

ASSURED GUARANTY LTD

Form 10-K

February 28, 2014

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the fiscal year ended December 31, 2013

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from to  
Commission File Number 001-32141

ASSURED GUARANTY LTD.

(Exact name of Registrant as specified in its charter)

Bermuda

98-0429991

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

30 Woodbourne Avenue  
Hamilton HM 08 Bermuda  
(441) 279-5700

(Address, including zip code, and telephone number,  
including area code, of Registrant's principal executive office)

None

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, \$0.01 per share	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a  
smaller reporting  
company)

Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of Common Shares held by non-affiliates of the Registrant as of the close of business on June 30, 2013 was \$3,659,040,438 (based upon the closing price of the Registrant's shares on the New York Stock Exchange on that date, which was \$22.06). For purposes of this information, the outstanding Common Shares which were owned by all directors and executive officers of the Registrant were deemed to be the only shares of Common Stock held by affiliates.

As of February 21, 2014, 182,355,159 Common Shares, par value \$0.01 per share, were outstanding (including 48,273 unvested restricted shares).

**DOCUMENTS INCORPORATED BY REFERENCE**

Certain portions of Registrant's definitive proxy statement relating to its 2014 Annual General Meeting of Shareholders are incorporated by reference to Part III of this report.

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Forward Looking Statements

This Form 10-K contains information that includes or is based upon forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward looking statements give the expectations or forecasts of future events of Assured Guaranty Ltd. (“AGL” and, together with its subsidiaries, “Assured Guaranty” or the “Company”). These statements can be identified by the fact that they do not relate strictly to historical or current facts and relate to future operating or financial performance.

Any or all of Assured Guaranty’s forward looking statements herein are based on current expectations and the current economic environment and may turn out to be incorrect. Assured Guaranty’s actual results may vary materially. Among factors that could cause actual results to differ materially are:

- rating agency action, including a ratings downgrade, a change in outlook, the placement of ratings on watch for downgrade, or a change in rating criteria, at any time, of Assured Guaranty or any of its subsidiaries and/or of transactions that Assured Guaranty’s subsidiaries have insured;
  - reduction in the amount of available insurance opportunities and/or in the demand for Assured Guaranty's insurance;
  - developments in the world’s financial and capital markets that adversely affect obligors’ payment rates, Assured Guaranty’s loss experience, or its exposure to refinancing risk in transactions (which could result in substantial liquidity claims on its guarantees);
  - the possibility that budget shortfalls or other factors will result in credit losses or impairments on obligations of state and local governments that the Company insures or reinsures;
  - the failure of Assured Guaranty to realize insurance loss recoveries or damages through loan putbacks, settlement negotiations or litigation;
  - deterioration in the financial condition of Assured Guaranty’s reinsurers, the amount and timing of reinsurance recoverables actually received and the risk that reinsurers may dispute amounts owed to Assured Guaranty under its reinsurance agreements;
  - increased competition, including from new entrants into the financial guaranty industry;
  - rating agency action on obligors, including sovereign debtors, resulting in a reduction in the value of securities in the Company’s investment portfolio and in collateral posted by and to the Company;
  - the inability of Assured Guaranty to access external sources of capital on acceptable terms;
  - changes in the world’s credit markets, segments thereof or general economic conditions;
  - the impact of market volatility on the mark-to-market of Assured Guaranty’s contracts written in credit default swap form;
  - changes in applicable accounting policies or practices;
  - changes in applicable laws or regulations, including insurance and tax laws;
  - other governmental actions;
  - difficulties with the execution of Assured Guaranty’s business strategy;
  - contract cancellations;
  - loss of key personnel;
  - adverse technological developments;
  - the effects of mergers, acquisitions and divestitures;
  - natural or man-made catastrophes;
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• other risks and uncertainties that have not been identified at this time;  
• management’s response to these factors; and  
• other risk factors identified in Assured Guaranty’s filings with the U.S. Securities and Exchange Commission (the “SEC”).

The foregoing review of important factors should not be construed as exhaustive, and should be read in conjunction with the other cautionary statements that are included in this Form 10-K. The Company undertakes no obligation to update publicly or review any forward looking statement, whether as a result of new information, future developments or otherwise, except as required by law. Investors are advised, however, to consult any further disclosures the Company makes on related subjects in the Company’s reports filed with the SEC.

