the decision of the Company not to enter into such new CDS in the foreseeable future. The Company actively pursues opportunities to terminate existing CDS, which have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities ("FG VIEs") for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of June 30, 2013 and cover the three-month period ended June 30, 2013 ("Second Quarter 2013") and the three-month period ended June 30, 2012 ("Second Quarter 2012"), the six-month period ended June 30, 2013 ("Six Months 2013") and the six-month period ended June 30, 2012 ("Six Months 2012"). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements.

The unaudited interim consolidated financial statements include the accounts of AGM and its subsidiaries (collectively, the "Subsidiaries"), and its consolidated FG VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in Exhibit 99.1 in AGL's Form 8-K dated April 23, 2013, filed with the U.S. Securities and Exchange Commission (the "SEC").

As of June 30, 2013, AGM's direct and indirect subsidiaries were as follows:

- Assured Guaranty (Europe) Ltd., organized in the United Kingdom;
- Assured Guaranty Municipal Insurance Company ("AGMIC"), domiciled in New York; and
- Assured Guaranty (Bermuda) Ltd. ("AGBM"), organized in Bermuda.

As of the date of this filing, after giving effect to the completion on July 16, 2013 of a series of transactions that resulted in Municipal Assurance Corp. ("MAC") becoming a subsidiary of AGM, with approximately $700 million of capital and $100 million of surplus note issued by MAC to AGM, AGM's direct and indirect subsidiaries are as follows:

- Assured Guaranty (Europe) Ltd.; organized in the United Kingdom and 100% owned by AGM;
- Municipal Assurance Holdings Inc. ("MAC Holdings"), incorporated in Delaware and 61% owned by AGM and 39% owned by AGM's affiliate, Assured Guaranty Corp.; and
- Municipal Assurance Corp., domiciled in New York and 100% owned by Municipal Assurance Holdings Inc.

The transactions are described in greater detail in Note 17, Subsequent Events.

2. Business Changes and Accounting Developments

Summarized below are updates of the most significant recent events that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

Rating Actions

When a rating agency assigns a public rating to a financial obligation guaranteed by AGM or its subsidiaries AGE or MAC, it generally awards that obligation the same rating it has assigned to the financial strength of those insurance companies. Investors in products insured by AGM or MAC and guaranteed by AGE frequently rely on ratings published by nationally recognized statistical rating organizations ("NRSROs") because such ratings influence the trading value of securities and form the basis for many institutions' investment guidelines as well as individuals' bond purchase decisions. Therefore, the Company manages its business with the goal of achieving high financial strength ratings. If the financial strength ratings were reduced below current levels, the Company expects it could have adverse effects on its future business opportunities as well as the premiums it could charge for its insurance policies and consequently, a downgrade could harm the Company's new business production and results of operations in a material respect. The models used by NRSROs differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. The models are not fully transparent, contain subjective data (such as assumptions about future market demand for the Company's products) and change frequently. Ratings reflect only the views of the respective NRSROs and are subject to continuous review and revision or withdrawal at any time.

In the last several years, Standard & Poor's Ratings Services ("S&P") and Moody's Investors Service, Inc. ("Moody's") have downgraded the financial strength ratings of AGM and AGE. On January 17, 2013, Moody's downgraded the financial strength rating of AGM and AGE to A2 from Aa3. While the outlook for the ratings from S&P and Moody's is stable, there can be no assurance that S&P and Moody's will not take further action on AGM's and AGE's ratings. For a discussion of the effect of rating actions on AGM and AGE, see the following:

- Note 5, Expected Loss to be Paid
- Note 13, Reinsurance and Other Monoline Exposures
- Note 15, Notes Payable and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

In July 2013, MAC was assigned a financial strength rating of AA+ (stable outlook) from Kroll Bond Rating Agency and of AA- (stable outlook) from S&P. These ratings are also subject to continuous review and revision or withdrawal at any time.

Accounting Changes

In 2013, the Company expanded Note 16, Other Comprehensive Income, upon adoption of new guidance on other comprehensive income disclosures (per Accounting Standards Update (ASU) No. 2013-02).

Significant Transactions

- On May 6, 2013, Assured Guaranty entered into an agreement with UBS Real Estate Securities Inc. and affiliates ("UBS") and a third party resolving the Assured Guaranty's claims and liabilities related to specified residential mortgage-backed securities ("RMBS") transactions that were issued, underwritten or sponsored by UBS and insured by AGM or Assured Guaranty Corp. ("AGC"), an affiliate of the Company, under financial guaranty insurance policies. See Note 5, Expected Loss to be Paid.

- On June 21, 2013, AGM entered into a settlement agreement with Flagstar Bank in connection with its litigation for breach of contract against Flagstar on the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 second lien transactions. The agreement followed judgments by the court in February and April 2013 in favor of AGM, which Flagstar had planned to appeal. As part of the settlement, AGM received a cash payment of $105 million and Flagstar withdrew its appeal. Flagstar also will reimburse AGM in full for all future claims on AGM's financial guaranty insurance policies for such transactions. This settlement resolved all RMBS claims that AGM had asserted against Flagstar and each party agreed to release the other from any and all other future RMBS-related claims between them.

- In August 2013, AGM reached an agreement in principle with a servicer of certain RMBS transactions that AGM had insured. See Note 5, Expected Loss to be Paid.

- See Note 17, Subsequent Events, for transactions related to capitalization of MAC.

3. Outstanding Exposure

The Company's financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party and affiliated reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Some of these VIEs are consolidated as described in Note 9, Consolidation of Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
	(in millions)			
Public finance	$ 503,820	$ 537,810	$ 365,771	$ 391,826
Structured finance	53,347	60,926	46,528	53,449
Total financial guaranty	$ 557,167	$ 598,736	$ 412,299	$ 445,275

Financial Guaranty Portfolio by Internal Rating
As of June 30, 2013

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	$ 3,409	1.6%	$ 516	2.4%	$ 21,433	64.3%	$ 5,918	75.3%	$ 31,276	11.2%
AA	76,289	35.2%	440	2.1%	6,278	18.8%	422	5.4%	83,429	29.9%
A	112,866	52.1%	5,371	25.5%	463	1.4%	344	4.3%	119,044	42.7%
BBB	22,353	10.3%	13,417	63.7%	158	0.5%	559	7.1%	36,487	13.1%
Below-investment-grade ("BIG")	1,779	0.8%	1,328	6.3%	5,018	15.0%	619	7.9%	8,744	3.1%
Total net par outstanding	$ 216,696	100.0%	$ 21,072	100.0%	$ 33,350	100.0%	$ 7,862	100.0%	$ 278,980	100.0%

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2012

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	3,521	1.5%	508	2.2%	24,416	63.7%	6,626	73.8%	35,071	11.7%
AA	82,798	36.2%	789	3.4%	6,833	17.8%	469	5.2%	90,889	30.3%
A	118,867	52.0%	5,946	25.4%	1,155	3.0%	586	6.6%	126,554	42.3%
BBB	21,795	9.5%	14,506	62.0%	215	0.6%	676	7.5%	37,192	12.4%
BIG	1,822	0.8%	1,635	7.0%	5,703	14.9%	624	6.9%	9,784	3.3%
Total net par outstanding	$ 228,803	100.0%	$ 23,384	100.0%	$ 38,322	100.0%	$ 8,981	100.0%	$ 299,490	100.0%

The Company classifies those portions of risks benefiting from reimbursement obligations collateralized, or expected to be collateralized, by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating.

Securities purchased for loss mitigation purposes, which are generally rated BIG, represented $719 million and $703 million of gross par outstanding as of June 30, 2013 and December 31, 2012, respectively. In addition, under the terms of certain credit derivative contracts, the referenced obligations in such contracts have been delivered to the Company and recorded in other invested assets in the consolidated balance sheets. Such amounts totaled $218 million and $219 million in gross par outstanding as of June 30, 2013 and December 31, 2012, respectively.

In addition to amounts shown in the tables above, AGM had outstanding commitments to provide guaranties of $136 million for structured finance and $1.5 billion for public finance obligations at June 30, 2013, of which up to $208 million can be used together with AGC, an affiliate of the Company. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between July 1, 2013 and February 25, 2017; with $1.4 billion expiring prior to December 31, 2013. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Economic Exposure to the Selected European Countries

Several European countries continue to experience significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The European countries where it believes heightened uncertainties exist are: Hungary, Ireland, Italy, Portugal and Spain (the “Selected European Countries”). The Company is closely monitoring its exposures in Selected European Countries where it believes heightened uncertainties exist. Published reports have identified countries that may be experiencing reduced demand for their sovereign debt in the current environment. The Company selected these European countries based on these reports and its view that their credit fundamentals are deteriorating. The Company's economic exposure to the Selected European Countries (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following table net of ceded reinsurance.

Net Economic Exposure to Selected European Countries(1)
June 30, 2013

	Hungary	Ireland	Italy	Portugal	Spain (2)	Total
			(in millions)			
Sovereign and sub-sovereign exposure:						
Public finance	$ —	$ —	$ 806	$ 94	$ 214	$ 1,114
Infrastructure finance	309	—	10	—	142	461
Sub-total	309	—	816	94	356	1,575
Non-sovereign exposure:						
Regulated utilities	—	—	126	—	0	126
RMBS	205	—	461	—	—	666
Pooled corporate obligations	—	74	56	12	109	251
Sub-total	205	74	643	12	109	1,043
Total	$ 514	$ 74	$ 1,459	$ 106	$ 465	$ 2,618
Total BIG	$ 514	$ 7	$ —	$ 94	$ 356	$ 971

(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars, Euros and British pounds sterling. One of the RMBS included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 5, Expected Loss to be Paid.

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. For direct exposure this can be a relatively straight-forward determination as, for example, a debt issue supported by availability payments for a toll road in a particular country. The Company may also assign portions of a risk to more than one geographic location.

The Company has included in the exposure tables above its indirect economic exposure to the Selected European Countries through exposure it provides on pooled corporate obligations. The Company considers economic exposure to a Selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. In most instances, the trustees and/or servicers for such transactions provide reports that identify the domicile of the underlying obligors in the pool, although occasionally such information is not available to the Company. The Company has reviewed transactions through which it believes it may have indirect exposure to the Selected European Countries that is material to the transaction and included in the tables above the proportion of the insured par equal to the proportion of obligors so identified as being domiciled in a Selected European Country.

The Company no longer guarantees any sovereign bonds of the Selected European Countries. The exposure shown in the “Public Finance Category” is from transactions backed by receivable payments from sub-sovereigns in Italy, Spain and Portugal. Sub-sovereign debt is debt issued by a governmental entity or government backed entity, or supported by such an entity, that is other than direct sovereign debt of the ultimate governing body of the country.

Surveillance Categories

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

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter.

Credits identified as BIG are subjected to further review to determine the probability of a loss (see Note 5, Expected Loss to be Paid). Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a lifetime loss is expected and whether a claim has been paid. The Company expects “lifetime losses” on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims over the life of that transaction than it ultimately will have reimbursed. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for recording of reserves for financial statement purposes.)

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The three BIG categories are:

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make lifetime losses possible, but for which none are currently expected. Transactions on which claims have been paid but are expected to be fully reimbursed (other than investment grade transactions on which only liquidity claims have been paid) are in this category.

- BIG Category 2: Below-investment-grade transactions for which lifetime losses are expected but for which no claims (other than liquidity claims which is a claim that the Company expects to be reimbursed within one year) have yet been paid.

- BIG Category 3: Below-investment-grade transactions for which lifetime losses are expected and on which claims (other than liquidity claims) have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains.

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of June 30, 2013

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 71	—%
Alt-A first lien	—	295	536	831	1,036	0.3
Option ARM	0	—	196	196	521	0.1
Subprime	31	961	569	1,561	3,206	0.6
Second lien U.S. RMBS:						
Closed end second lien	—	20	207	227	372	0.1
Home equity lines of credit ("HELOCs")	129	—	1,725	1,854	2,224	0.7
Total U.S. RMBS	160	1,276	3,233	4,669	7,430	1.8
Trust preferred securities ("TruPS")	—	—	—	—	72	0.0
Other structured finance	669	210	89	968	33,710	0.3
U.S. public finance	1,494	49	236	1,779	216,696	0.5
Non-U.S. public finance	759	569	—	1,328	21,072	0.5
Total	$ 3,082	$ 2,104	$ 3,558	$ 8,744	$ 278,980	3.1%

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of December 31, 2012

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 77	—%
Alt-A first lien	26	285	571	882	1,104	0.3
Option ARM	—	—	525	525	762	0.2
Subprime	78	934	583	1,595	3,313	0.5
Second lien U.S. RMBS:						
Closed end second lien	—	205	98	303	461	0.1
HELOCs	72	—	1,967	2,039	2,464	0.7
Total U.S. RMBS	176	1,424	3,744	5,344	8,181	1.8
TruPS	—	—	—	—	90	0.0
Other structured finance	678	216	89	983	39,032	0.3
U.S. public finance	1,633	—	189	1,822	228,803	0.6
Non-U.S. public finance	1,635	—	—	1,635	23,384	0.6
Total	$ 4,122	$ 1,640	$ 4,022	$ 9,784	$ 299,490	3.3%

Below-Investment-Grade Credits
By Category
As of June 30, 2013

	Net Par Outstanding			Number of Risks(2)		
Description	**Financial Guaranty Insurance(1)**	**Credit Derivative**	**Total**	**Financial Guaranty Insurance(1)**	**Credit Derivative**	**Total**
	(dollars in millions)					
BIG:						
Category 1	$ 2,894	$ 188	$ 3,082	65	6	71
Category 2	2,104	—	2,104	26	—	26
Category 3	3,444	114	3,558	51	9	60
Total BIG	$ 8,442	$ 302	$ 8,744	142	15	157

Below-Investment-Grade Credits
By Category
As of December 31, 2012

	Net Par Outstanding			Number of Risks(2)		
Description	**Financial Guaranty Insurance(1)**	**Credit Derivative**	**Total**	**Financial Guaranty Insurance(1)**	**Credit Derivative**	**Total**
	(dollars in millions)					
BIG:						
Category 1	$ 3,723	$ 399	$ 4,122	71	6	77
Category 2	1,640	—	1,640	21	—	21
Category 3	3,892	130	4,022	50	9	59
Total BIG	$ 9,255	$ 529	$ 9,784	142	15	157

(1) Includes net par outstanding for FG VIE.

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

4. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives, for a discussion of credit derivative revenues.

Net Earned Premiums

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Scheduled net earned premiums	$ 79	$ 102	$ 166	$ 207
Acceleration of premium earnings	27	51	113	76
Accretion of discount on net premiums receivable	3	3	6	7
Total net earned premiums(1)	$ 109	$ 156	$ 285	$ 290

(1) Excludes $14 million and $15 million for Second Quarter 2013 and 2012, respectively, and $32 million and $31 million for the Six Months 2013 and 2012, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of June 30, 2013			As of December 31, 2012		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
	(in millions)					
Deferred premium revenue	$ 3,691	$ 1,144	$ 2,547	$ 4,016	$ 1,224	$ 2,792
Contra-paid	(134)	(33)	(101)	(150)	(37)	(113)
Total	$ 3,557	$ 1,111	$ 2,446	$ 3,866	$ 1,187	$ 2,679

(1) Excludes $201 million and $251 million of deferred premium revenue and $58 million and $98 million of contra-paid related to FG VIEs as of June 30, 2013 and December 31, 2012, respectively.

Gross Premium Receivable, Net of Ceding Commissions Roll Forward

	Six Months	
	2013	2012
	(in millions)	
Balance beginning of period	$ 653	$ 645
Premium written, net	37	78
Premium payments received, net	(81)	(116)
Adjustments:		
Changes in the expected term of financial guaranty insurance contracts	(1)	17
Accretion of discount	9	11
Foreign exchange remeasurement	(24)	0
Consolidation of FG VIEs	0	(5)
Other adjustments	—	(1)
Balance, end of period (1)	$ 593	$ 629

(1) Excludes $9 million and $21 million as of June 30, 2013 and 2012, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 66%, 66% and 69% of installment premiums at June 30, 2013, December 31, 2012 and June 30, 2012, respectively, are denominated in currencies other than the U.S. dollar, primarily Euro and British Pound Sterling.

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

Expected Collections of Gross Premiums Receivable,
Net of Ceding Commissions (Undiscounted)

	June 30, 2013
	(in millions)
2013 (July 1- September 30)	$ 19
2013 (October 1 - December 31)	23
2014	65
2015	60
2016	56
2017	52
2018-2022	202
2023-2027	125
2028-2032	90
After 2032	104
Total(1)	$ 796

(1) Excludes expected cash collections on FG VIEs of $10 million.

Scheduled Net Earned Premiums
Financial Guaranty Insurance Contracts

	As of June 30, 2013
	(in millions)
2013 (July 1- September 30)	$ 77
2013 (October 1 - December 31)	72
Subtotal 2013	149
2014	268
2015	231
2016	205
2017	180
2018-2022	661
2023-2027	396
2028-2032	229
After 2032	228
Total present value basis(1)	2,547
Discount	127
Total future value	$ 2,674

(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $201 million.

Selected Information for Policies Paid in Installments

	As of June 30, 2013	As of December 31, 2012
	(dollars in millions)	
Premiums receivable, net of ceding commission payable	$ 593	$ 653
Gross deferred premium revenue	1,397	1,562
Weighted-average risk-free rate used to discount premiums	3.5%	3.5%
Weighted-average period of premiums receivable (in years)	9.7	10.0

5. Expected Loss to be Paid

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives, or FG VIEs, by sector after the benefit for contractual and expected breaches of representations and warranties ("R&W"). The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 4.03% as of June 30, 2013 and 0.0% to 3.28% as of December 31, 2012.