If one or more of these or other risks or uncertainties materialize, or if the Company’s underlying assumptions prove to be incorrect, actual results may vary materially from what the Company projected. Any forward looking statements in this Form 10-K reflect the Company’s current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to its operations, results of operations, growth strategy and liquidity.

For these statements, the Company claims the protection of the safe harbor for forward looking statements contained in Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

Convention

Unless otherwise noted, ratings on Assured Guaranty’s insured portfolio and on bonds purchased pursuant to loss mitigation or risk management strategies are Assured Guaranty’s internal ratings. Internal credit ratings are expressed on a rating scale similar to that used by the rating agencies and generally reflect an approach similar to that employed by the rating agencies, except that Assured Guaranty’s internal credit ratings focus on future performance, rather than lifetime performance.

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PART I

ITEM 1. BUSINESS

Overview

Assured Guaranty Ltd. ("AGL" and, together with its subsidiaries, "Assured Guaranty" or the "Company") is a Bermuda-based holding company incorporated in 2003 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 financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment ("Debt Service"), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. Obligations insured by the Company include bonds issued by U.S. state or municipal governmental authorities; notes issued to finance international infrastructure projects; and asset-backed securities issued by special purpose entities. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom ("U.K"). The Company also guarantees obligations issued in other countries and regions, including Australia and Western Europe.

The Company conducts its financial guaranty business on a direct basis from the following companies: Assured Guaranty Municipal Corp. ("AGM"), Assured Guaranty Corp. ("AGC"), Municipal Assurance Corp. ("MAC") and Assured Guaranty (Europe) Ltd. ("AGE"). It also conducts business through Assured Guaranty Re Ltd. ("AG Re"), a Bermuda-based reinsurer. The following is a description of AGL's principal operating subsidiaries:

Assured Guaranty Municipal Corp. AGM is located and domiciled in New York, was organized in 1984 and commenced operations in 1985. Since mid-2008, AGM has provided financial guaranty insurance on debt obligations issued in the U.S. public finance and global infrastructure markets. Previously, AGM also offered insurance and reinsurance in the global structured finance market. AGM formerly was named Financial Security Assurance Inc. It was acquired, together with its holding company Financial Security Assurance Holdings Ltd. (renamed Assured Guaranty Municipal Holdings Inc., "AGMH") and the subsidiaries owned by that holding company, by Assured Guaranty on July 1, 2009.

Municipal Assurance Corp. MAC is located and domiciled in New York and was organized in 2008. Assured Guaranty acquired MAC (formerly named Municipal and Infrastructure Assurance Corporation) on May 31, 2012. On July 16, 2013, Assured Guaranty completed a series of transactions that increased the capitalization of MAC and resulted in MAC assuming a portfolio of geographically diversified U.S. public finance exposure from AGM and AGC. Management believes MAC enhances the Company's overall competitive position because:

- MAC only has exposure to U.S. public finance risk and no exposure to structured finance risk;
- MAC insures only U.S. public finance risk, focusing on investment grade obligations in select sectors of the municipal market;
- MAC had approximately \$1.5 billion of claims-paying resources as of December 31, 2013, consisting of \$834 million of statutory capital and \$671 million of statutory unearned premium reserve; and
- MAC has strong financial strength ratings from two rating agencies: AA+ (stable outlook) from Kroll Bond Rating Agency ("Kroll") and AA- (stable outlook) from Standard & Poor's Rating Services ("S&P").

MAC issued its first financial guaranty insurance policy in August 2013.



Assured Guaranty (Europe) Ltd. AGE is a U.K. incorporated company licensed as a U.K. insurance company and authorized to operate in various countries throughout the European Economic Area ("EEA"). It was organized in 1990 and issued its first financial guarantee in 1994. AGE issues financial guarantees in both the international public finance and structured finance markets and is the primary entity from which the Company writes business in the EEA. As discussed further under "Business" below, AGE has agreed with its regulator that new business it writes would be guaranteed using a co-insurance structure pursuant to which AGE would co-insure municipal and infrastructure transactions with AGM, and structured finance transactions with AGC. AGE must obtain the approval of the Prudential Regulation Authority ("PRA") before it can guarantee any new structured finance transaction.

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Assured Guaranty Corp. AGC is located in New York and domiciled in Maryland, was organized in 1985 and commenced operations in 1988. It is the only financial guaranty insurer providing insurance on debt obligations in the global structured finance market. It also guarantees obligations in the U.S. public finance and international infrastructure markets.

Assured Guaranty Re Ltd. AG Re is incorporated under the laws of Bermuda and is licensed as a Class 3B insurer under the Insurance Act 1978 and related regulations of Bermuda. AG Re owns, indirectly, Assured Guaranty Re Overseas Ltd. ("AGRO"), which is a Bermuda Class 3A and Class C insurer. AG Re and AGRO underwrite financial guaranty reinsurance. They write business as reinsurers of third-party primary insurers and of certain affiliated companies.

Since 2009, the Company has been the most active provider of financial guaranty insurance. The Company's position in the market benefited from its acquisition of AGMH in 2009, its ability to maintain strong financial strength ratings, its strong claims-paying resources, and its ability to achieve recoveries in respect of the claims that it has paid on insured residential mortgage-backed securities. However, since 2009, the Company has continued to face challenges in maintaining its market penetration. The challenges in 2013 were primarily due to:

Sustained low interest rate environment in the U.S. Within the last five years, interest rates in the U.S. had been at low levels by historical standards. Although such interest rates did rise slightly in 2013 from record lows in 2012, they are expected to remain low for the near future. As a result, the difference in yield (or the credit spread) between a bond insured by Assured Guaranty and an uninsured bond has provided comparatively little room for issuer savings and insurance premium, and Assured Guaranty has seen a lower demand for its financial guaranty insurance from issuers than it had prior to 2008.

- Continued low volume of issuance in the U.S. public finance market. According to industry compilations, U.S. municipalities issued only \$311.9 billion of bonds in 2013, 15% less than in 2012. With the exception of 2011, the 2013 volume of issuance in the U.S. public finance market was the lowest since 2001. The decline was caused in part by fewer refunding transactions — approximately \$132 billion in 2013, compared with approximately \$189 billion in 2012. In 2014, the Company expects the volume of issuance to continue to be low, in light of austerity measures municipalities have been implementing in order to address budget shortfalls, including those resulting from increased pension and healthcare costs.
- Increased competition. The Company estimates, based on third party industry compilations, that of the insured U.S. public finance bonds issued in the primary market in 2013, the Company insured approximately 62.3% of the par, while Build America Mutual Assurance Company ("BAM"), a newly formed insurance company that commenced operations in 2012, insured 36.8% of the par. The continued presence in the market of BAM, as well as any other new entrants, may affect the Company's insured volume as well as the amount of premium the Company is able to charge.
- Continued uncertainty over the Company's financial strength ratings. When Assured Guaranty issues a financial guaranty on a debt obligation, the rating agencies generally raise the debt or short-term credit ratings of the obligation to the same rating as the financial strength rating of the Assured Guaranty subsidiary that has guaranteed that obligation. Accordingly, investors in products insured by AGM, AGC, MAC or AGE frequently rely on rating agency ratings, and a failure of the insurer to maintain strong financial strength ratings or uncertainty over such ratings would have a negative impact on the demand for its insurance product. The Company's financial strength ratings have been subject to substantial uncertainty in recent years due to changes in rating agency methodologies for rating financial guaranty insurance companies, periodic rating agency reviews for possible downgrade and actual downgrades. For example, in March 2012, Moody's Investors Service, Inc. ("Moody's") placed the ratings of AGL and its subsidiaries, including the financial

strength ratings of AGL's insurance subsidiaries, on review for possible downgrade. Moody's did not complete its review until January 2013, when it downgraded the financial strength ratings of AGM and AGC from Aa3 to A2 and A3, respectively, and that of AG Re from A1 to Baa1. In February 2014, Moody's affirmed the financial strength ratings and outlooks of AGM and AGC, and affirmed AG Re's financial strength rating but changed AG Re's outlook to negative, citing its vulnerability to adverse developments within its insured portfolio. The uncertainty over the Company's financial strength ratings over time has had a negative effect on the demand for the Company's financial guaranties. If the financial strength rating of one or more of the Company's insurance subsidiaries were reduced below current levels, the Company expects that would reduce the number of transactions that would benefit from the Company's insurance and consequently harm the Company's new business opportunities.