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Second Quarter 2013

	Net Expected Loss to be Paid as of March 31, 2013	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2013(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 146	$ (2)	$ (11)	$ 133
Option ARM	(317)	14	295	(8)
Subprime	175	19	(7)	187
Total first lien	4	31	277	312
Second lien:				
Closed end second lien	(31)	7	1	(23)
HELOCs	(129)	(12)	68	(73)
Total second lien	(160)	(5)	69	(96)
Total U.S. RMBS	(156)	26	346	216
Other structured finance	29	(5)	—	24
U.S. public finance	(59)	15	(3)	(47)
Non-U.S. public finance	44	3	—	47
Total	$ (142)	$ 39	$ 343	$ 240

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Second Quarter 2012

	Net Expected Loss to be Paid as of March 31, 2012	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2012
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 82	$ 18	$ 53	$ 153
Option ARM	52	(4)	(107)	(59)
Subprime	159	10	(20)	149
Total first lien	293	24	(74)	243
Second lien:				
Closed end second lien	(40)	(5)	(1)	(46)
HELOCs	(84)	13	(22)	(93)
Total second lien	(124)	8	(23)	(139)
Total U.S. RMBS	169	32	(97)	104
Other structured finance	33	5	—	38
U.S. public finance	(36)	18	(1)	(19)
Non-U.S. public finance	240	(7)	(34)	199
Total	$ 406	$ 48	$ (132)	$ 322

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Six Months 2013

	Net Expected Loss to be Paid as of December 31, 2012(2)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2013(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 149	$ 1	$ (17)	$ 133
Option ARM	(142)	(120)	254	(8)
Subprime	162	33	(8)	187
Total first lien	169	(86)	229	312
Second lien:				
Closed end second lien	(49)	8	18	(23)
HELOCs	(128)	(10)	65	(73)
Total second lien	(177)	(2)	83	(96)
Total U.S. RMBS	(8)	(88)	312	216
Other structured finance	28	(3)	(1)	24
U.S. public finance	(58)	30	(19)	(47)
Non-U.S. public finance	38	9	0	47
Total	$ 0	$ (52)	$ 292	$ 240

Net Expected Loss to be Paid
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Six Months 2012

	Net Expected Loss to be Paid as of December 31, 2011	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of June 30, 2012
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 93	$ 15	$ 45	$ 153
Option ARM	135	(11)	(183)	(59)
Subprime	155	21	(27)	149
Total first lien	383	25	(165)	243
Second lien:				
Closed end second lien	(32)	(8)	(6)	(46)
HELOCs	(75)	15	(33)	(93)
Total second lien	(107)	7	(39)	(139)
Total U.S. RMBS	276	32	(204)	104
Other structured finance	62	(23)	(1)	38
U.S. public finance	(35)	19	(3)	(19)
Non-U.S. public finance	38	150	11	199
Total	$ 341	$ 178	$ (197)	$ 322

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

(2) Includes net expected loss adjustment expenses ("LAE") to be paid for mitigating claim liabilities of $12 million as of June 30, 2013 and $19 million as of December 31, 2012. The Company paid $12 million and $8 million in LAE for Second Quarter 2013 and 2012, respectively, and $20 million and $14 million in LAE for Six Months 2013 and 2012, respectively.

Net Expected Recoveries from Breaches of R&W Rollforward Second Quarter 2013

	Future Net R&W Benefit as of March 31, 2013	R&W Development and Accretion of Discount During Second Quarter 2013	R&W Recovered During Second Quarter 2013(1)	Future Net R&W Benefit as of June 30, 2013(2)
		(in millions)		
U.S. RMBS:				
Alt-A first lien	$ 130	$ —	(5)	$ 125
Option ARM	581	13	(399)	195
Subprime	112	(5)	—	107
Total first lien	823	8	(404)	427
Second lien:				
Closed end second lien	88	—	(2)	86
HELOC	136	27	(102)	61
Total second lien	224	27	(104)	147
Total	$ 1,047	$ 35	$ (508)	$ 574

Net Expected Recoveries from Breaches of R&W Rollforward Second Quarter 2012

	Future Net R&W Benefit as of March 31, 2012	R&W Development and Accretion of Discount During Second Quarter 2012	R&W Recovered During Second Quarter 2012(1)	Future Net R&W Benefit as of June 30, 2012(2)
		(in millions)		
U.S. RMBS:				
Alt-A first lien	$ 186	$ 10	(62)	$ 134
Option ARM	630	28	(58)	600
Subprime	96	(4)	—	92
Total first lien	912	34	(120)	826
Second lien:				
Closed end second lien	117	1	(6)	112
HELOC	114	(1)	(16)	97
Total second lien	231	0	(22)	209
Total	$ 1,143	$ 34	$ (142)	$ 1,035

(1) Gross amounts recovered were $529 million and $155 million for Second Quarter 2013 and 2012, respectively.

(2) Includes excess spread that the Company will receive as salvage as a result of a settlement agreement with a R&W provider.

Net Expected Recoveries from Breaches of R&W Rollforward Six Months 2013

	Future Net R&W Benefit as of December 31, 2012	R&W Development and Accretion of Discount During Six Months 2013	R&W Recovered During Six Months 2013(1)	Future Net R&W Benefit as of June 30, 2013(2)
	(in millions)			
U.S. RMBS:				
Alt-A first lien	$ 132	$ —	(7)	$ 125
Option ARM	481	162	(448)	195
Subprime	107	—	—	107
Total first lien	720	162	(455)	427
Second lien:				
Closed end second lien	115	(9)	(20)	86
HELOC	125	44	(108)	61
Total second lien	240	35	(128)	147
Total	$ 960	$ 197	$ (583)	$ 574

Net Expected Recoveries from Breaches of R&W Rollforward Six Months 2012

	Future Net R&W Benefit as of December 31, 2011	R&W Development and Accretion of Discount During Six Months 2012	R&W Recovered During Six Months 2012(1)	Future Net R&W Benefit as of June 30, 2012(2)
	(in millions)			
U.S. RMBS:				
Alt-A first lien	$ 181	$ 16	(63)	$ 134
Option ARM	619	56	(75)	600
Subprime	101	(9)	—	92
Total first lien	901	63	(138)	826
Second lien:				
Closed end second lien	118	—	(6)	112
HELOC	151	(1)	(53)	97
Total second lien	269	(1)	(59)	209
Total	$ 1,170	$ 62	$ (197)	$ 1,035

(1) Gross amounts recovered were $608 million and $220 million for Six Months 2013 and 2012, respectively.

(2) Includes excess spread that the Company will receive as salvage as a result of a settlement agreement with a R&W provider.

The following tables present the present value of net expected loss to be paid for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Expected Loss to be Paid
By Accounting Model
As of June 30, 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 115	$ 18	$ —	$ 133
Option ARM	(11)	3	—	(8)
Subprime	118	69	—	187
Total first lien	222	90	—	312
Second lien:				
Closed end second lien	(40)	19	(2)	(23)
HELOCs	20	(93)	—	(73)
Total second lien	(20)	(74)	(2)	(96)
Total U.S. RMBS	202	16	(2)	216
Other structured finance	19	—	5	24
U.S. public finance	(47)	—	—	(47)
Non-U.S. public finance	47	—	—	47
Total	$ 221	$ 16	$ 3	$ 240

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
	(in millions)			
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 131	$ 18	$ —	$ 149
Option ARM	(106)	(36)	—	(142)
Subprime	112	50	—	162
Total first lien	137	32	—	169
Second lien:				
Closed end second lien	(62)	23	(10)	(49)
HELOCs	39	(167)	—	(128)
Total second lien	(23)	(144)	(10)	(177)
Total U.S. RMBS	114	(112)	(10)	(8)
Other structured finance	23	—	5	28
U.S. public finance	(58)	—	—	(58)
Non-U.S. public finance	38	—	—	38
Total	$ 117	$ (112)	$ (5)	$ 0

(1) Refer to Note 9, Consolidation of Variable Interest Entities.

The following tables present the net economic loss development for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Economic Loss Development
By Accounting Model
Second Quarter 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ (4)	$ 1	$ 1	$ (2)
Option ARM	8	5	1	14
Subprime	4	16	(1)	19
Total first lien	8	22	1	31
Second lien:				
Closed end second lien	(5)	2	10	7
HELOCs	10	(22)	—	(12)
Total second lien	5	(20)	10	(5)
Total U.S. RMBS	13	2	11	26
Other structured finance	(3)	—	(2)	(5)
U.S. public finance	15	—	—	15
Non-U.S.Public finance	3	—	—	3
Total	$ 28	$ 2	$ 9	$ 39

Net Economic Loss Development
By Accounting Model
Second Quarter 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 4	$ 14	$ —	$ 18
Option ARM	75	(79)	—	(4)
Subprime	(9)	19	—	10
Total first lien	70	(46)	—	24
Second lien:				
Closed end second lien	(49)	43	1	(5)
HELOCs	(68)	81	—	13
Total second lien	(117)	124	1	8
Total U.S. RMBS	(47)	78	1	32
Other structured finance	6	—	(1)	5
U.S. public finance	18	—	—	18
Non-U.S.Public finance	(7)	—	—	(7)
Total	$ (30)	$ 78	$ 0	$ 48

Net Economic Loss Development
By Accounting Model
Six Months 2013

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ —	$ 1	$ —	$ 1
Option ARM	(87)	(33)	—	(120)
Subprime	14	20	(1)	33
Total first lien	(73)	(12)	(1)	(86)
Second lien:				
Closed end second lien	(2)	—	10	8
HELOCs	7	(18)	1	(10)
Total second lien	5	(18)	11	(2)
Total U.S. RMBS	(68)	(30)	10	(88)
Other structured finance	(3)	—	—	(3)
U.S. public finance	30	—	—	30
Non-U.S.Public finance	9	—	—	9
Total	$ (32)	$ (30)	$ 10	$ (52)

Net Economic Loss Development
By Accounting Model
Six Months 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 2	$ 13	$ —	$ 15
Option ARM	74	(85)	—	(11)
Subprime	(4)	25	—	21
Total first lien	72	(47)	—	25
Second lien:				
Closed end second lien	(46)	39	(1)	(8)
HELOCs	(66)	81	—	15
Total second lien	(112)	120	(1)	7
Total U.S. RMBS	(40)	73	(1)	32
Other structured finance	(19)	—	(4)	(23)
U.S. public finance	19	—	—	19
Non-U.S.Public finance	150	—	—	150
Total	$ 110	$ 73	$ (5)	$ 178

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(1) Refer to Note 9, Consolidation of Variable Interest Entities.

(2) Refer to Note 8, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Second Quarter 2013 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will eventually improve. Each quarter the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as to whether those changes are normal fluctuations or part of a trend. During Second Quarter 2013 the Company observed improvements in the performance of its second lien RMBS transactions that, when viewed in the context of their performance in past quarters, suggested those transactions were beginning to respond to the improvements in the residential property market and economy being widely reported. The Company did not observe the same trends in the performance of its first lien RMBS transactions. Based on such observations, in projecting losses for its second lien RMBS the Company chose to decrease by two months in its base scenario and by three months in its optimistic scenario the period it assumed it would take the mortgage market to recover as compared to March 31, 2013 and December 31, 2012. Also based on such observations the Company chose to use essentially the same assumptions and scenarios to project RMBS losses as of June 30, 2013 as it used as of March 31, 2013 and December 31, 2012, in its first lien RMBS and in the pessimistic scenario for its second lien RMBS. The Company's use of essentially the same assumptions and scenarios to project RMBS losses for its first lien RMBS as of June 30, 2013, as at March 31, 2013 and December 31, 2012 was consistent with its view at June 30, 2013 that the housing and mortgage market recovery is not being reflected as quickly in the performance of those transactions as it had anticipated at March 31, 2013 or December 31, 2012. Since the Company's projections for each RMBS transaction are based on the delinquency performance of the loans in that individual RMBS transaction, improvement or deterioration in that aspect of a transaction's performance impacts the projections for that transaction. The methodology and assumptions the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "- U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and " - U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

U.S. Second Lien RMBS Loss Projections: HELOCs and Closed End Second Lien

The Company believes the primary variables affecting its expected losses in second lien RMBS transactions are the amount and timing of future losses in the collateral pool supporting the transactions and the amount of loans repurchased for breaches of R&W (or agreements with R&W providers related to such obligations). Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as conditional prepayment rate ("CPR") of the collateral); the interest rate environment; and assumptions about the draw rate and loss severity. These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company's assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

The following table shows the range of key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
Second Lien RMBS(1)

HELOC key assumptions	As of June 30, 2013	As of March 31, 2013	As of December 31, 2012
Plateau conditional default rate ("CDR")	3.4% - 9.8%	5.0% - 17.2%	3.8% - 15.9%
Final CDR trended down to	0.4% - 3.2%	0.4% - 3.2%	0.4% - 3.2%
Expected period until final CDR	34 months	36 months	36 months
Initial CPR	2.1% - 15.0%	2.4% - 14.8%	2.9% - 14.6%
Final CPR	10%	10%	10%
Loss severity	98%	98%	98%
Initial draw rate	0.0% - 3.3%	0.0% - 3.3%	0.0% - 4.8%

Closed end second lien key assumptions	As of June 30, 2013	As of March 31, 2013	As of December 31, 2012
Plateau CDR	9.1% - 15.8%	9.7% - 18.6%	10.6% - 20.7%
Final CDR trended down to	3.5% - 8.6%	3.5% - 8.6%	3.5% - 8.6%
Expected period until final CDR	34 months	36 months	36 months
Initial CPR	3.4% - 6.0%	2.7% - 6.8%	2.3% - 5.0%
Final CPR	10%	10%	10%
Loss severity	98%	98%	98%

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(1) Represents variables for most heavily weighted scenario (the "base case").

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (*i.e.*, 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding twelve months' liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a CDR. The first four months' CDR is calculated by applying the liquidation rates to the current period past due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the CDR is generally calculated using the average 30-59 day past due balances for the prior three months, adjusted as necessary to reflect one-time servicing events. The fifth month CDR is then used as the basis for the plateau period that follows the embedded five months of losses.

As of June 30, 2013, for the base case scenario, the CDR (the "plateau CDR") was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. In the base case scenario, the time over which the CDR trends down to its final CDR is 28 months. Therefore, the total stress period for second lien transactions is 34 months, comprising five months of delinquent data, a one month plateau period and 28 months of decrease to the steady state CDR. This is two months shorter than used for March 31, 2013 and December 31, 2012. The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as March 31, 2013 and December 31, 2012.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (which is a function of the CDR and the loan balance over time) as well as the amount of excess spread (which is the excess of the interest paid by the borrowers on the underlying loan over the amount of interest and expenses owed on the insured obligations). In the base case, the current CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the CPR at March 31, 2013 and December 31, 2012. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). For HELOC transactions, the draw rate is assumed to decline from the current level to a final draw rate over a period of three months. The final draw rates were assumed to range from 0.0% to 1.6%.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate the assumptions affecting its modeling results.

As of June 30, 2013, the Company's base case assumed a one month CDR plateau and a 28 month ramp-down (for a total stress period of 34 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of December 31, 2012. Increasing the CDR plateau to four months and increasing the ramp-down by five months to 33-months (for a total stress period of 42 months) would increase the expected loss by approximately $36 million for HELOC transactions and $2 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 18 months (for a total stress period of 24 months) would decrease the expected loss by approximately $33 million for HELOC transactions and $2 million for closed-end second lien transactions.

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

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are delinquent or in foreclosure or where the loan has been foreclosed and the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various delinquency categories. The liquidation rate is a standard industry measure that is used to estimate the number of loans in a given aging category that will default within a specified time period. The Company arrived at its liquidation rates based on data purchased from a third party and assumptions about how delays in the foreclosure process may ultimately affect the rate at which loans are liquidated. The Company projects these liquidations to occur over two years. For both year-end 2012 and year-end 2011 the Company reviewed the data supplied by the third-party provider. Based on its review of that data, the Company maintained the same liquidation assumptions at December 31, 2012 as it had used at December 31, 2011, and used them at June 30, 2013 and March 31, 2013. The following table shows liquidation assumptions for various delinquency categories.

First Lien Liquidation Rates

	June 30, 2013	December 31, 2012
30 - 59 Days Delinquent		
Alt-A and Prime	35%	35%
Option ARM	50	50
Subprime	30	30
60 - 89 Days Delinquent		
Alt-A and Prime	55	55
Option ARM	65	65
Subprime	45	45
90 + Days Delinquent		
Alt-A and Prime	65	65
Option ARM	75	75
Subprime	60	60
Bankruptcy		
Alt-A and Prime	55	55
Option ARM	70	70
Subprime	50	50
Foreclosure		
Alt-A and Prime	85	85
Option ARM	85	85
Subprime	80	80
Real Estate Owned		
All	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans, it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (*i.e*., the CDR plateau), which, if applied for each of the next 24 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 24-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 24 months represent defaults that can be attributed to loans that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 24 month period represent defaults attributable to borrowers that are currently performing. The CDR trend the Company used in its base case for June 30, 2013 was the same as it used for March 31, 2013 and December 31, 2012.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historic high levels, and the Company is assuming that these high levels generally will continue for another year (in the case of subprime loans, the Company assumes the unprecedented 90% loss severity rate will continue for six months then drop to 80% for six months before following the ramp described below). The Company determines its initial loss severity based on actual recent experience. The Company's loss severity assumptions for June 30, 2013 were the same as it used for March 31, 2013 and December 31, 2012. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning in one year, and in the base case scenario, decline from there over two years to 40%.

The following table shows the range of key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS(1)

	As of June 30, 2013	As of March 31, 2013	As of December 31, 2012
Alt-A First Lien			
Plateau CDR	6.2% - 22.3%	5.6% - 22.6%	6.8% - 23.2%
Intermediate CDR	1.2% - 4.5%	1.1% - 4.5%	1.4% - 4.6%
Final CDR	0.3% - 1.1%	0.3% - 1.1%	0.3% - 1.2%
Initial loss severity	65%	65%	65%
Initial CPR	0.4% - 20.6%	0.1% - 20.4%	0.0% - 14.3%
Final CPR	15%	15%	15%
Option ARM			
Plateau CDR	5.6% - 24.2%	6.4% - 25.2%	7.0% - 26.1%
Intermediate CDR	1.1% - 4.8%	1.3% - 5.0%	1.4% - 5.2%
Final CDR	0.3% - 1.2%	0.3% - 1.3%	0.4% - 1.3%
Initial loss severity	65%	65%	65%
Initial CPR	0.3% - 7.7%	0.4% - 5.1%	0.4% - 3.8%
Final CPR	15%	15%	15%
Subprime			
Plateau CDR	10.0% - 24.7%	7.8% - 20.3%	7.3% - 21.2%
Intermediate CDR	2.0% - 4.9%	1.6% - 4.1%	1.5% - 4.2%
Final CDR	0.5% - 1.2%	0.5% - 1.3%	0.5% - 1.3%
Initial loss severity	90%	90%	90%
Initial CPR	0.0% - 7.1%	0.0% - 7.5%	0.0% - 9.2%
Final CPR	15%	15%	15%

(1) Represents variables for most heavily weighted scenario (the "base case").