In addition, the Company's business continues to be affected by negative perceptions of the value of the financial guaranty insurance sold by other companies that had been active in the industry. The losses suffered by such other insurers

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resulted in those companies being downgraded to below investment grade levels by the rating agencies and/or subject to intervention by their state insurance regulators. In a number of cases, the state insurance regulators prevented the distressed financial guaranty insurers from paying claims or paying such claims in full; in addition, such financial guaranty insurers were perceived by market participants not to be actively conducting surveillance on transactions or fully exercising rights and remedies to mitigate losses.

The Company believes that issuers and investors in securities will continue to purchase financial guaranty insurance, especially if interest rates rise and credit spreads widen. U.S. municipalities have budgetary requirements that are best met through financings in the fixed income capital markets. In particular, smaller municipal issuers frequently use financial guaranties in order to access the capital markets with new debt offerings at a lower all-in interest rate than on an unguaranteed basis. In addition, the Company expects long-term debt financings for infrastructure projects will grow throughout the world, as will the financing needs associated with privatization initiatives or refinancing of infrastructure projects in developed countries.

### The Company's Financial Guaranty Portfolio

The Company primarily conducts its business through subsidiaries located in the U.S., Europe and Bermuda. The Company generally insures obligations issued in the U.S., although it has also guaranteed securities issued in Europe, Australia and other international markets.

Financial guaranty insurance generally provides an unconditional and irrevocable guaranty that protects the holder of a debt instrument or other monetary obligation against non-payment of scheduled principal and interest payments when due. Upon an obligor's default on scheduled principal or interest payments due on the debt obligation, the Company is generally required under the financial guaranty contract to pay the investor the principal or interest shortfall then due.

Financial guaranty insurance may be issued to all of the investors of the guaranteed series or tranche of a municipal bond or structured finance security at the time of issuance of those obligations or it may be issued in the secondary market to only specific individual holders of such obligations who purchase the Company's credit protection.

Both issuers of and investors in financial instruments may benefit from financial guaranty insurance. Issuers benefit when they purchase financial guaranty insurance for their new issue debt transaction because the insurance may have the effect of lowering an issuer's interest cost over the life of the debt transaction to the extent that the insurance premium charged by the Company is less than the net present value of the difference between the yield on the obligation insured by Assured Guaranty (which carries the credit rating of the specific subsidiary that guarantees the debt obligation) and the yield on the debt obligation if sold on the basis of its uninsured credit rating. The principal benefit to investors is that the Company's guaranty provides certainty that scheduled payments will be received when due. The guaranty may also improve the marketability of obligations issued by infrequent or unknown issuers, as well as obligations with complex structures or backed by asset classes new to the market. This benefit to market liquidity, which we call a "liquidity benefit," results from the increase in secondary market trading values for Assured Guaranty-insured obligations as compared with uninsured obligations by the same issuer. In general, the liquidity benefit of financial guaranties is that investors are able to sell insured bonds more quickly and, depending on the financial strength rating of the insurer, at a higher secondary market price than for uninsured debt obligations.

As an alternative to traditional financial guaranty insurance, the Company also has provided credit protection relating to a particular security or obligor through a credit derivative contract, such as a credit default swap ("CDS"). Under the terms of a CDS, the seller of credit protection agrees to make a specified payment to the buyer of credit protection if one or more specified credit events occurs with respect to a reference obligation or entity. In general, the credit events specified in the Company's CDS are for interest and principal defaults on the reference obligation. One

difference between CDS and traditional primary financial guaranty insurance is that credit default protection is typically provided to a particular buyer of credit protection, who is not always required to own the reference obligation, rather than to all investors in the reference obligation. As a result, the Company's rights and remedies under a CDS may be different and more limited than on a financial guaranty of an entire issuance. Credit derivatives may be preferred by some investors, however, because they generally offer the investor ease of execution and standardized terms as well as more favorable accounting or capital treatment. The Company has not provided credit protection through a CDS since March 2009, other than in connection with loss mitigation and other remediation efforts relating to its existing book of business.