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the CPR follows a similar pattern to that of the conditional default rate. The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be either 10% or 15% depending on the scenario run. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those the Company used for March 31, 2013 and December 31, 2012.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the current conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of June 30, 2013. For June 30, 2013 the Company used the same five scenarios and weightings as it used for March 31, 2013 and December 31, 2012. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended three months (to be 27 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over four rather than two years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately $17 million for Alt-A first liens, $11 million for Option ARM and $82 million for subprime transactions. In an even more stressful scenario where loss severities were assumed to rise and then recover over eight years and the initial ramp-down of the CDR was assumed to occur over 15 months and other assumptions were the same as the other stress scenario), expected loss to be paid would increase from current projections by approximately $47 million for Alt-A first liens, $20 million for Option ARM and $127 million for subprime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 12 months and was assumed to recover to 40% over two years, expected loss to be paid would decrease from current projections by approximately $1 million for Alt-A first lien, $12 million for Option ARM and $29 million for subprime transactions. In an even less stressful scenario where the conditional default rate plateau was three months shorter (21 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the CDR over nine months) expected loss to be paid would decrease from current projections by approximately $17 million for Alt-A first lien, $32 million for Option ARM and $62 million for subprime transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W, that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these R&W provisions. Soon after the Company observed the deterioration in the performance of its insured RMBS following the deterioration of the residential mortgage and property markets, the Company began using internal resources as well as third party forensic underwriting firms and legal firms to pursue breaches of R&W on a loan-by-loan basis. Where a provider of R&W refused to honor its repurchase obligations, the Company sometimes chose to initiate litigation. See "-Recovery Litigation" below.The Company's success in pursuing these strategies permitted the Company to enter into agreements with R&W providers under which those providers made payments to the Company, agreed to make payments to the Company in the future, and / or repurchased loans from the transactions, all in return for releases of related liability by the Company. Such agreements provide the Company with many of the benefits of pursuing the R&W claims on a loan by loan basis or through litigation, but without the related expense and uncertainty. The Company continues to pursue these strategies against R&W providers with which it does not yet have agreements.

Using these strategies, through June 30, 2013 the Company has caused entities providing R&Ws to pay or agree to pay approximately $2.7 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance.

	(in billions)
Agreement amounts already received	$ 1.9
Agreement amounts projected to be received in the future	0.4
Repurchase amounts paid into the relevant RMBS prior to settlement (1)	0.4
Total R&W payments, gross of reinsurance	$ 2.7

(1) These amounts were paid into the relevant RMBS transactions prior to settlement and distributed in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions.

Based on this success, the Company has included in its net expected loss estimates as of June 30, 2013 an estimated net benefit related to breaches of R&W of $574 million, which includes $388 million from agreements with R&W providers and $186 million in transactions where the Company does not yet have such an agreement, all net of reinsurance.

Representations and Warranties Agreements (1)

	Agreement Date	Current Net Par Covered	Receipts to June 30, 2013 (net of reinsurance)	Estimated Future Receipts (net of reinsurance)	Eligible Assets Held in Trust (gross of reinsurance)	
			(in millions)			
Bank of America - First Lien	April 2011	$ 789	$ 379	$ 174	$ 564	(2)
Bank of America - Second Lien	April 2011	1,146	744	N/A	N/A	
Deutsche Bank	May 2012	505	86	64	171	(3)
UBS	May 2013	733	347	93	227	(4)
Others	Various	506	172	57	—	
Total		$ 3,679	$ 1,728	$ 388	$ 962	

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(1) This table relates only to past and projected future recoveries under R&W and related agreements. Excluded is the $186 million of future net recoveries the Company projects receiving from R&W counterparties in transactions with $1,023 million of net par outstanding as of June 30, 2013 not covered by current agreements.

(2) Of the $564 million in trust, $237 million collateralizes Bank of America reimbursement obligations in respect of AGM-insured transactions, and $327 million is available to either AGM or AGC, as required.

(3) Of the $171 million in trust, $43 million collateralizes Deutsche Bank reimbursement obligations in respect of AGM-insured transactions, and $128 million is available to either AGM or AGC, as required.

(4) The entire $227 million in trust collateralizes UBS' reimbursement obligations in respect of AGM-insured transactions. Eligible assets were first placed in trust in July 2013, so that amount is shown here.

The Company's agreements with the counterparties named in the table above required an initial payment to the Company to reimburse it for past claims as well as an obligation to reimburse it for a portion of future claims. The named counterparties placed eligible assets in trust to collateralize their future reimbursement obligations, and the amount of collateral they are required to post may be increased or decreased from time to time as determined by rating agency requirements. Reimbursement payments under these agreements are made either monthly or quarterly and have been made timely. With respect to the reimbursement for future claims:

- Under the Company's agreement with Bank of America Corporation and certain of its subsidiaries ("Bank of America" or "BofA"), Bank of America agreed to reimburse Assured Guaranty for 80% of claims on the first lien transactions covered by the agreement that Assured Guaranty pays in the future, until the aggregate lifetime collateral losses (not insurance losses or claims) on those transactions reach $6.6 billion. As of June 30, 2013, aggregate lifetime collateral losses on those transactions was $3.5 billion ($3.2 billion for AGM and $0.3 billion for AGC), and Assured Guaranty was projecting in its base case that such collateral losses would eventually reach $5.1 billion ($4.7 billion for AGM and $0.4 billion for AGC).

- Under the Company's agreement with Deutsche Bank AG and certain of its affiliates (collectively, "Deutsche Bank"), Deutsche Bank agreed to reimburse Assured Guaranty for certain claims it pays in the future on eight first and second lien transactions, including 80% of claims it pays until the aggregate lifetime claims (before reimbursement) reach $319 million. As of June 30, 2013, Assured Guaranty was projecting in its base case that such aggregate lifetime claims would remain below $319 million. As of June 30, 2013, the projected base case aggregate lifetime claims are estimated to be $178 million for the AGM-insured covered transactions and $130 million for the AGC-insured covered transactions. The agreement also requires Deutsche Bank to reimburse Assured Guaranty for future claims it pays on certain RMBS re-securitizations that include uninsured tranches ("Uninsured Tranches") of three of the eight transactions for which it is providing the reimbursement described above. Deutsche Bank is obligated to reimburse Assured Guaranty under the re-securitization transactions in an amount calculated as a percent of the losses in the Uninsured Tranches. That percent is 60% of losses up to $141 million and then from $161 million to $185 million, and 100% from $185 million to $248 million. There is no reimbursement from $141 million to $161 million and above $248 million. As of June 30, 2013, Assured Guaranty was projecting in its base case that such losses would be $146 million. There were no AGM insured transactions related to this portion of the settlement. Except for the reimbursement obligation relating to the Uninsured tranches, the Deutsche Bank Agreement does not include transactions where Assured Guaranty has provided protection to Deutsche Bank on RMBS transactions in CDS form.

- Under the Company's agreement with UBS and a third party, UBS agreed to reimburse AGM for 85% of future losses on three first lien RMBS transactions.

The Company includes in the table above payments it has received under agreements with various other counterparties for breaches of R&W. Included in the table are benefits of the settlement AGM reached with Flagstar in connection with the favorable judgment AGM had won against Flagstar, under which Flagstar paid AGM $105 million and agreed to reimburse AGM for all future losses on certain insured RMBS transactions. Also included in the table above are payments the Company received for breaches of underwriting and servicing obligations. Some of the agreements with various other counterparties include obligations to reimburse the Company for all or a portion of future claims. In one instance, the Company is entitled to reimbursement from the cash flow from the mortgage loans still outstanding from a securitization as to which the insured notes have been paid off, and the Company includes in its projected R&W benefit an amount based on the cash flow it projects receiving from those mortgage loans.

Finally, based on its experience to date, the Company calculated an expected recovery of $186 million from breaches of R&W in transactions not covered by agreements with $1,023 million of net par outstanding as of June 30, 2013. The Company did not incorporate any gain contingencies or damages paid from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to such contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W not already covered by agreements, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized. The calculation of expected recovery from breaches of such contractual R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future. For the RMBS transactions as to which the Company had not yet reached an agreement with the R&W counterparty as of June 30, 2013, the Company had performed a detailed review of approximately 14,400 loan files, representing approximately $3.2 billion loans underlying insured transactions. In the majority of its loan file reviews, the Company identified breaches of one or more R&W regarding the characteristics of the loans, such as misrepresentation of income or employment of the borrower, occupancy, undisclosed debt and non-compliance with underwriting guidelines at loan origination.

The Company uses the same RMBS projection scenarios and weightings to project its future R&W benefit as it uses to project RMBS losses on its portfolio. To the extent the Company increases its loss projections, the R&W benefit (whether pursuant to an R&W agreement or not) generally will also increase, subject to the agreement limits and thresholds described above.

The Company accounts for the loss sharing obligations under the R&W agreements on financial guaranty contracts as subrogation, offsetting the losses it projects by an R&W benefit from the relevant party for the applicable portion of the projected loss amount. Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have no effect on the amount of the Company's exposure. Loss sharing obligations under R&W agreements covering CDS and consolidated FG VIEs are recorded at fair value. See Notes 7, Fair Value Measurement and 9, Consolidation of Variable Interest Entities.

U.S. RMBS Risks with R&W Benefit

	Number of Risks(1) as of		Debt Service as of	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
			(dollars in millions)	
Alt-A first lien	10	10	$ 1,026	$ 1,091
Option ARM	7	7	464	666
Subprime	5	5	951	975
Closed-end second lien	2	2	72	145
HELOC	7	6	581	521
Total	31	30	$ 3,094	$ 3,398

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(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. This table shows the full future Debt Service (not just the amount of Debt Service expected to be reimbursed) for risks with projected future R&W benefit, whether pursuant to an agreement or not.

The following table provides a breakdown of the development and accretion amount in the roll forward of estimated recoveries associated with alleged breaches of R&W.

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Inclusion or removal of deals with breaches of R&W during period	$ 6	$ (4)	$ 6	$ (4)
Change in recovery assumptions as the result of additional file review and recovery success	5	(10)	16	68
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	15	46	24	(8)
Results of settlements	5	—	145	—
Accretion of discount on balance	4	2	6	6
Total	$ 35	$ 34	$ 197	$ 62

The Company assumes that recoveries on second lien transactions that were not subject to the settlement agreements will occur in two to four years from the balance sheet date depending on the scenarios and that recoveries on transactions backed by Alt-A first lien, Option ARM and Subprime loans will occur as claims are paid over the life of the transactions.

Selected U.S. Public Finance Transactions

U.S. municipalities and related entities have been under increasing pressure over the last few quarters, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. Given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain and may lead to an increase in defaults on some of the Company's insured public finance obligations. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code are: Detroit, Michigan; Jefferson County, Alabama; and Stockton, California. The City Council of Harrisburg, Pennsylvania had also filed a purported bankruptcy petition, which was later dismissed by the bankruptcy court; a receiver for the City of Harrisburg was appointed by the Commonwealth Court of Pennsylvania on December 2, 2011.

The Company has net par exposure to the City of Detroit, Michigan of $1,505 million as of June 30, 2013. On July 18, 2013, the City of Detroit filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Most of the Company's net exposure relates to $717 million of sewer revenue bonds and $738 million of water revenue bonds, both of which the Company rates triple-B. Both the sewer and water systems provide services to areas that extend beyond the city limits, and the bonds are secured by a pledge of "special revenues". The Company also has net par exposure of $50 million to the City's general obligation bonds (which are secured by a pledge of the unlimited tax, full faith, credit and resources of the City), which the Company rates below investment grade. The Company paid no claims in Second Quarter 2013.

The Company has net exposure to Jefferson County, Alabama of $268 million as of June 30, 2013. On November 9, 2011, Jefferson County filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Some of the Company's net Jefferson County exposure relates to $114 million in sewer revenue exposure. The sewer revenue warrants are secured by a pledge of the net revenues of the sewer system. The bankruptcy court has affirmed that the net revenues constitute a “special revenue” under Chapter 9. Therefore, the lien on net revenues of the sewer system survives the bankruptcy filing and such net revenues are not subject to the automatic stay during the pendency of Jefferson County's bankruptcy case. BNY Mellon, as trustee, had brought a lawsuit regarding the amount of net revenues to which it is entitled. Since its bankruptcy filing, Jefferson County had been withholding estimated bankruptcy-related legal expenses and an amount representing a monthly reserve for future expenditures and depreciation and amortization from the monthly payments it had been making to the trustee from sewer revenues for Debt Service. On June 29, 2012, the Bankruptcy Court ruled that “Operating Expenses” as determined under the bond indenture do not include (1) a reserve for depreciation, amortization, or future expenditures, or (2) an estimate for professional fees and expenses, such that, after payment of Operating Expenses (as defined in the indenture), monies remaining in the Revenue Account created under the bond indenture must be distributed in accordance with the waterfall set forth in the indenture without withholding any monies for depreciation, amortization, reserves, or estimated expenditures that are the subject of this litigation. Whether sufficient net revenues will be available for the payment of regularly scheduled debt service ultimately depends on the bankruptcy court's valuation of the sewer revenue stream. The Company's remaining net exposure of $154 million to Jefferson County relates to obligations that are secured by, or payable from, certain taxes that may have the benefit of a statutory lien or a lien on “special revenues” or other collateral. In June 2013 AGM and several other monoline insurers and financial institutions having claims against Jefferson County entered into plan support agreements with the county, and in July 2013 Jefferson County filed its Chapter 9 plan of adjustment and related materials with the Bankruptcy Court.

On June 28, 2012, the City of Stockton, California filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to Stockton's general fund is $64 million, consisting of pension obligation bonds. As of June 30, 2013, the Company had paid $6 million in net claims.

The Company has $132 million of net par exposure to The City of Harrisburg, Pennsylvania, of which $69 million is BIG. The Company has paid $13 million in net claims as of June 30, 2013.

The Company has $23 million remaining in net par exposure to bonds secured by the excess free cash flow of the Foxwoods Casino, run by the Mashantucket Pequot Tribe. The Company had paid $75 million in net claims as of June 30, 2013, and expects full recovery of such amount.

The Company projects that its total future expected net recovery across its troubled U.S. public finance credits as of June 30, 2013 will be $47 million. As of March 31, 2013 the Company was projecting a net recovery of $59 million across its troubled U.S. public finance credits. While the deterioration was due to a number of factors, it was attributable primarily to negative developments in Detroit.

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish regions where a Spanish sovereign default causes the regions also to default. The Company's gross exposure to these credits is €434 million and its exposure net of reinsurance is €274 million. During 2012, the Company downgraded most of these exposures to the BB category due to concerns that these regions would not pay under their contractual obligations. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities and covered mortgage bonds issued by Hungarian banks. The Company's gross exposure to these credits is $621 million and its exposure net of reinsurance is $514 million, all of which is rated below investment grade. The Company estimated net expected losses of $38 million related to these Spanish and Hungarian credits down from $41 million as of March 31, 2013 largely due to movements in exchange rates, interest rates and timing of its projected defaults. Information regarding the Company's exposure to other Selected European Countries may be found under Note 3, Outstanding Exposure, –Economic Exposure to the Selected European Countries.

Manufactured Housing

The Company insures a total of $202 million net par of securities backed by manufactured housing loans, a total of $120 million rated BIG. The Company has expected loss to be paid of $18 million as of June 30, 2013 down from $22 million as of March 31, 2013, due primarily to the higher risk free rates used to discount losses and higher projected recoveries on certain transactions.

Infrastructure Finance

The Company has exposure to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued; the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. Total liabilities for the three largest transactions with significant refinancing risk may amount to as much as $2.7 billion, payable in varying amounts over the next 13 years. Of this liability, as much as approximately $2.3 billion may be payable between 2014 and 2020. As of June 30, 2013, the Company estimates that it may pay claims of approximately $1.2 billion, without giving effect to any payments that the Company may receive from reinsurers to which it has ceded a portion of this exposure. This estimate is based on certain assumptions the Company has made as to the performance of the transactions, including the refinancing of a certain portion of the debt, the payment of certain anticipated contributions, and the Company prevailing in certain litigation proceedings. These transactions generally involve long-term infrastructure projects that are financed by bonds that mature prior to the expiration of the project concession. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, the Company expected it to be refinanced in the market at or prior to its maturity. Due to market conditions, the Company may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments may take a long time and is uncertain. The claim payments are anticipated to occur substantially between 2014 and 2018, while the recoveries could take from 10 to 35 years, depending on the transaction and the performance of the underlying collateral.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM has lawsuits pending against a number of providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages. In all the lawsuits, AGM has alleged breaches of R&W in respect of the underlying loans in the transactions, and failure to cure or repurchase defective loans identified by AGM to such persons. In addition, in the lawsuits against DLJ Mortgage Capital, Inc. ("DLJ") and Credit Suisse Securities (USA) LLC ("Credit Suisse"), AGM has alleged breaches of contract in procuring falsely inflated shadow ratings (a condition to the issuance by AGM of its policies) by providing false and misleading information to the rating agencies:

- **Deutsche Bank**: AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. in the Supreme Court of the State of New York on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

- **ResCap**: AGM has sued GMAC Mortgage, LLC (formerly GMAC Mortgage Corporation; Residential Asset Mortgage Products, Inc.; Ally Bank (formerly GMAC Bank); Residential Funding Company, LLC (formerly Residential Funding Corporation); Residential Capital, LLC (formerly Residential Capital Corporation, "ResCap"); Ally Financial (formerly GMAC, LLC); and Residential Funding Mortgage Securities II, Inc. on the GMAC RFC Home Equity Loan-Backed Notes, Series 2006-HSA3 and GMAC Home Equity Loan-Backed Notes, Series 2004-HE3 second lien transactions. On May 14, 2012, ResCap and several of its affiliates (the "Debtors") filed for Chapter 11 protection with the U.S. Bankruptcy Court. The automatic stay of Bankruptcy Code Section 362 (a) stays lawsuits (such as the suit brought by AGM) against the Debtors.
  As a way of resolving ResCap's motion for an adversary proceeding, several defendants in the adversary proceeding (including AGM) and the debtors and their non-debtor affiliates filed a stipulation with the court agreeing to extend the automatic stay to the non-debtor affiliates until April 30, 2013. The agreement has expired and the debtors have not requested that it be extended. The debtors, however, have agreed to provide AGM with an extension of the time to respond to the adversary complaint until 60 days following notice from ResCap to AGM of its intent to continue the adversary proceeding. The Bankruptcy Court approved a plan support agreement which had the support of Ally Financial Inc. and a majority of the debtors' largest claimants on June 26, 2013 and entered an order on August 23, 2013 approving the disclosure statement regarding the Joint Chapter 11 Plan of Residential Capital, LLC, et al. and establishing procedures for the solicitation process. A hearing on confirmation of the plan is scheduled for November 19, 2013.

- **Credit Suisse**: AGM and its affiliate AGC have sued DLJ and Credit Suisse in the Supreme Court of the State of New York on first lien U.S. RMBS transactions insured by them. The ones insured by AGM are: CSAB Mortgage-Backed Pass Through Certificates, Series 2006-2; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-3; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-4; and CMSC Mortgage-Backed Pass Through Certificates, Series 2007-3. On December 6, 2011, DLJ and Credit Suisse filed a motion to dismiss the cause of action asserting breach of the document containing the condition precedent regarding the rating of the securities and claims for recissionary damages and other relief in the complaint, and on October 11, 2012, the Supreme Court of the State of New York granted the motion to dismiss. AGM and AGC intend to appeal the dismissal of certain of its claims. The causes of action against DLJ for breach of R&W and breach of its repurchase obligations remain.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, "RBS") in the United States District Court for the Southern District of New York on the Soundview Home Loan Trust 2007-WMC1 transaction. The complaint alleges that RBS made fraudulent misrepresentations to AGM regarding the quality of the underlying mortgage loans in the transaction and that RBS's misrepresentations induced AGM into issuing a financial guaranty insurance policy in respect of the Class II-A-1 certificates issued in the transaction.

On August 9, 2012, AGM filed a complaint against OneWest Bank, FSB, the servicer of the mortgage loans underlying the HOA1 Transaction and the IndyMac Home Equity Mortgage Loan Asset-Backed Trust, Series 2007-H1 HELOC transaction seeking damages, specific performance and declaratory relief in connection with OneWest failing to properly service the mortgage loans.

Public Finance Transactions

In June 2010, AGM sued JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc. (together, "JPMorgan"), the underwriter of debt issued by Jefferson County, in the Supreme Court of the State of New York alleging that JPMorgan induced AGM to issue its insurance policies in respect of such debt through material and fraudulent misrepresentations and omissions, including concealing that it had secured its position as underwriter and swap provider through bribes to Jefferson County commissioners and others. In December 2010, the court denied JPMorgan's motion to dismiss. After JPMorgan interpleaded Jefferson County into the lawsuit, the Jefferson County bankruptcy court ruled in April 2013 that the lawsuit against JPMorgan was subject to the automatic stay applicable to Jefferson County. As described above under "Selected U.S. Public Finance Transactions," AGM, JPMorgan and various other financial institutions entered into plan support agreements with Jefferson County in June 2013, and Jefferson County has filed a plan of adjustment with the bankruptcy court. As a result, the litigation is currently subject to a standstill order. AGM will dismiss the litigation if the Jefferson County bankruptcy plan is confirmed and is continuing its risk remediation efforts for its Jefferson County exposure.

In September 2010, AGM, together with TD Bank, National Association and Manufacturers and Traders Trust Company, as trustees, filed a complaint in the Court of Common Pleas of Dauphin County, Pennsylvania against The Harrisburg Authority, The City of Harrisburg, Pennsylvania, and the Treasurer of the City in connection with certain Resource Recovery Facility bonds and notes issued by The Harrisburg Authority, alleging, among other claims, breach of contract by both The Harrisburg Authority and The City of Harrisburg, and seeking remedies including an order of mandamus compelling the City to satisfy its obligations on the defaulted bonds and notes and the appointment of a receiver for The Harrisburg Authority ("RRF receiver"). Acting on its own, the City Council of Harrisburg filed a purported bankruptcy petition for the City in October 2011, which petition and a subsequent appeal were dismissed by the bankruptcy court in November 2011. The Commonwealth Court of Pennsylvania appointed a receiver for The City of Harrisburg (the "City receiver") in December 2011. The City receiver filed a motion to intervene in the mandamus action and action for the appointment of the RRF receiver, and asserted that the provisions of Pennsylvania's Financially Distressed Municipalities Act ("Act 47"), which authorized his appointment, preempted AGM's statutory remedies. In March 2012, the judge issued an order granting the motion for the appointment of the RRF receiver and found that Act 47 did not preempt the more specific statutory remedies available. The Harrisburg Authority appealed the judge's order for the appointment of the RRF receiver and oral argument was heard by the court on June 4, 2012. The parties are awaiting a decision by the court. Subsequently, following the resignation of the original City receiver and the confirmation of a new City receiver, the new city Receiver has been negotiating the sale of Harrisburg's resource recovery facility and the lease of its parking system. In addition, in July 2012, the City receiver filed a petition for an order of mandamus to order a 1% increase in the earned income tax; the City Council of Harrisburg subsequently passed an increase in the earned income tax for calendar year 2013.

6. Financial Guaranty Insurance Losses

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves, net of reinsurance and salvage and subrogation recoverable.

Loss and LAE Reserve (Recovery), Net of Reinsurance and Salvage and Subrogation Recoverable Insurance Contracts

	As of June 30, 2013			As of December 31, 2012		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net
			(in millions)			
U.S. RMBS:						
First lien:						
Alt-A first lien	$ 47	$ —	$ 47	$ 52	$ —	$ 52
Option ARM	23	58	(35)	29	213	(184)
Subprime	104	2	102	78	—	78
Total first lien	174	60	114	159	213	(54)
Second lien:						
Closed-end second lien	—	48	(48)	—	71	(71)
HELOC	—	98	(98)	—	169	(169)
Total second lien	—	146	(146)	—	240	(240)
Total U.S. RMBS	174	206	(32)	159	453	(294)
Other structured finance	7	—	7	10	—	10
U.S. public finance	19	86	(67)	16	86	(70)
Non-U.S. public finance	21	—	21	23	—	23
Subtotal	221	292	(71)	208	539	(331)
Effect of consolidating FG VIEs	(77)	(103)	26	(53)	(217)	164
Total (1)	$ 144	$ 189	$ (45)	$ 155	$ 322	$ (167)

(1) See “Components of Net Reserves (Salvage)” table for loss and LAE reserve and salvage and subrogation recoverable components.

The following table reconciles the loss and LAE reserve and salvage and subrogation components on the consolidated balance sheet to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)
Insurance Contracts

	As of June 30, 2012	As of December 31, 2012
	(in millions)	
Loss and LAE reserve	$ 225	$ 230
Reinsurance recoverable on unpaid losses	(81)	(75)
Subtotal	144	155
Salvage and subrogation recoverable	(240)	(383)
Salvage and subrogation payable(1)	51	61
Subtotal	(189)	(322)
Financial guaranty net reserves (salvage)	$ (45)	$ (167)

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

Balance Sheet Classification of
Net Expected Recoveries for Breaches of R&W
Insurance Contracts

	As of June 30, 2013			As of December 31, 2012		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)
	(in millions)					
Salvage and subrogation recoverable	$ 153	$ (71)	$ 82	$ 393	$ (170)	$ 223
Loss and LAE reserve	333	(6)	327	455	(11)	444

(1) The remaining benefit for R&W is either recorded at fair value in FG VIE assets, or not recorded on the balance sheet until the expected loss, net of R&W, exceeds unearned premium reserve.

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) for transactions with a net expected recovery, the addition of claim payments that have been made (and therefore are not included in expected loss to be paid) that are expected to be recovered in the future (and therefore have reduced expected loss to be paid), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

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

	As of June 30, 2013
	(in millions)
Net expected loss to be paid	$ 237
Less: net expected loss to be paid for FG VIEs	16
Total	221
Contra-paid, net	101
Salvage and subrogation recoverable, net of reinsurance	189
Loss and LAE reserve, net of reinsurance	(144)
Net expected loss to be expensed (1)	$ 367

(1) Excludes $99 million as of June 30, 2013 related to consolidated FG VIEs.

The following table provides a schedule of the expected timing of net expected losses to be expensed. The amount and timing of actual loss and LAE may differ from the estimates shown below due to factors such as refundings, accelerations, commutations, changes in expected lives and updates to loss estimates. A loss and LAE reserve is only recorded for the amount by which expected loss to be expensed exceeds deferred premium revenue determined on a contract-by-contract basis. This table excludes amounts related to consolidated FG VIEs, which are eliminated in consolidation.

Net Expected Loss to be Expensed
Insurance Contracts

	As of June 30, 2013
	(in millions)
2013 (July 1- September 30)	$ 17
2013 (October 1 - December 31)	15
Subtotal 2013	32
2014	48
2015	39
2016	34
2017	30
2018-2022	106
2023-2027	46
2028-2032	20
After 2032	12
Total present value basis(1)	367
Discount	141
Total future value	$ 508

(1) Consolidation of FG VIEs resulted in reductions of $99 million in net expected loss to be expensed.

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

Loss and LAE
Reported on the
Consolidated Statements of Operations

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 0	$ 23	$ 8	$ 29
Option ARM	21	11	(64)	58
Subprime	23	17	32	24
Total first lien	44	51	(24)	111
Second lien:				
Closed-end second lien	0	0	19	0
HELOC	0	2	7	11
Total second lien	0	2	26	11
Total U.S. RMBS	44	53	2	122
Other structured finance	(3)	3	(3)	(16)
U.S. public finance	15	19	23	19
Non-U.S. public finance	(1)	3	(2)	154
Total insurance contracts before FG VIE consolidation	55	78	20	279
Effect of consolidating FG VIEs	(22)	(2)	(16)	(13)
Total loss and LAE	$ 33	$ 76	$ 4	$ 266

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

Financial Guaranty Insurance
BIG Transaction Loss Summary
June 30, 2013

	BIG Categories								
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded	Total BIG, Net	Effect of Consolidating VIEs	Total
	(dollars in millions)								
Number of risks(1)	65	(57)	26	(26)	51	(51)	142	—	142
Remaining weighted-average contract period (in years)	8.7	7.8	8.5	13.8	6.6	7.5	7.5	—	7.5
Outstanding exposure:									
Principal	$ 4,652	$ (1,758)	$ 2,695	$ (591)	$ 4,211	$ (767)	$ 8,442	$ —	$ 8,442
Interest	2,095	(704)	999	(254)	1,297	(263)	3,170	—	3,170
Total(2)	$ 6,747	$ (2,462)	$ 3,694	$ (845)	$ 5,508	$ (1,030)	$ 11,612	$ —	$ 11,612
Expected cash outflows (inflows)	$ 1,164	$ (584)	$ 789	$ (120)	$ 1,711	$ (235)	$ 2,725	$ (594)	$ 2,131
Potential recoveries(3)	(1,217)	593	(502)	36	(1,407)	183	(2,314)	545	(1,769)
Subtotal	(53)	9	287	(84)	304	(52)	411	(49)	362
Discount	(3)	1	(73)	27	(139)	13	(174)	33	(141)
Present value of expected cash flows	$ (56)	$ 10	$ 214	$ (57)	$ 165	$ (39)	$ 237	$ (16)	$ 221
Deferred premium revenue	$ 129	$ (53)	$ 209	$ (37)	$ 608	$ (109)	$ 747	$ (196)	$ 551
Reserves (salvage)(4)	$ (81)	$ 17	$ 69	$ (36)	$ (29)	$ (11)	$ (71)	$ 26	$ (45)

Financial Guaranty Insurance
BIG Transaction Loss Summary
December 31, 2012

	BIG Categories								
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded	Total BIG, Net	Effect of Consolidating VIEs	Total
	(dollars in millions)								
Number of risks(1)	71	(66)	21	(21)	50	(50)	142	—	142
Remaining weighted-average contract period (in years)	9.5	9.6	9.3	15.6	5.3	6.8	7.4	—	7.4
Outstanding exposure:									
Principal	$ 6,004	$ (2,281)	$ 1,820	$ (180)	$ 4,680	$ (788)	$ 9,255	$ —	$ 9,255
Interest	2,583	(893)	982	(179)	1,157	(240)	3,410	—	3,410
Total(2)	$ 8,587	$ (3,174)	$ 2,802	$ (359)	$ 5,837	$ (1,028)	$ 12,665	$ —	$ 12,665
Expected cash outflows (inflows)	$ 1,535	$ (900)	$ 733	$ (64)	$ 1,827	$ (250)	$ 2,881	$ (617)	$ 2,264
Potential recoveries(3)	(1,586)	883	(475)	22	(1,818)	209	(2,765)	713	(2,052)
Subtotal	(51)	(17)	258	(42)	9	(41)	116	96	212
Discount	(2)	6	(78)	15	(59)	7	(111)	16	(95)
Present value of expected cash flows	$ (53)	$ (11)	$ 180	$ (27)	$ (50)	$ (34)	$ 5	$ 112	$ 117
Deferred premium revenue	$ 93	$ (36)	$ 211	$ (17)	$ 728	$ (122)	$ 857	$ (244)	$ 613
Reserves (salvage)(4)	$ (100)	$ 6	$ 49	$ (15)	$ (266)	$ (5)	$ (331)	$ 164	$ (167)

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes estimated future recoveries for breaches of R&W as well as excess spread, and draws on HELOCs.

(4) See table "Components of net reserves (salvage)."

Ratings Impact on Financial Guaranty Business

A downgrade of the Company or of one of its insurance subsidiaries may result in increased claims under financial guaranties issued by the Company, if the insured obligors were unable to pay.

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. At AGM's current financial strength ratings, if the conditions giving rise to the obligation of AGM to make a termination payment under the swap termination policies were all satisfied, then AGM could pay claims in an amount not exceeding approximately $118 million in respect of such termination payments. Taking into consideration whether the rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding approximately $332 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM or AGC may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a “bank bond rate” that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of June 30, 2013, AGM had insured approximately $7.0 billion net par of VRDOs, of which approximately $0.3 billion of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company’s internal rating. The specific terms relating to the rating levels that trigger the bank’s termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

In addition, AGM may be required to pay claims in respect of AGMH’s former financial products business if Dexia SA (the parent of Dexia Holdings Inc.) and its affiliates do not comply with their obligations following a downgrade of the financial strength rating of AGM. Most of the guaranteed investment contracts ("GICs") insured by AGM allow for the withdrawal of GIC funds in the event of a downgrade of AGM, unless the relevant GIC issuer posts collateral or otherwise enhances its credit. Most GICs insured by AGM allow for the termination of the GIC contract and a withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM below a specified threshold, generally below A- by S&P or A3 by Moody’s, with no right of the GIC issuer to avoid such withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities.

7. Fair Value Measurement

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

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party’s proprietary pricing models. In addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company’s credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company’s creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During Six Months 2013, no changes were made to the Company’s valuation models that had or are expected to have, a material impact on the Company’s consolidated balance sheets or statements of operations and comprehensive income.

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

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

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

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

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

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

Measured and Carried at Fair Value

Fixed Maturity Securities and Short-term Investments

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news. The market inputs used in the pricing evaluation, listed in the approximate order of priority include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently. The extent of the use of each input is dependent on the asset class and the market conditions. Given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur.

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

Prices determined based upon model processes where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. At June 30, 2013, the Company used model processes to price 25 fixed maturity securities, which was 8.5% or $463 million of the Company's fixed-maturity securities and short-term investments at fair value. Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party’s proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); home price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

Other invested assets includes certain investments that are carried and measured at fair value on a recurring basis and non-recurring basis, as well as assets not carried at fair value. Within other invested assets, $54 million are carried at fair value on a recurring basis as of June 30, 2013. These assets comprise certain short-term investments and fixed maturity securities classified as trading and are Level 2 in the fair value hierarchy. Also carried at fair value on a recurring basis are $2 million in notes classified as Level 3 in the fair value hierarchy. The fair value of these notes is determined by calculating the present value of the expected cash flows. The unobservable inputs used in the fair value measurement of the notes are discount rate, prepayment speed and default rate.

Within other invested assets, $6 million are carried at fair value on a non-recurring basis as of June 30, 2013. These assets are comprised of mortgage loans which are classified as Level 3 in the fair value hierarchy as there are significant unobservable inputs used in the valuation of such loans. The non-performing portion of these mortgage loans is valued using an average recovery rate. The performing loans are valued using management’s determination of future cash flows arising from these loans, discounted at the rate of return that would be required by a market participant. The unobservable inputs used in the fair value measurement of the mortgage loans are discount rate, recovery on delinquent loans, loss severity, prepayment speed and default rate.

Other Assets

Committed Capital Securities

The fair value of committed capital securities ("CCS"), which is recorded in “other assets” on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGM Committed Preferred Trust Securities (the “AGM CPS Securities”) agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 15, Notes Payable and Credit Facilities). The estimated current cost of the Company’s CCS depends on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company’s credit derivatives consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The Company does not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. Such terminations generally are completed for an amount that approximates the present value of future premiums, not at fair value.

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

Due to the lack of quoted prices for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the fair value of the Company’s contracts in principal markets. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Management does not believe there is an established market where financial guaranty insured credit derivatives are actively traded. The terms of the protection under an insured financial guaranty credit derivative do not, except for certain rare circumstances, allow the Company to exit its contracts. Management has determined that the exit market for the Company’s credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company’s deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The Company's models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely and relevant market information.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining premiums the Company expects to receive or pay for the credit protection under the contract and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay the Company for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual cash flows are the most readily observable inputs since they are based on the CDS contractual terms. These cash flows include premiums to be received or paid under the terms of the contract. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity also affects valuations of the underlying obligations. Consistent with the previous several years, market conditions at June 30, 2013 were such that market prices of the Company's CDS contracts were not available. Since market prices were not available, the Company used proprietary valuation models that used both unobservable and observable market data inputs as described under "Assumptions and Inputs" below. These models are primarily developed internally based on market conventions for similar transactions.

Valuation models include management estimates and current market information. Management is also required to make assumptions of how the fair value of credit derivative instruments is affected by current market conditions. Management considers factors such as current prices charged for similar agreements, when available, performance of underlying assets, life of the instrument, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine the fair value may change in the future due to market conditions. Due to the inherent uncertainties of the assumptions used in the valuation models to determine the fair value of these credit derivative products, actual experience may differ from the estimates reflected in the Company's consolidated financial statements and the differences may be material.

Assumptions and Inputs

Listed below are various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts.

- How gross spread is calculated.

- The allocation of gross spread among:

    - the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction ("bank profit");

    - premiums paid to the Company for the Company's credit protection provided ("net spread"); and

    - the cost of CDS protection purchased by the originator to hedge their counterparty credit risk exposure to the Company ("hedge cost").

- The weighted average life which is based on expected remaining contractual cash flows and Debt Service schedules.

- The rates used to discount future premium expected cash flows.

The expected future premium cash flows for the Company's credit derivatives were discounted at rates ranging from 0.24% to 3.44% at June 30, 2013 and 0.25% to 2.81% at December 31, 2012.

Gross spread is used to ultimately determine the net spread a comparable financial guarantor would charge the Company to transfer its risk at the reporting date. The Company obtains gross spreads on risks assumed from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within the Company's transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resemble the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. These indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

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

The following spread hierarchy is utilized in determining which source of gross spread to use, with the rule being to use CDS spreads where available. If not available, CDS spreads are either interpolated or extrapolated based on similar transactions or market indices.

- Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available).
- Deals priced or closed during a specific quarter within a specific asset class and specific rating.
- Credit spreads interpolated based upon market indices.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Information by Credit Spread Type (1)

	As of June 30, 2013	As of December 31, 2012
Based on actual collateral specific spreads	0.2%	0.2%
Based on market indices	99.8%	99.8%
Total	100%	100%

(1) Based on par.

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or management's assessment that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is close to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions' current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness.

The premium the Company receives is referred to as the "net spread." The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGM. For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 29%, and 82%, based on number of deals, of the Company's CDS contracts are fair valued using this minimum premium as of June 30, 2013 and December 31, 2012, respectively. The change period over period is driven by AGM's credit spreads narrowing to levels not seen since 2008. As a result of this, the cost to hedge AGM's name has declined significantly causing more transactions to price above previously established floor levels. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGM. This reduces the amount of contractual cash flows AGM can capture as premium for selling its protection.

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

A fair value resulting in a credit derivative asset on protection sold is the result of contractual cash inflows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize a gain representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Example

Following is an example of how changes in gross spreads, the Company's own credit spread and the cost to buy protection on the Company affect the amount of premium the Company can demand for its credit protection. The assumptions used in these examples are hypothetical amounts. Scenario 1 represents the market conditions in effect on the transaction date and Scenario 2 represents market conditions at a subsequent reporting date.

	Scenario 1		Scenario 2	
	bps	% of Total	bps	% of Total
Original gross spread/cash bond price (in bps)	185		500	
Bank profit (in bps)	115	62%	50	10%
Hedge cost (in bps)	30	16%	440	88%
The Company premium received per annum (in bps)	40	22%	10	2%

In Scenario 1, the gross spread is 185 basis points. The bank or deal originator captures 115 basis points of the original gross spread and hedges 10% of its exposure to AGM, when the CDS spread on AGM was 300 basis points (300 basis points × 10% = 30 basis points). Under this scenario the Company received premium of 40 basis points, or 22% of the gross spread.

In Scenario 2, the gross spread is 500 basis points. The bank or deal originator captures 50 basis points of the original gross spread and hedges 25% of its exposure to AGM, when the CDS spread on AGM was 1,760 basis points (1,760 basis points × 25% = 440 basis points). Under this scenario the Company would receive premium of 10 basis points, or 2% of the gross spread. Due to the increased cost to hedge AGM's name, the amount of profit the bank would expect to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

Strengths and Weaknesses of Model

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

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

- The model takes into account the transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.

- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by the Company to be the key parameters that affect fair value of the transaction.

- The model is a consistent approach to valuing positions. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

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

- There is no exit market or actual exit transactions. Therefore the Company’s exit market is a hypothetical one based on the Company’s entry market.

- There is a very limited market in which to validate the reasonableness of the fair values developed by the Company’s model.

- At June 30, 2013 and December 31, 2012, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

These contracts were classified as Level 3 in the fair value hierarchy because there is a reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of non-standard terms and conditions of its credit derivative contracts and of amount of protection purchased on AGM's name.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all the FG VIEs assets and liabilities. See Note 9, Consolidation of Variable Interest Entities.

The FG VIEs that are consolidated by the Company issued securities collateralized by HELOCs, first lien and second lien RMBS, subprime automobile loans, and other loans and receivables. The lowest level input that is significant to the fair value measurement of these assets and liabilities in its entirety was a Level 3 input (i.e. unobservable), therefore management classified them as Level 3 in the fair value hierarchy. Prices were generally determined with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach and the third-party’s proprietary pricing models. The models to price the FG VIEs' liabilities used, where appropriate, inputs such as estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; house price depreciation/appreciation rates based on macroeconomic forecasts and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the FG VIE tranches insured by the Company, taking into account the timing of the potential default and the Company's own credit rating. The third-party also utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithm's designed to aggregate market color, received by the third-party, on comparable bonds.

Changes in fair value of the FG VIEs' assets and liabilities are included in fair value gains (losses) on FG VIEs within the consolidated statement of operations. Except for net credit impairment that triggers a claim on the financial guaranty contract (i.e. net expected loss to be paid as described in Note 5), the unrealized fair value gains (losses) related to the consolidated FG VIEs will reverse to zero over the terms of these financial instruments.

The fair value of the Company's FG VIE assets is sensitive to changes related to estimated prepayment speeds; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. Significant changes to some of these inputs could materially change the market value of the FG VIE's assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIE asset is most sensitive to changes in the projected collateral losses, where an increase in collateral losses typically leads to a decrease in the fair value of FG VIE assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIE assets. These factors also directly impact the fair value of the Company's FG VIE liabilities.

The fair value of the Company's FG VIE liabilities is also sensitive to changes relating to estimated prepayment speeds; market values of the underlying assets; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. In addition, the Company's FG VIE liabilities with recourse are also sensitive to changes in the Company's implied credit worthiness. Significant changes to any of these inputs could materially change the timing of expected losses within the insured transaction which is a significant factor in determining the implied benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the tranches of debt issued by the FG VIE that is insured by the Company. In general, extending the timing of expected loss payments by the Company into the future typically leads to a decrease in the value of the Company's insurance and a decrease in the fair value of the Company's FG VIE liabilities with recourse, while a shortening of the timing of expected loss payments by the Company typically leads to an increase in the value of the Company's insurance and an increase in the fair value of the Company's FG VIE liabilities with recourse.

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

The fair value of the Company's financial guaranty contracts accounted for as insurance was based on management's estimate of what a similarly rated financial guaranty insurance company would demand to acquire the Company's in-force book of financial guaranty insurance business. This amount was based on the pricing assumptions management has observed for portfolio transfers that have occurred in the financial guaranty market and included adjustments to the carrying value of unearned premium reserve for stressed losses, ceding commissions and return on capital. The significant inputs were not readily observable. The Company accordingly classified this fair value measurement as Level 3.

Other Invested Assets

Other invested assets primarily consist of a surplus note issued by AGC to AGM and assets acquired in refinancing transactions. The fair value of the surplus note was determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period.

The fair value of the assets acquired in refinancing transactions was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, including LIBOR curve projections and prepayment and default assumptions. The fair value measurement was classified as Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including the discount rates, prepayment and default assumptions, loss severity and recovery on delinquent loans.

Other Assets and Other Liabilities

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

Notes Payable

The fair value of the notes payable was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, if applicable, including LIBOR curve projections, prepayment and default assumptions, and AGM CDS spreads. The fair value measurement was classified as Level 3 in the fair value hierarchy.

Loan Receivable from Affiliate

The fair value of the Company's loan receivable from affiliate is determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period. Please refer to Note 17, Subsequent Events, for information impacting the loan receivable.

Financial Instruments Carried at Fair Value

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

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of June 30, 2013

	Fair Value	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 79	$ —	$ 79	$ —
Obligations of state and political subdivisions	3,379	—	3,368	11
Corporate securities	359	—	359	—
Mortgage-backed securities:				
RMBS	385	—	159	226
Commercial mortgage-backed securities ("CMBS")	131	—	131	—
Asset-backed securities	340	—	114	226
Foreign government securities	174	—	174	—
Total fixed maturity securities	4,847	—	4,384	463
Short-term investments	623	530	93	—
Other invested assets (1)	62	—	54	8
Credit derivative assets	114	—	—	114
FG VIEs' assets, at fair value	1,784	—	—	1,784
Other assets(2)	10	—	—	10
Total assets carried at fair value	$ 7,440	$ 530	$ 4,531	$ 2,379
Liabilities:				
Credit derivative liabilities	$ 424	$ —	$ —	$ 424
FG VIEs' liabilities with recourse, at fair value	1,422	—	—	1,422
FG VIEs' liabilities without recourse, at fair value	717	—	—	717
Total liabilities carried at fair value	$ 2,563	$ —	$ —	$ 2,563

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2012

	Fair Value	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 93	$ —	$ 93	$ —
Obligations of state and political subdivisions	3,503	—	3,491	12
Corporate securities	230	—	230	—
Mortgage-backed securities:				
RMBS	359	—	175	184
CMBS	103	—	103	—
Asset-backed securities	341	—	92	249
Foreign government securities	202	—	202	—
Total fixed maturity securities	4,831	—	4,386	445
Short-term investments	473	308	165	—
Other invested assets (1)	97	—	89	8
Credit derivative assets	131	—	—	131
FG VIEs' assets, at fair value	1,870	—	—	1,870
Other assets(2)	14	—	—	14
Total assets carried at fair value	$ 7,416	$ 308	$ 4,640	$ 2,468
Liabilities:				
Credit derivative liabilities	$ 414	$ —	$ —	$ 414
FG VIEs' liabilities with recourse, at fair value	1,605	—	—	1,605
FG VIEs' liabilities without recourse, at fair value	678	—	—	678
Total liabilities carried at fair value	$ 2,697	$ —	$ —	$ 2,697

(1) Includes mortgage loans that are recorded at fair value on a non-recurring basis. At June 30, 2013 and December 31, 2012, such investments were carried at their market value of $6 million and $7 million, respectively.

(2) Includes fair value of CCS.

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during Second Quarter 2013 and 2012 and Six Months 2013 and 2012.

Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2013

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of March 31, 2013	$ 11	$ 188	$ 225	$ 1	$ 1,948	$ 11	$ (351)	$ (1,566)	$ (708)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	0 (2)	5 (2)	3 (2)	(1)	299 (3)	(1) (4)	63 (6)	(59) (3)	(90) (3)
Other comprehensive income (loss)	0	(3)	(1)	2	—	—	—	—	—
Purchases	—	47	—	—	—	—	—	—	—
Settlements	0	(11)	(1)	—	(285)	—	(22)	68	33
FG VIE consolidations	—	—	—	—	—	—	—	—	—
FG VIE deconsolidations	—	—	—	—	(178)	—	—	135	48
Fair value as of June 30, 2013	$ 11	$ 226	$ 226	$ 2	$ 1,784	$ 10	$ (310)	$ (1,422)	$ (717)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2013	$ 0	$ (2)	$ (1)	$ 2	$ 171	$ (1)	$ 47	$ (60)	$ (96)

Fair Value Level 3 Rollforward
Recurring Basis
Second Quarter 2012

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	**RMBS**	**Asset-Backed Securities**	**Other Invested Assets**	**FG VIEs' Assets at Fair Value**	**Other Assets**	**Credit Derivative Asset (Liability), net(5)**	**FG VIEs' Liabilities with Recourse, at Fair Value**	**FG VIEs' Liabilities without Recourse, at Fair Value**
	(in millions)								
Fair value as of March 31, 2012	$ 10	$ 108	$ 229	$ 2	$ 2,050	$ 17	$ (352)	$ (1,881)	$ (724)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	0 (2)	4 (2)	7 (2)	—	19 (3)	2 (4)	47 (6)	(15) (3)	(7) (3)
Other comprehensive income (loss)	0	(15)	3	(1)	—	—	—	—	—
Purchases	—	54	—	—	—	—	—	—	—
Settlements	—	(9)	(2)	0	(124)	—	4	126	41
FG VIE consolidations	—	—	—	—	—	—	—	—	—
Fair value as of June 30, 2012	$ 10	$ 142	$ 237	$ 1	$ 1,945	$ 19	$ (301)	$ (1,770)	$ (690)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2012	$ 0	$ (16)	$ 2	$ (1)	$ (94)	$ 2	$ 52	$ 62	$ 44

Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2013

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2012	$ 12	$ 184	$ 249	$ 1	$ 1,870	$ 14	$ (283)	$ (1,605)	$ (678)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	0 (2)	10 (2)	7 (2)	(1)	446 (3)	(4) (4)	7 (6)	(110) (3)	(124) (3)
Other comprehensive income (loss)	0	4	(27)	2	—	—	—	—	—
Purchases	—	50	—	—	—	—	—	—	—
Settlements	(1)	(22)	(3)	—	(402)	—	(34)	170	74
FG VIE consolidations	—	—	—	—	48	—	—	(12)	(37)
FG VIE deconsolidations	—	—	—	—	(178)	—	—	135	48
Fair value as of June 30, 2013	$ 11	$ 226	$ 226	$ 2	$ 1,784	$ 10	$ (310)	$ (1,422)	$ (717)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2013	$ 0	$ 5	$ (26)	$ 2	$ 288	$ (4)	$ (21)	$ (108)	$ (142)

Fair Value Level 3 Rollforward
Recurring Basis
Six Months 2012

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2011	$ 10	$ 105	$ 211	$ 2	$ 2,057	$ 22	$ (316)	$ (1,926)	$ (704)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	0 (2)	5 (2)	12 (2)	—	122 (3)	(3) (4)	17 (6)	(82) (3)	(66) (3)
Other comprehensive income (loss)	1	(6)	(1)	(1)	—	—	—	—	—
Purchases	—	54	18	—	—	—	—	—	—
Settlements	(1)	(16)	(3)	—	(242)	—	(2)	251	80
FG VIE consolidations	—	—	—	—	8	—	—	(13)	—
Fair value as of June 30, 2012	$ 10	$ 142	$ 237	$ 1	$ 1,945	$ 19	$ (301)	$ (1,770)	$ (690)
Change in unrealized gains/(losses) related to financial instruments held as of June 30, 2012	$ 1	$ (9)	$ (1)	$ (1)	$ 57	$ (3)	$ 22	$ (21)	$ (21)

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(1) Realized and unrealized gains (losses) from changes in values of Level 3 financial instruments represent gains (losses) from changes in values of those financial instruments only for the periods in which the instruments were classified as Level 3.

(2) Included in net realized investment gains (losses) and net investment income.

(3) Included in fair value gains (losses) on FG VIEs.

(4) Recorded in fair value gains (losses) on CCS.

(5) Represents net position of credit derivatives. The consolidated balance sheet presents gross assets and liabilities based on net counterparty exposure.

(6) Reported in net change in fair value of credit derivatives.

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At June 30, 2013

Financial Instrument Description	Fair Value at June 30, 2013 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	$ 11	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	4.8% - 22.9%
			Yield	4.6%
			Collateral recovery period	1 month - 9 years
RMBS	226	Discounted cash flow	CPR	1.0% - 7.0%
			CDR	5.9% - 23.0%
			Severity	51.6% - 102.8%
			Yield	4.8% - 9.7%
Asset-backed securities:				
Whole business securitization	62	Discounted cash flow	Annual gross revenue projections (in millions)	$54 - $96
			Value of primary financial guaranty policy	43.8%
			Liquidity discount	5.0% - 20.0%
Investor owned utility	164	Discounted cash flow	Liquidation value (in millions)	$216 - $217
			Years to liquidation	0 years - 2.5 years
			Collateral recovery period	6 months - 6 years
			Discount factor	15.3%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	1.0% - 11.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
FG VIEs' assets, at fair value	1,784	Discounted cash flow	CPR	0.6% - 9.7%
			CDR	2.8% - 27.8%
			Loss severity	38.1% - 101.9%
			Yield	2.8% - 8.9%

Financial Instrument Description	Fair Value at June 30, 2013 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	10	Discounted cash flow	Quotes from third party pricing	$57
			Term (years)	3 years
Liabilities:				
Credit derivative liabilities, net	(310)	Discounted cash flow	Hedge cost (in bps)	17.9 - 365.0
			Bank profit (in bps)	1.0 - 1,364.0
			Internal floor (in bps)	7.0 - 100.0
			Internal credit rating	AAA - BIG
FG VIEs' liabilities, at fair value	(2,139)	Discounted cash flow	CPR	0.6% - 9.7%
			CDR	2.8% - 27.8%
			Loss severity	38.1% - 101.9%
			Yield	2.8% - 8.9%

Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2012

Financial Instrument Description	Fair Value at December 31, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	$ 12	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	4.9% - 29.7%
			Yield	4.6%
			Collateral recovery period	1 month - 11 years
RMBS	184	Discounted cash flow	CPR	1.0% - 6.9%
			CDR	6.2% - 23.0%
			Severity	51.6% - 102.8%
			Yield	3.5% - 12.5%
Asset-backed securities:				
Whole business securitization	63	Discounted cash flow	Annual gross revenue projections (in millions)	$54 - $96
			Value of primary financial guaranty policy	43.8%
			Liquidity discount	5.0% - 20.0%
Investor owned utility	186	Discounted cash flow	Liquidation value (in millions)	$212 - $242
			Years to liquidation	0 years - 3 years
			Discount factor	15.3%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	1.0% - 12.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
FG VIEs' assets, at fair value	1,870	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

Financial Instrument Description	Fair Value at December 31, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	14	Discounted cash flow	Quotes from third party pricing	$45 - $51
			Term (years)	3 years
Liabilities:				
Credit derivative liabilities, net	(283)	Discounted cash flow	Hedge cost (in bps)	64.2 - 536.2
			Bank profit (in bps)	1.0 - 1,312.9
			Internal floor (in bps)	7.0 - 60.0
			Internal credit rating	AAA - BIG
FG VIEs' liabilities, at fair value	(2,283)	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

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

Fair Value of Financial Instruments

	As of June 30, 2013		As of December 31, 2012	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Assets:				
Fixed maturity securities	$ 4,847	$ 4,847	$ 4,831	$ 4,831
Short-term investments	623	623	473	473
Other invested assets	395	461	441	548
Loan receivable from affiliate	83	80	83	82
Credit derivative assets	114	114	131	131
FG VIEs' assets, at fair value	1,784	1,784	1,870	1,870
Other assets	94	94	72	72
Liabilities:				
Financial guaranty insurance contracts(1)	2,013	2,096	2,091	2,949
Note payable	53	55	66	72
Credit derivative liabilities	424	424	414	414
FG VIEs' liabilities with recourse, at fair value	1,422	1,422	1,605	1,605
FG VIEs' liabilities without recourse, at fair value	717	717	678	678
Other liabilities	37	37	25	25

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

8. Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS). Until the Company ceased selling credit protection through credit derivative contracts in the beginning of 2009, following the issuance of regulatory guidelines that limited the terms under which the credit protection could be sold, management considered these agreements to be a normal part of its financial guaranty business. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer Protection Act contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future.

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, while the Company's exposure under credit derivatives, like the Company's exposure under financial guaranty insurance contracts, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty contracts, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. A loss payment is made only upon the occurrence of one or more defined credit events with respect to the referenced securities or loans. A credit event may be a non-payment event such as a failure to pay, bankruptcy or restructuring, as negotiated by the parties to the credit derivative transactions. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. The Company may be required to make a termination payment to its swap counterparty upon such termination. The Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 2.4 years at June 30, 2013 and 2.5 years at December 31, 2012. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives Net Par Outstanding

	As of June 30, 2013				As of December 31, 2012			
Asset Type	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating
				(dollars in millions)				
Pooled corporate obligations:								
Collateralized loan obligations/ collateralized bond obligations	$ 12,706	29.3%	30.9%	AAA	$ 15,614	29.1%	30.4%	AAA
Synthetic investment grade pooled corporate	9,057	21.1	19.2	AAA	9,089	21.1	19.2	AAA
Synthetic high yield pooled corporate	2,684	47.2	41.1	AAA	3,616	35.0	30.4	AAA
Trust preferred securities collateralized debt obligations ("TruPS CDOs")	28	55.3	85.8	AAA	41	55.1	78.8	AAA
Market value CDOs of corporate obligations	1,184	17.0	31.0	AAA	1,492	17.0	29.9	AAA
Total pooled corporate obligations	25,659	27.7	27.9	AAA	29,852	26.8	27.0	AAA
U.S. RMBS:								
Subprime first lien (including net interest margin)	69	—	—	AA	72	—	—	AA
Closed end second lien and HELOCs	79	—	—	BBB+	101	—	—	BBB
Total U.S. RMBS	148	—	—	A	173	—	—	A
Other	2,899	—	—	A-	3,269	—	—	A-
Total	$ 28,706			AAA	$ 33,294			AAA

(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure consists of collateralized loan obligation ("CLO") or synthetic pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

The $2.9 billion of exposure in "Other" CDS contracts as of June 30, 2013 comprises numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of June 30, 2013 Net Par Outstanding	As of June 30, 2013 % of Total	As of December 31, 2012 Net Par Outstanding	As of December 31, 2012 % of Total
	(dollars in millions)			
AAA	$ 24,534	85.5%	$ 27,826	83.6%
AA	1,970	6.9	1,839	5.5
A	827	2.9	1,781	5.3
BBB	1,073	3.6	1,319	4.0
BIG	302	1.1	529	1.6
Total credit derivative net par outstanding	$ 28,706	100.0%	$ 33,294	100.0%

Net Change in Fair Value of Credit Derivatives

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

	Second Quarter 2013	Second Quarter 2012	Six Months 2013	Six Months 2012
	(in millions)			
Net credit derivative premiums received and receivable	$ 18	$ 14	$ 30	$ 23
Net ceding commissions (paid and payable) received and receivable	1	1	1	1
Realized gains on credit derivatives	19	15	31	24
Net credit derivative losses (paid and payable) recovered and recoverable	(1)	(21)	(2)	(31)
Total realized gains (losses) and other settlements on credit derivatives	18	(6)	29	(7)
Net unrealized gains (losses) on credit derivatives	45	53	(22)	24
Net change in fair value of credit derivatives	$ 63	$ 47	$ 7	$ 17

In Second Quarter 2013 and 2012, CDS contracts totaling $1.4 billion and $0.4 billion, respectively, in net par were terminated resulting in accelerations of credit derivative revenue of $9 million and $0.4 million, respectively. In Six Months 2013 and 2012, CDS contracts totaling $2.4 billion and $0.5 billion, respectively, in net par were terminated resulting in accelerations of credit derivative revenue of $10 million and $0.5 million, respectively.

Changes in the fair value of credit derivatives occur primarily because of changes in interest rates, credit spreads, notional amounts, credit ratings of the referenced entities, expected terms, realized gains (losses) and other settlements, and the issuing company's own credit rating, credit spreads and other market factors. Except for net estimated credit impairments (i.e., net expected loss to be paid as discussed in Note 5), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Net Change in Unrealized Gains (Losses) on Credit Derivatives By Sector

Asset Type	Second Quarter 2013	Second Quarter 2012	Six Months 2013	Six Months 2012
	(in millions)			
Pooled corporate obligations	$ 2	$ 7	$ (28)	$ 20
U.S. RMBS	—	20	(2)	27
Other	43	26	8	(23)
Total	$ 45	$ 53	$ (22)	$ 24

During Second Quarter 2013, unrealized fair value gains were driven primarily by the price improvement on a XXX life securitization transaction in the Other sector. The cost of AGM's 5 Year and 1 Year credit protection also changed during Second Quarter 2013, but did not lead to significant fair value losses, as the policies which represent the majority of the Company's current outstanding exposure continue to price at previous established floor level (or the minimum rate at which the Company would expect to consider assuming these risks based on historical experience).

During Six Months 2013, the cost to buy protection on AGM's name declined. This led to unrealized fair value losses which were generated primarily in the high yield and investment grade synthetic pooled corporate sectors. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGM's name as the market cost of AGM's credit decreased significantly during the period. Several transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGM, which management refers to as the CDS spread on AGM, decreased the implied spreads that the Company would expect to receive on these transactions increased. Six Months 2013 changes in fair value of credit derivatives in the Other category includes a $17 million loss for guaranteed interest rate swaps identified during 2013.

During Second Quarter 2012, unrealized fair value gains were generated primarily in the subprime first lien and Other sectors due to narrower implied net spread. The narrower implied net spreads were primarily a result of the increased cost to buy protection on AGM's name as the market cost of AGM's credit increased during the period. Several transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGM increased, the implied spreads that the Company would expect to receive on these transactions decreased. The unrealized gain in the Other sector was driven primarily by the price improvement on a XXX life securitization transaction.

During Six Months 2012, the unrealized fair value gains were generated primarily in the high yield and investment grade synthetic pooled corporate sectors, as well as the subprime first lien sector. The gains in all three sectors were a result of a significant run-off of par outstanding as the transactions in these sectors approach maturity, as well as the expiration of several large transactions. The unrealized gains were partially offset by unrealized losses in the Other sector. The unrealized losses in Other were a result of the decreased cost to buy protection in AGM's name as the market cost of AGM's credit decreased during the period. Several transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGM decreased, the implied spreads that the Company would expect to receive on these transactions increased.

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

Five Year CDS Spread on AGM

	As of June 30, 2013	As of March 31, 2013	As of December 31, 2012	As of June 30, 2012	As of March 31, 2012	As of December 31, 2011
Quoted price of CDS contract (in basis points)	365	380	536	652	555	778

One-Year CDS Spread on AGM

	As of June 30, 2013	As of March 31, 2013	As of December 31, 2012	As of June 30, 2012	As of March 31, 2012	As of December 31, 2011
Quoted price of CDS contract (in basis points)	72	60	257	416	378	538

	As of June 30, 2013	As of December 31, 2012
	(in millions)	
Fair value of credit derivatives before effect of AGM credit spread	$ (492)	$ (627)
Plus: Effect of AGM credit spread	182	344
Net fair value of credit derivatives	$ (310)	$ (283)

The fair value of CDS contracts at June 30, 2013, before considering the implications of AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets and ratings downgrades. The asset classes that remain most affected are pooled corporate securities and a XXX life securitization transaction. Comparing June 30, 2013 with December 31, 2012, there was a narrowing of spreads primarily related to pooled corporate obligations and a XXX life securitization transaction. This narrowing of spreads combined with the run-off of par outstanding and termination of securities, resulted in a gain of approximately $135 million, before taking into account AGM's credit spreads.

Management believes that the trading level of AGM's credit spreads over the past several years has been due to the correlation between AGM's risk profile and the current risk profile of the broader financial markets and to increased demand for credit protection against AGM as the result of its financial guaranty volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, and CLO markets as well as continuing market concerns over the most recent vintages of RMBS.

The following table presents the fair value and the present value of expected claim payments or recoveries (i.e. net expected loss to be paid as described in Note 5) for contracts accounted for as derivatives.

Net Fair Value and Expected Losses of Credit Derivatives by Sector

	Fair Value of Credit Derivative Asset (Liability), net		Present Value of Expected Claim (Payments) Recoveries (1)	
Asset Type	As of June 30, 2013	As of December 31, 2012	As of June 30, 2013	As of December 31, 2012
		(in millions)		
Pooled corporate obligations	$ (34)	$ (5)	$ —	$ —
U.S. RMBS	(12)	(10)	2	10
Other	(264)	(268)	(4)	(4)
Total	$ (310)	$ (283)	$ (2)	$ 6

(1) Represents amount in excess of the present value of future installment fees to be received of $1 million as of June 30, 2013 and $1 million as of December 31, 2012. There is no R&W benefit on credit derivatives as of June 30, 2013 and as of December 31, 2012.

Sensitivity to Changes in Credit Spread

The following table summarizes the estimated change in fair values on the net balance of the Company's credit derivative positions assuming immediate parallel shifts in credit spreads on AGM and on the risks that it assumes.

Effect of Changes in Credit Spread
As of June 30, 2013

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax)	Estimated Change in Gain/(Loss) (Pre-Tax)
	(in millions)	
100% widening in spreads	$ (571)	$ (261)
50% widening in spreads	(440)	(130)
25% widening in spreads	(375)	(65)
10% widening in spreads	(335)	(25)
Base Scenario	(310)	—
10% narrowing in spreads	(292)	18
25% narrowing in spreads	(265)	45
50% narrowing in spreads	(221)	89

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(1) Includes the effects of spreads on both the underlying asset classes and the Company’s own credit spread.

9. Consolidation of Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGM does not sponsor any VIEs when underwriting third party financial guaranty insurance or credit derivative transactions, nor does it act as the servicer or collateral manager for any VIE obligations that it insures. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction’s cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

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

As part of the terms of its financial guaranty contracts, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company obtains protective rights under its insurance contracts that give the Company additional controls over a VIE if there is either deterioration of deal performance or in the financial health of the deal servicer. The Company is deemed to be the control party under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the Company's protective rights that could make it the control party have not been triggered, then it does not consolidate the VIE. As of June 30, 2013, the Company had issued financial guaranty contracts for approximately 500 VIEs that it did not consolidate.

Consolidated FG VIEs

Number of FG VIE's Consolidated

	As of June 30, 2013	As of December 31, 2012
Beginning of the period	25	26
Consolidated(1)	11	1
Deconsolidated(1)	(2)	—
Matured	(1)	(2)
End of the year	33	25

(1) Net loss on consolidation and deconsolidation was $7 million in Six Months 2013 and $5 million in 2012, respectively, and recorded in "fair value gains (losses) on FG VIEs" in the consolidated statement of operations.

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately $603 million at June 30, 2013. The aggregate unpaid principal of the FG VIEs' assets was approximately $1,666 million greater than the aggregate fair value at June 30, 2013. The change in the instrument-specific credit risk of the FG VIEs' assets for Second Quarter 2013 and Six Months were gains of $71 million and $123 million, respectively. The change in the instrument-specific credit risk of the FG VIEs' assets for Second Quarter 2012 and Six Months 2012 were gains of $73 million and $105 million, respectively.

The aggregate unpaid principal balance was approximately $1,297 million greater than the aggregate fair value of the FG VIEs' liabilities as of June 30, 2013.

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

Consolidated FG VIEs
By Type of Collateral

	As of June 30, 2013			As of December 31, 2012		
	Number of FG VIEs	Assets	Liabilities	Number of FG VIEs	Assets	Liabilities
			(dollars in millions)			
With recourse:						
First liens:	23	$ 598	$ 789	12	$ 565	$ 767
Second lien	9	422	621	11	553	799
Other	1	12	12	2	39	39
Total with recourse	33	1,032	1,422	25	1,157	1,605
Without recourse	—	752	717	—	713	678
Total	33	$ 1,784	$ 2,139	25	$ 1,870	$ 2,283

Unpaid Principal for FG VIEs' Liabilities With Recourse

	As of June 30, 2013	As of December 31, 2012
	(in millions)	
Unpaid principal for FG VIEs' liabilities with recourse(1)	$ 1,780	$ 2,087

(1) FG VIE liabilities with recourse will mature at various dates ranging from 2025 to 2047, except for $12 million maturing in 2014.

The consolidation of FG VIEs has a significant effect on net income and shareholder's equity due to (1) changes in fair value gains (losses) on FG VIE assets and liabilities, (2) the elimination of premiums and losses related to the AGM FG VIE liabilities with recourse and (3) the elimination of investment balances related to the Company's purchase of AGM insured FG VIE debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

Effect of Consolidating FG VIEs on Net Income and Shareholder's Equity

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Net earned premiums	$ (14)	$ (15)	$ (32)	$ (31)
Net investment income	(3)	(3)	(6)	(5)
Net realized investment gains (losses)	0	3	1	4
Fair value gains (losses) on FG VIEs	147	65	222	30
Loss and LAE	22	2	16	13
Total pretax effect on net income	152	52	201	11
Less: tax provision (benefit)	53	17	70	3
Total effect on net income (loss)	$ 99	$ 35	$ 131	$ 8

	As of June 30, 2013	As of December 31, 2012
	(in millions)	
Total (decrease) increase on shareholder's equity	$ (193)	$ (321)

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities. For Second Quarter 2013, the Company recorded a pre-tax fair value gain on FG VIEs of $147 million. The primary driver of this gain was a $149 million fair value gain as a result of R&W benefits recognized during the quarter on policies relating to Flagstar and UBS. This was also the primary driver of the $222 million pre-tax fair value gain of consolidated FG VIEs during Six Months 2013. The additional gain for Six Months 2013 was primarily also a result of a $64 million R&W benefit related to the Flagstar policies referenced above. During Second Quarter 2013, the Company signed an agreement that resulted in the deconsolidation of two FG VIEs.

During Second Quarter 2012, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of $65 million. The majority of this gain, $57 million, is a result of a R&W settlement with Deutsche Bank during the period. This was also the primary driver of the $30 million pre-tax fair value gain of consolidated FG VIEs during Six Months 2012. The Six Months 2012 amount was partially offset by an unrealized loss in first quarter 2012, which resulted from price appreciation on wrapped FG VIE liabilities, as market participants gave more value to the guarantees provided by monoline insurers.

Non-Consolidated VIEs

To date, the Company's analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, they are not consolidated in the consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 3, Outstanding Exposure.

10. Investments and Cash

Investment Portfolio

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Income earned on the general portfolio excluding loss mitigation bonds declined due to lower reinvestment rates. Accrued interest on investment portfolio and loan receivable from affiliate was $63 million and $54 million as of June 30, 2013 and December 31, 2012, respectively.

Net Investment Income

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Income from fixed maturity securities in general investment portfolio	$ 40	$ 43	$ 79	$ 84
Income from fixed maturity securities purchased or obtained for loss mitigation purposes	11	12	23	21
Interest income from notes receivable from affiliates	5	4	9	8
Other(1)	1	1	3	2
Gross investment income	57	60	114	115
Investment expenses	(1)	(1)	(2)	(2)
Net investment income	$ 56	$ 59	$ 112	$ 113

(1) Includes income from short-term investments and assets acquired in refinancing transactions.

Net Realized Investment Gains (Losses)

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Gross realized gains on investment portfolio	$ 3	$ 8	$ 5	$ 15
Gross realized losses on investment portfolio	(2)	(17)	(8)	(21)
Other-than-temporary impairment ("OTTI")	(3)	0	(7)	(2)
Net realized investment gains (losses)	$ (2)	$ (9)	$ (10)	$ (8)

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

Roll Forward of Credit Losses in the Investment Portfolio

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Balance, beginning of period	$ 40	$ 34	$ 36	$ 31
Additions for credit losses on securities for which an OTTI was not previously recognized	—	—	1	—
Additions for credit losses on securities for which an OTTI was previously recognized	1	0	4	3
Balance, end of period	$ 41	$ 34	$ 41	$ 34

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of June 30, 2013

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI (2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
	(dollars in millions)						
Fixed maturity securities:							
U.S. government and agencies	1%	$ 75	$ 5	$ (1)	$ 79	$ —	AA+
Obligations of state and political subdivisions	60	3,203	187	(11)	3,379	3	AA
Corporate securities	7	360	6	(7)	359	—	AA-
Mortgage-backed securities(4):							
RMBS	8	425	10	(50)	385	(42)	BBB-
CMBS	3	129	3	(1)	131	—	AAA
Asset-backed securities	6	314	26	0	340	14	BIG
Foreign government securities	3	177	1	(4)	174	0	AA+
Total fixed maturity securities	88	4,683	238	(74)	4,847	(25)	AA-
Short-term investments	12	623	0	0	623	—	AAA
Total investment portfolio	100%	$ 5,306	$ 238	$ (74)	$ 5,470	$ (25)	AA-

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2012

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
	(dollars in millions)						
Fixed maturity securities:							
U.S. government and agencies	2%	$ 86	$ 8	$ 0	$ 94	$ —	AA+
Obligations of state and political subdivisions	65	3,197	306	0	3,503	6	AA
Corporate securities	4	215	15	0	230	—	AA-
Mortgage-backed securities(4):							
RMBS	8	398	13	(53)	358	(37)	BBB-
CMBS	2	97	6	—	103	—	AAA
Asset-backed securities	6	288	54	—	342	41	BIG
Foreign government securities	3	192	9	0	201	1	AAA
Total fixed maturity securities	90	4,473	411	(53)	4,831	11	AA-
Short-term investments	10	473	0	—	473	—	AAA
Total investment portfolio	100%	$ 4,946	$ 411	$ (53)	$ 5,304	$ 11	AA-

(1) Based on amortized cost.

(2) Accumulated OCI ("AOCI"). See also Note 16.

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

(4) Government-agency obligations were approximately 31% of mortgage backed securities as of June 30, 2013 and 38% as of December 31, 2012 based on fair value.

The Company’s investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories. Securities rated lower than A-/A3 by S&P or Moody’s are not eligible to be purchased for the Company’s portfolio unless acquired for loss mitigation or risk management strategies.

The Company’s investment portfolio is managed by four outside managers. As municipal investments are a material portion of the Company’s overall investment portfolio, the Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. Each of the portfolio managers perform independent analysis on every municipal security they purchase for the Company’s portfolio. The Company meets with each of its portfolio managers quarterly and reviews all investments with a change in credit rating as well as any investments on the manager’s watch list of securities with the potential for downgrade.

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

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of June 30, 2013

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
U.S. government and agencies	$ 11	$ (1)	$ —	$ —	$ 11	(1)
Obligations of state and political subdivisions	272	(11)	—	—	272	(11)
Corporate securities	174	(7)	—	—	174	(7)
Mortgage-backed securities:						
RMBS	128	(9)	122	(41)	250	(50)
CMBS	32	(1)	—	—	32	(1)
Asset-backed securities	19	0	—	—	19	0
Foreign government securities	126	(4)	—	—	126	(4)
Total	$ 762	$ (33)	$ 122	$ (41)	$ 884	$ (74)
Number of securities		167		12		179
Number of securities with OTTI		6		7		13

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2012

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(dollars in millions)					
U.S. government and agencies	$ 12	$ 0	$ —	$ —	$ 12	0
Obligations of state and political subdivisions	17	0	—	—	17	0
Corporate securities	5	0	—	—	5	0
Mortgage-backed securities:						
RMBS	76	(17)	97	(36)	173	(53)
Foreign government securities	6	0	—	—	6	0
Total	$ 116	$ (17)	$ 97	$ (36)	$ 213	$ (53)
Number of securities		16		10		26
Number of securities with OTTI		5		4		9

Of the securities in an unrealized loss position for 12 months or more as of June 30, 2013, eight securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of June 30, 2013 was $41 million. The Company has determined that the unrealized losses recorded as of June 30, 2013 are yield related and not the result of OTTI.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of June 30, 2013 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of June 30, 2013

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	$ 45	$ 45
Due after one year through five years	694	717
Due after five years through 10 years	1,461	1,520
Due after 10 years	1,929	2,049
Mortgage-backed securities:		
RMBS	425	385
CMBS	129	131
Total	$ 4,683	$ 4,847

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts for the benefit of reinsured companies, which amounted to $21 million as of June 30, 2013 and December 31, 2012. In addition, to fulfill state licensing requirements, the Company has placed on deposit eligible securities of $11 million and $15 million as of June 30, 2013 and December 31, 2012, respectively, for the protection of policyholders.

No material investments of the Company were non-income producing for Six Months 2013 and 2012, respectively.

Loss Mitigation Assets

One of the Company's strategies for mitigating losses has been to purchase insured securities that have expected losses at discounted prices. The Company may also obtain the obligations referenced in CDS transactions that have triggered the insured's obligation to put these bonds to AGM, or assets may be obtained as part of a negotiated agreement.

Loss Mitigation Assets
Carrying Value

	As of June 30, 2013	As of December 31, 2012
	(in millions)	
Fixed maturity securities:		
Obligations of state and political subdivisions	$ 11	$ 12
RMBS	207	184
Asset-backed securities	226	249
Other invested assets:		
Assets acquired in refinancing transactions	61	72
Other	2	1
Total	$ 507	$ 518

11. Insurance Company Regulatory Requirements

Dividend Restrictions and Capital Requirements

AGM is a New York domiciled insurance company. Under New York insurance law, AGM may pay dividends out of "earned surplus", which is the portion of a company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends or transferred to stated capital or capital surplus, or applied to other purposes permitted by law, but does not include unrealized appreciation of assets. AGM may pay an ordinary dividend that, together with all dividends paid in the prior 12 months, does not exceed the lesser of 10% of its policyholders' surplus (as of the last annual or quarterly statement filed) or 100% of its adjusted net investment income during that period. As of June 30, 2013, approximately $141 million was available for distribution of dividends, after giving effect to dividends paid in the prior 12 months of $38 million. This amount does not take into account the July 2013 transactions to capitalize MAC, including AGM contributing MAC's outstanding common stock, cash and marketable securities to MAC Holdings (a new company formed to own 100% of the outstanding stock of MAC - please refer to Note 17 Subsequent Events for additional information), ceding a portfolio of policies covering U.S. municipal bonds to MAC, and paying MAC unearned premium for such cession.

Dividends Paid and Repayment of Surplus Note
By Insurance Company

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Dividends paid by AGM to AGMH	$ 38	$ —	$ 38	$ 30
Repayment of surplus note by AGM to AGMH	—	50	25	50

12. Income Taxes

Provision for Income Taxes

The Company's Bermuda subsidiary, AGBM (formerly Financial Security Assurance International Ltd.), is not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, AGBM will be exempt from taxation in Bermuda until March 28, 2035. Please refer to Note 17, Subsequent Events for series of transactions impacting AGBM in July 2013.

The Company's U.S. and United Kingdom ("U.K.") subsidiary are subject to income taxes imposed by U.S. and U.K. authorities at marginal corporate income tax rates of 35% and 23.25%, respectively, and file applicable tax returns. For periods subsequent to April 1, 2013, the U.K. corporation tax rate has been reduced to 23%, for the period April 1, 2012 to April 1, 2013 the U.K. corporation tax rate was 24% resulting in a blended tax rate of 23.25% in 2013 and prior to April 1, 2012, the U.K. corporation rate was 26% resulting in a blended tax rate of 24.5% in 2012. The Company's overall corporate effective tax rate fluctuates based on the distribution of income across jurisdictions. In addition, AGE, a U.K. domiciled company, has elected under Section 953(d) of the U.S. Internal Revenue Code to be taxed as a U.S. domestic corporation.

In conjunction with AGL's purchase of AGMH on July 1, 2009, AGM and its insurance company subsidiaries have joined the consolidated federal tax group of Assured Guaranty US Holdings Inc. ("AGUS"), an indirect parent holding company of AGM. A new tax sharing agreement was entered into effective July 1, 2009 whereby each company in the AGUS consolidated tax group pays or receives its proportionate share of the consolidated federal tax burden for the group as if each company filed on a separate return basis with current period credit for net losses.

The Company's provision for income taxes for interim financial periods is not based on an estimated annual effective rate due to the variability in fair value of its credit derivatives, which prevents the Company from projecting a reliable estimated annual effective tax rate and pretax income for the full year 2013. A discrete calculation of the provision is calculated for each interim period.

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

Effective Tax Rate Reconciliation

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Expected tax provision (benefit) at statutory rate	$ 113	$ 81	$ 192	$ 75
Tax-exempt interest	(10)	(11)	(20)	(22)
Other	—	—	1	1
Total provision (benefit) for income taxes	$ 103	$ 70	$ 173	$ 54
Effective tax rate	32.0%	30.7%	31.6%	25.6%

The expected tax provision at statutory rates in taxable jurisdictions is calculated as the sum of pretax income in each jurisdiction multiplied by the statutory tax rate of the jurisdiction by which it will be taxed. Pretax income of the Company's subsidiaries which are not U.S. domiciled but are subject to U.S. tax by election or as controlled foreign corporations are included at the U.S. statutory tax rate.

Valuation Allowance

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

13. Reinsurance and Other Monoline Exposures

AGM assumes exposure on insured obligations ("Assumed Business") and cedes portions of its exposure on obligations it has insured ("Ceded Business") in exchange for premiums, net of ceding commissions.

Ceded and Assumed Business

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

Commutations of Ceded Business resulted in net increase to unearned premium reserves of $106 million, net par outstanding of $19,073 million and gains of $83 million which were recorded in other income, for Six Months 2012. There were no commutations in 2013. While certain Ceded Business has been reassumed, the Company still has significant Ceded Business with third parties.

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

Effect of Reinsurance on Statement of Operations

	Second Quarter		Six Months	
	2013	2012	2013	2012
	(in millions)			
Premiums Written:				
Direct	$ 18	$ 48	$ 35	$ 95
Ceded	(7)	(18)	(13)	63
Net	$ 11	$ 30	$ 22	$ 158
Premiums Earned:				
Direct	$ 152	$ 213	$ 381	$ 394
Ceded	(43)	(57)	(96)	(104)
Net	$ 109	$ 156	$ 285	$ 290
Loss and LAE:				
Direct	$ 46	$ 100	$ 31	$ 411
Ceded	(13)	(24)	(27)	(145)
Net	$ 33	$ 76	$ 4	$ 266

Reinsurer Exposure

In addition to assumed and ceded reinsurance arrangements, the Company may also have exposure to some financial guaranty reinsurers (i.e., monolines) in other areas. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monolines. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. Another area of exposure is in the investment portfolio where the Company holds fixed maturity securities that are wrapped by monolines and whose value may decline based on the rating of the monoline. At June 30, 2013, based on fair value, the Company had $457 million of fixed maturity securities in its investment portfolio wrapped by National Public Finance Guarantee Corporation, $363 million by Ambac Assurance Corporation ("Ambac"), $81 million by AGC, and $23 million by other guarantors.

Exposure by Reinsurer

Reinsurer	Ratings as of August 21, 2013: Moody's Reinsurer Rating	Ratings as of August 21, 2013: S&P Reinsurer Rating	Par Outstanding as of June 30, 2013: Ceded Par Outstanding(1)	Par Outstanding as of June 30, 2013: Second-to-Pay Insured Par Outstanding	Par Outstanding as of June 30, 2013: Assumed Par Outstanding
			(dollars in millions)		
Affiliated Companies	(2)	(2)	$ 62,689	$ 491	$ 26
Non-Affiliated Companies:					
Tokio Marine & Nichido Fire Insurance Co., Ltd.	Aa3(3)	AA-(3)	7,660	—	—
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	WR(4)	WR	7,149	—	30
Radian Asset Assurance Inc.	Ba1	B+	4,840	39	—
Syncora Guarantee Inc.	WR	WR	4,031	610	—
Mitsui Sumitomo Insurance Co. Ltd.	A1	A+(3)	2,186	—	—
ACA Financial Guaranty Corp.	NR	WR	810	5	—
Swiss Reinsurance Co.	A1	AA-	426	—	—
CIFG Assurance North America Inc. ("CIFG")	WR	WR	61	119	—
MBIA Inc.	(5)	(5)	—	7,497	—
Ambac	WR	WR	—	3,010	—
Financial Guaranty Insurance Co.	WR	WR	—	1,032	—
Other	Various	Various	877	—	1
Non-Affiliated Companies			28,040	12,312	31
Total			$ 90,729	$ 12,803	$ 57

(1) Includes $3,067 million in ceded par outstanding related to insured credit derivatives.

(2) As of the date of this document, the affiliates of AGM are Assured Guaranty Re Ltd. and its subsidiaries ("AG Re"), rated Baa1 (stable) by Moody's and AA- (stable) by S&P, and AGC and its subsidiaries, rated A3 (stable) by Moody's and AA- (stable) by S&P.

(3) The Company has structural collateral agreements satisfying the triple-A credit requirement of S&P and/or Moody's.

(4) Represents "Withdrawn Rating."

(5) MBIA Inc. includes various subsidiaries which are rated A and B by S&P and Baa1, B1, B3, WR and NR by Moody's.

Amounts Due (To) From Reinsurers
As of June 30, 2013

	Ceded Premium, net of Commissions	Ceded Expected Loss and LAE
	(in millions)	
Affiliated Companies	$ (54)	$ 29
Tokio Marine & Nichido Fire Insurance Co., Ltd.	(23)	36
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	(9)	5
Radian Asset Assurance Inc.	(18)	1
Syncora Guarantee Inc.	(40)	1
Mitsui Sumitomo Insurance Co. Ltd.	(4)	8
Swiss Reinsurance Co.	(3)	2
CIFG	—	5
Other	(40)	—
Total	$ (191)	$ 87

14. Commitments and Contingencies

Legal Proceedings

Litigation

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

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

In addition, in the ordinary course of its business, the Company asserts claims in legal proceedings against third parties to recover losses paid in prior periods. For example, as described in the "Recovery Litigation" section within Note 5, Expected Loss to be Paid, as of the date of this filing, AGM has filed complaints against certain sponsors and underwriters of RMBS securities that AGM had insured, alleging, among other claims, that such persons had breached R&W in the transaction documents, failed to cure or repurchase defective loans and/or violated state securities laws. The amounts, if any, the Company will recover in proceedings to recover losses are uncertain, and recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or year could be material to the Company's results of operations in that particular quarter or year.

Proceedings Relating to the Company's Financial Guaranty Business

AGM and AGMH receive subpoenas *duces tecum* and interrogatories from regulators from time to time.

In August 2008, a number of financial institutions and other parties, including AGM and other bond insurers, were named as defendants in a civil action brought in the circuit court of Jefferson County, Alabama relating to the County's problems meeting its sewer debt obligations: *Charles E. Wilson vs. JPMorgan Chase & Co et al* (filed the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00, a putative class action. The action was brought on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleges conspiracy and fraud in connection with the issuance of the County’s debt. The complaint in this lawsuit seeks equitable relief, unspecified monetary damages, interest, attorneys’ fees and other costs. On January, 13, 2011, the circuit court issued an order denying a motion by the bond insurers and other defendants to dismiss the action. Defendants, including the bond insurers, have petitioned the Alabama Supreme Court for a writ of mandamus to the circuit court vacating such order and directing the dismissal with prejudice of plaintiffs’ claims for lack of standing. Currently, the litigation is stayed pending confirmation of Jefferson County's plan of adjustment or further court orders. In July 2013, Jefferson County filed its Chapter 9 plan of adjustment, disclosure statement, and motions to approve the disclosure statement and solicitation procedures with the bankruptcy court and in August 2013, the bankruptcy court approved Jefferson County's disclosure statement and related solicitation procedures. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from this lawsuit.

Beginning in July 2008, AGM and various other financial guarantors were named in complaints filed in the Superior Court for the State of California, City and County of San Francisco by a number of plaintiffs. Subsequently, plaintiffs' counsel filed amended complaints against AGM and AGC and added additional plaintiffs. These complaints alleged that the financial guaranty insurer defendants (i) participated in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance, (ii) participated in risky financial transactions in other lines of business that damaged each insurer's financial condition (thereby undermining the value of each of their guaranties), and (iii) failed to adequately disclose the impact of those transactions on their financial condition. In addition to their antitrust claims, various plaintiffs asserted claims for breach of the covenant of good faith and fair dealing, fraud, unjust enrichment, negligence, and negligent misrepresentation. At hearings held in July and October 2011 relating to AGM, AGC and the other defendants' demurrer, the court overruled the demurrer on the following claims: breach of contract, violation of California's antitrust statute and of its unfair business practices law, and fraud. The remaining claims were dismissed. On December 2, 2011, AGM, AGC and the other bond insurer defendants filed an anti-SLAPP ("Strategic Lawsuit Against Public Participation") motion to strike the complaints under California's Code of Civil Procedure. On July 9, 2013, the court entered its order denying in part and granting in part the bond insurers' motion to strike. As a result of the order, the causes of action that remain against AGM and AGC are: claims of breach of contract and fraud, brought by the City of San Jose, the City of Stockton, East Bay Municipal Utility District and Sacramento Suburban Water District, relating to the failure to disclose the impact of risky financial transactions on their financial condition; and a claim of breach of the unfair business practices law brought by The Jewish Community Center of San Francisco. The complaints generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from these lawsuits.

On November 19, 2012, Lehman Brothers Holdings Inc. (“LBHI”) and Lehman Brothers Special Financing Inc. (“LBSF") commenced an adversary complaint and claim objection in the United States Bankruptcy Court for the Southern District of New York against Credit Protection Trust 283 (“CPT 283”), FSA Administrative Services, LLC, as trustee for CPT 283, and AGM, in connection with CPT 283's termination of a CDS between LBSF and CPT 283. CPT 283 terminated the CDS as a consequence of LBSF failing to make a scheduled payment owed to CPT 283, which termination occurred after LBHI filed for bankruptcy but before LBSF filed for bankruptcy. The CDS provided that CPT 283 was entitled to receive from LBSF a termination payment in that circumstance of approximately $43.8 million (representing the economic equivalent of the future fixed payments CPT 283 would have been entitled to receive from LBSF had the CDS not been terminated), and CPT 283 filed proofs of claim against LBSF and LBHI (as LBSF's credit support provider) for such amount. LBHI and LBSF seek to disallow and expunge (as impermissible and unenforceable penalties) CPT 283's proofs of claim against LBHI and LBSF and recover approximately $67.3 million, which LBHI and LBSF allege was the mark-to-market value of the CDS to LBSF (less unpaid amounts) on the day CPT 283 terminated the CDS, plus interest, attorney's fees, costs and other expenses. On the same day, LBHI and LBSF also commenced an adversary complaint and claim objection against Credit Protection Trust 207 (“CPT 207”), FSA Administrative Services, LLC, as trustee for CPT 207, and AGM, in connection with CPT 207's termination of a CDS between LBSF and CPT 207. Similarly, the CDS provided that CPT 207 was entitled to receive from LBSF a termination payment in that circumstance of $492,555. LBHI and LBSF seek to disallow and expunge CPT 207's proofs of claim against LBHI and LBSF and recover approximately $1.5 million. AGM believes the terminations of the CDS and the calculation of the termination payment amounts were consistent with the terms of the ISDA master agreements between the parties. The Company cannot reasonably estimate the possible loss, if any, that may arise from this lawsuit.

Proceedings Related to AGMH's Former Financial Products Business

The following is a description of legal proceedings involving AGMH’s former financial products business. Although Assured Guaranty did not acquire AGMH’s former financial products business, which included AGMH’s former GIC business, medium term notes business and portions of the leveraged lease businesses, certain legal proceedings relating to those businesses are against entities that Assured Guaranty did acquire. While Dexia SA and Dexia Crédit Local S.A. (“DCL”), jointly and severally, have agreed to indemnify Assured Guaranty against liability arising out of the proceedings described below in the “—Proceedings Related to AGMH’s Former Financial Products Business” section, such indemnification might not be sufficient to fully hold Assured Guaranty harmless against any injunctive relief or civil or criminal sanction that is imposed against AGMH or its subsidiaries.

Governmental Investigations into Former Financial Products Business

AGMH and/or AGM have received subpoenas *duces tecum* and interrogatories or civil investigative demands from the Attorneys General of the States of Connecticut, Florida, Illinois, Massachusetts, Missouri, New York, Texas and West Virginia relating to their investigations of alleged bid rigging of municipal GICs. AGMH is responding to such requests. AGMH may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future. In addition,

- AGMH received a subpoena from the Antitrust Division of the Department of Justice in November 2006 issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives;

- AGM received a subpoena from the Securities and Exchange Commission ("SEC") in November 2006 related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives; and

- AGMH received a “Wells Notice” from the staff of the Philadelphia Regional Office of the SEC in February 2008 relating to the investigation concerning the bidding of municipal GICs and other municipal derivatives. The Wells Notice indicates that the SEC staff is considering recommending that the SEC authorize the staff to bring a civil injunctive action and/or institute administrative proceedings against AGMH, alleging violations of Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

Pursuant to the subpoenas, AGMH has furnished to the Department of Justice and SEC records and other information with respect to AGMH’s municipal GIC business. The ultimate loss that may arise from these investigations remains uncertain.

In July 2010, a former employee of AGM who had been involved in AGMH's former financial products business was indicted along with two other persons with whom he had worked at Financial Guaranty Insurance Company. Such former employee and the other two persons were convicted on fraud conspiracy counts. They have appealed the convictions.

Lawsuits Relating to Former Financial Products Business

During 2008, nine putative class action lawsuits were filed in federal court alleging federal antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. These cases have been coordinated and consolidated for pretrial proceedings in the U.S. District Court for the Southern District of New York as *MDL 1950, In re Municipal Derivatives Antitrust Litigation,* Case No. 1:08-cv-2516 ("MDL 1950").

Five of these cases named both AGMH and AGM: (a) *Hinds County, Mississippi v. Wachovia Bank, N.A.*; (b) *Fairfax County, Virginia v. Wachovia Bank, N.A.*; (c) *Central Bucks School District, Pennsylvania v. Wachovia Bank, N.A.*; (d) *Mayor and City Council of Baltimore, Maryland v. Wachovia Bank, N.A.*; and (e) *Washington County, Tennessee v. Wachovia Bank, N.A.* In April 2009, the MDL 1950 court granted the defendants' motion to dismiss on the federal claims, but granted leave for the plaintiffs to file a second amended complaint. In June 2009, interim lead plaintiffs' counsel filed a Second Consolidated Amended Class Action Complaint; although the Second Consolidated Amended Class Action Complaint currently describes some of AGMH's and AGM's activities, it does not name those entities as defendants. In March 2010, the MDL 1950 court denied the named defendants' motions to dismiss the Second Consolidated Amended Class Action Complaint. In March 2013, the putative class plaintiffs served a Third Consolidated Amended Class Action Complaint that does not list AGMH or AGM. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

Four of the cases named AGMH (but not AGM) and also alleged that the defendants violated California state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the cities or municipalities of competition in the awarding of GICs and ultimately resulting in the cities paying higher fees for these products: (f) *City of Oakland, California v. AIG Financial Products Corp.*; (g) *County of Alameda, California v. AIG Financial Products Corp.*; (h) *City of Fresno, California v. AIG Financial Products Corp.*; and (i) *Fresno County Financing Authority v. AIG Financial Products Corp*. When the four plaintiffs filed a consolidated complaint in September 2009, the plaintiffs did not name AGMH as a defendant. However, the complaint does describe some of AGMH's and AGM's activities. The consolidated complaint generally seeks unspecified monetary damages, interest, attorneys' fees and other costs. In April 2010, the MDL 1950 court granted in part and denied in part the named defendants' motions to dismiss this consolidated complaint.

In 2008, AGMH and AGM also were named in five non-class action lawsuits originally filed in the California Superior Courts alleging violations of California law related to the municipal derivatives industry: (a) *City of Los Angeles, California v. Bank of America, N.A.*; (b) *City of Stockton, California v. Bank of America, N.A.*; (c) *County of San Diego, California v. Bank of America, N.A.*; (d) *County of San Mateo, California v. Bank of America, N.A.*; and (e) *County of Contra Costa, California v. Bank of America, N.A.* Amended complaints in these actions were filed in September 2009, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. These cases have been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings.

In late 2009, AGM and AGUS, among other defendants, were named in six additional non-class action cases filed in federal court, which also have been coordinated and consolidated for pretrial proceedings with MDL 1950: (f) City of Riverside, California v. Bank of America, N.A.; (g) Sacramento Municipal Utility District v. Bank of America, N.A.; (h) Los Angeles World Airports v. Bank of America, N.A.; (i) Redevelopment Agency of the City of Stockton v. Bank of America, N.A.; (j) Sacramento Suburban Water District v. Bank of America, N.A.; and (k) County of Tulare, California v. Bank of America, N.A.

The MDL 1950 court denied AGM and AGUS's motions to dismiss these eleven complaints in April 2010. Amended complaints were filed in May 2010. On October 29, 2010, AGM and AGUS were voluntarily dismissed with prejudice from the Sacramento Municipal Utility District case only. The complaints in these lawsuits generally seek or sought unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from the remaining lawsuits.

In May 2010, AGM and AGUS, among other defendants, were named in five additional non-class action cases filed in federal court in California: (a) City of Richmond, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (b) City of Redwood City, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (c) Redevelopment Agency of the City and County of San Francisco, California v. Bank of America, N.A. (filed on May 21, 2010, N.D. California); (d) East Bay Municipal Utility District, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); and (e) City of San Jose and the San Jose Redevelopment Agency, California v. Bank of America, N.A (filed on May 18, 2010, N.D. California). These cases have also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In September 2010, AGM and AGUS, among other defendants, were named in a sixth additional non-class action filed in federal court in New York, but which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Active Retirement Community, Inc. d/b/a Jefferson's Ferry v. Bank of America, N.A. (filed on September 21, 2010, E.D. New York), which has also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In December 2010, AGM and AGUS, among other defendants, were named in a seventh additional non-class action filed in federal court in the Central District of California, Los Angeles Unified School District v. Bank of America, N.A., and in an eighth additional non-class action filed in federal court in the Southern District of New York, Kendal on Hudson, Inc. v. Bank of America, N.A. These cases also have been consolidated with MDL 1950 for pretrial proceedings. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

In January 2011, AGM and AGUS, among other defendants, were named in an additional non-class action case filed in federal court in New York, which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Peconic Landing at Southold, Inc. v. Bank of America, N.A. This case has been consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

In September 2009, the Attorney General of the State of West Virginia filed a lawsuit (Circuit Ct. Mason County, W. Va.) against Bank of America, N.A. alleging West Virginia state antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. An amended complaint in this action was filed in June 2010, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. This case has been removed to federal court as well as transferred to the S.D.N.Y. and consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks civil penalties, unspecified monetary damages, interest, attorneys’ fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

15. Notes Payable and Credit Facilities

Notes Payable

Notes Payable represents debt issued by VIEs consolidated by AGM to one of the Financial Products Companies that were transferred to Dexia Holdings prior to the AGMH Acquisition. The funds borrowed were used to finance the purchase of the underlying obligations of AGM-insured obligations which had breached triggers allowing AGM to exercise its right to accelerate payment of a claim in order to mitigate loss. The assets purchased are classified as assets acquired in refinancing transactions and recorded in “other invested assets.” The terms of the notes payable match the terms of the assets acquired in refinancing transactions. On the Acquisition Date, the fair value of these notes payable was $164 million, including a premium of $10 million that is being amortized over the term of the debt.

The principal and carrying values of the Company's notes payable are presented in the table below.

Principal and Carrying Amounts of Notes Payable

	As of June 30, 2013		As of December 31, 2012	
	Principal	Carrying Value	Principal	Carrying Value
	(in millions)			
Notes Payable	$ 48	$ 53	$ 61	$ 66

Recourse Credit Facilities

In connection with the AGMH Acquisition, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. The liquidity risk to AGM related to the strip policy portion of the leveraged lease business is mitigated by the strip coverage facility described below.

In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds). The tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the “strip coverage”) from its own sources. AGM issued financial guaranty insurance policies (known as “strip policies”) that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. AGM can then seek reimbursement of its strip policy payments from the tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

Currently, all the leveraged lease transactions in which AGM acts as strip coverage provider are breaching a rating trigger related to AGM and are subject to early termination. However, early termination of a lease does not result in a draw on the AGM policy if the tax-exempt entity makes the required termination payment. If all the leases were to terminate early and the tax-exempt entities do not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of approximately $1.7 billion as of June 30, 2013. To date, none of the leveraged lease transactions that involve AGM has experienced an early termination due to a lease default and a claim on the AGM policy. It is difficult to determine the probability that AGM will have to pay strip provider claims or the likely aggregate amount of such claims. At June 30, 2013, approximately $1 billion of cumulative strip par exposure had been terminated since 2008 on a consensual basis. The consensual terminations have resulted in no claims on AGM.

On July 1, 2009, AGM and DCL, acting through its New York Branch (“Dexia Crédit Local (NY)”), entered into a credit facility (the “Strip Coverage Facility”). Under the Strip Coverage Facility, Dexia Crédit Local (NY) agreed to make loans to AGM to finance all draws made by lessors on AGM strip policies that were outstanding as of November 13, 2008, up to the commitment amount. The commitment amount of the Strip Coverage Facility was $1 billion at closing of the AGMH Acquisition but is scheduled to amortize over time. As of June 30, 2013, the maximum commitment amount of the Strip Coverage Facility has amortized to $981 million. It may also be reduced in 2014 to $750 million, if AGM does not have a specified consolidated net worth at that time.

Fundings under this facility are subject to certain conditions precedent, and their repayment is collateralized by a security interest that AGM granted to Dexia Crédit Local (NY) in amounts that AGM recovers—from the tax-exempt entity, or from asset sale proceeds—following its payment of strip policy claims. The Strip Coverage Facility will terminate upon the earliest to occur of an AGM change of control, the reduction of the commitment amount to $0, and January 31, 2042.

The Strip Coverage Facility's financial covenants require that AGM and its subsidiaries maintain a maximum debt-to-capital ratio of 30% and maintain a minimum net worth of 75% of consolidated net worth as of July 1, 2009, plus, starting July 1, 2014, (i) 25% of the aggregate consolidated net income (or loss) for the period beginning July 1, 2009 and ending on June 30, 2014 or, (2) zero, if the commitment amount has been reduced to $750 million as described above. The Company is in compliance with all financial covenants as of June 30, 2013.

The Strip Coverage Facility contains restrictions on AGM, including, among other things, in respect of its ability to incur debt, permit liens, pay dividends or make distributions, dissolve or become party to a merger or consolidation. Most of these restrictions are subject to exceptions. The Strip Coverage Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, bankruptcy or insolvency proceedings and cross-default to other debt agreements.

As of June 30, 2013, no amounts were outstanding under this facility, nor have there been any borrowings during the life of this facility.

AGM CPS Securities

In June 2003, $200 million of "AGM CPS Securities", money market preferred trust securities, were issued by trusts created for the primary purpose of issuing the AGM CPS Securities, investing the proceeds in high-quality commercial paper and selling put options to AGM, allowing AGM to issue the trusts non-cumulative redeemable perpetual preferred stock (the "AGM Preferred Stock") of AGM in exchange for cash. There are four trusts, each with an initial aggregate face amount of $50 million. These trusts hold auctions every 28 days, at which time investors submit bid orders to purchase AGM CPS Securities. If AGM were to exercise a put option, the applicable trust would transfer the portion of the proceeds attributable to principal received upon maturity of its assets, net of expenses, to AGM in exchange for AGM Preferred Stock. AGM pays a floating put premium to the trusts, which represents the difference between the commercial paper yield and the winning auction rate (plus all fees and expenses of the trust). If an auction does not attract sufficient clearing bids, however, the auction rate is subject to a maximum rate of one-month LIBOR plus 200 basis points for the next succeeding distribution period. Beginning in August 2007, the AGM CPS Securities required the maximum rate for each of the relevant trusts. AGM continues to have the ability to exercise its put option and cause the related trusts to purchase AGM Preferred Stock. The trusts provide AGM access to new capital at its sole discretion through the exercise of the put options. As of June 30, 2013 the put option had not been exercised. The Company does not consider itself to be the primary beneficiary of the trusts. See Note 7, Fair Value Measurement, –Other Assets–Committed Capital Securities, for a fair value measurement discussion.

16. Other Comprehensive Income

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

Changes in Accumulated Other Comprehensive Income by Component
Second Quarter 2013

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Total Accumulated Other Comprehensive Income
		(in millions)	
Balance, March 31, 2013	$ 204	$ (8)	$ 196
Other comprehensive income before reclassifications	(81)	(11)	(92)
Amounts reclassified from AOCI to:			
Other net realized investment gains (losses)	—	4	4
Tax (provision) benefit	—	(1)	(1)
Total amounts reclassified from AOCI, net of tax	—	3	3
Net current period other comprehensive income (loss)	(81)	(8)	(89)
Balance, June 30, 2013	$ 123	$ (16)	$ 107

Changes in Accumulated Other Comprehensive Income by Component
Second Quarter 2012

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Total Accumulated Other Comprehensive Income
		(in millions)	
Balance, March 31, 2012	$ 175	$ (2)	$ 173
Other comprehensive income (loss)	10	2	12
Balance, June 30, 2012	$ 185	$ 0	$ 185

Changes in Accumulated Other Comprehensive Income by Component
Six Months 2013

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Total Accumulated Other Comprehensive Income
		(in millions)	
Balance, December 31, 2012	$ 226	$ 6	$ 232
Other comprehensive income before reclassifications	(103)	(30)	(133)
Amounts reclassified from AOCI to:			
Other net realized investment gains (losses)	0	12	12
Tax (provision) benefit	0	(4)	(4)
Total amounts reclassified from AOCI, net of tax	0	8	8
Net current period other comprehensive income (loss)	(103)	(22)	(125)
Balance, June 30, 2013	$ 123	$ (16)	$ 107

Changes in Accumulated Other Comprehensive Income by Component
Six Months 2012

	Net Unrealized Gains (Losses) on Investments with no OTTI	Net Unrealized Gains (Losses) on Investments with OTTI	Total Accumulated Other Comprehensive Income
		(in millions)	
Balance, December 31, 2011	$ 161	$ (5)	$ 156
Other comprehensive income (loss)	24	5	29
Balance, June 30, 2012	$ 185	$ 0	$ 185

17. Subsequent Events

On July 16, 2013, subsidiaries of Assured Guaranty Ltd. completed a series of transactions that resulted in the capitalization of its subsidiary, MAC, to approximately $700 million. In addition, AGM purchased a surplus note issued by MAC in the principal amount of $100 million.

AGM and its subsidiaries AGMIC and AGBM terminated the pooling reinsurance agreement pursuant to which AGMIC and AGBM had assumed a quota share percentage of the financial guaranty insurance policies issued by AGM, and AGM reassumed such ceded business. Subsequently, AGMIC was merged into AGM, with AGM as the surviving company.

AGBM, which had made a loan of $82.5 million to AGUS, an indirect parent holding company of AGM, received all of the outstanding shares of MAC held by AGUS and cash, in full satisfaction of the principal of and interest on such loan. AGBM dividended substantially all of its assets, including the MAC shares, to AGM and AGM sold AGBM to its affiliate AG Re. Subsequently, AGBM and AG Re merged, with AG Re as the surviving company. The sale of AGBM to, and subsequent merger with, AG Re were each effective as of July 17, 2013.

A new company, MAC Holdings, was formed to own 100% of the outstanding stock of MAC. AGM contributed approximately $425 million and AGM's affiliate AGC contributed approximately $275 million, consisting of all of MAC's outstanding common stock (in the case of AGM), cash and marketable securities, to MAC Holdings. AGM and AGC received approximately 61% and 39% of the outstanding MAC Holdings common stock, respectively.

MAC Holdings then contributed cash and marketable securities having a fair market value sufficient to increase MAC's policyholders' surplus to approximately $400 million, and purchased a surplus note issued by MAC in the principal amount of $300 million.

Following MAC's capitalization, AGM ceded par exposure of approximately $87 billion and unearned premiums of approximately $468 million to MAC, and AGC ceded par exposure of approximately $24 billion and unearned premiums of approximately $249 million.

In addition, on July 15, 2013, AGM and AGE (together, the "AGM Group") were notified that the New York State Department of Financial Services ("NYSDFS") does not object to the AGM Group reassuming contingency reserves that they had ceded to AG Re and electing to cease ceding future contingency reserves to AG Re under the following circumstances:

- The AGM Group may reassume 33% of a contingency reserve base of approximately $250 million (the “NY Contingency Reserve Base”) in 2013, after July 16, 2013, the date on which the transactions for the capitalization of MAC were completed (the “Closing Date”).
- The AGM Group may reassume 50% of the NY Contingency Reserve Base in 2014, no earlier than the one year anniversary of the Closing Date, with the prior approval of the NYSDFS.
- The AGM Group may reassume the remaining 17% of the NY Contingency Reserve Base in 2015, no earlier than the two year anniversary of the Closing Date, with the prior approval of the NYSDFS.

The reassumption of the contingency reserves by the AGM Group would have the effect of increasing contingency reserves by the amount reassumed and decreasing policyholders' surplus by the same amount; there would be no impact on the statutory or rating agency capital of the AGM Group. The reassumption of contingency reserves by the AGM Group permits the release of amounts from the AG Re trust accounts securing AG Re's reinsurance of the AGM Group.

Subsequent events have been considered through August 29, 2013, the date on which these financial statements were issued.

INDEX OF DEFINED TERMS

THE ISSUER

S4B (Issuer) plc
Boundary House
91-93 Charterhouse Street
London EC1M 6HR

FINANCIAL GUARANTEE PROVIDERS

Assured Guaranty Municipal Corp.
31 West 52nd Street
New York NY10019
United States of America

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

SOLE ARRANGER AND LEAD MANAGER

Lloyds Bank PLC
10 Gresham Street
London EC4R 3BF

BOND TRUSTEE

BNY Mellon Corporate Trustee Services Limited
One Canada Square
London E14 5AL

SECURITY TRUSTEE

BNY Mellon Corporate Trustee Services Limited
One Canada Square
London E14 5AL

PRINCIPAL PAYING AGENT AND PAYING AGENT

The Bank of New York Mellon, London Branch
One Canada Square
London E14 5AL

LEGAL ADVISORS

To the Sole Arranger and Lead Manager, AGE, AGM, the Bond Trustee, the Principal Paying Agent and Security Trustee as to English Law

Ashurst LLP
Broadwalk House
5 Appold Street
London EC2A 2HA

To the Issuer, ProjectCo and HoldCo

Nabarro LLP
Lacon House
84 Theobald's Road
Road
London WC1X 8RW

IRISH LISTING AGENT

Arthur Cox Listing Services Limited
Earlsfort Centre
Earlsfort Terrace
Dublin 2
Ireland

AUDITORS

To AGE

PricewaterhouseCoopers LLP
7 More London Riverside
London SE1 2RT

To AGM

PricewaterhouseCoopers LLP
300 Madison Avenue
New York, NY 10017
U.S.A.

To the Issuer, ProjectCo and HoldCo

Deloitte LLP
2 New Street Square
London EC4A 3BT