The Company also offers credit protection through reinsurance, and in the past has provided reinsurance to other financial guaranty insurers with respect to their guaranty of public finance, infrastructure and structured finance obligations. The Company believes that the opportunities currently available to it in the reinsurance market consist primarily of potentially assuming portfolios of transactions from inactive primary insurers and recapturing portfolios that it has previously ceded to third party reinsurers.

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The Company's financial guaranty direct and assumed businesses provide credit enhancement, on public finance, infrastructure and structured finance obligations. For information on the geographic breakdown of the Company's financial guaranty portfolio and on its income and revenue by jurisdiction, see "Geographic Distribution of Net Par Outstanding" in Note 3, Outstanding Exposure, and "Provision for Income Taxes" in Note 13, Income Taxes, of the Financial Statements and Supplementary Data.

**U.S. Public Finance Obligations** The Company insures and reinsures a number of different types of U.S. public finance obligations, including the following:

**General Obligation Bonds** are full faith and credit bonds that are issued by states, their political subdivisions and other municipal issuers, and are supported by the general obligation of the issuer to pay from available funds and by a pledge of the issuer to levy ad valorem taxes in an amount sufficient to provide for the full payment of the bonds.

**Tax-Backed Bonds** are obligations that are supported by the issuer from specific and discrete sources of taxation. They include tax-backed revenue bonds, general fund obligations and lease revenue bonds. Tax-backed obligations may be secured by a lien on specific pledged tax revenues, such as a gasoline or excise tax, or incrementally from growth in property tax revenue associated with growth in property values. These obligations also include obligations secured by special assessments levied against property owners and often benefit from issuer covenants to enforce collections of such assessments and to foreclose on delinquent properties. Lease revenue bonds typically are general fund obligations of a municipality or other governmental authority that are subject to annual appropriation or abatement; projects financed and subject to such lease payments ordinarily include real estate or equipment serving an essential public purpose. Bonds in this category also include moral obligations of municipalities or governmental authorities.

**Municipal Utility Bonds** are obligations of all forms of municipal utilities, including electric, water and sewer utilities and resource recovery revenue bonds. These utilities may be organized in various forms, including municipal enterprise systems, authorities or joint action agencies.

**Transportation Bonds** include a wide variety of revenue-supported bonds, such as bonds for airports, ports, tunnels, municipal parking facilities, toll roads and toll bridges.

**Healthcare Bonds** are obligations of healthcare facilities, including community based hospitals and systems, as well as of health maintenance organizations and long-term care facilities.

**Higher Education Bonds** are obligations secured by revenue collected by either public or private secondary schools, colleges and universities. Such revenue can encompass all of an institution's revenue, including tuition and fees, or in other cases, can be specifically restricted to certain auxiliary sources of revenue.

**Housing Revenue Bonds** are obligations relating to both single and multi-family housing, issued by states and localities, supported by cash flow and, in some cases, insurance from entities such as the Federal Housing Administration.

**Infrastructure Bonds** include obligations issued by a variety of entities engaged in the financing of infrastructure projects, such as roads, airports, ports, social infrastructure and other physical assets delivering essential services supported by long-term concession arrangements with a public sector entity.

**Investor-Owned Utility Bonds** are obligations primarily backed by investor-owned utilities, first mortgage bond obligations of for-profit electric or water utilities providing retail, industrial and commercial service, and also include

sale-leaseback obligation bonds supported by such entities.

Other Public Finance Bonds include other debt issued, guaranteed or otherwise supported by U.S. national or local governmental authorities, as well as student loans, revenue bonds, and obligations of some not-for-profit organizations.

A portion of the Company's exposure to tax-backed bonds, municipal utility bonds and transportation bonds constitute "special revenue" bonds under the U.S. Bankruptcy Code. Even if an obligor under a special revenue bond were to seek protection from creditors under Chapter 9 of the U.S. Bankruptcy Code, holders of the special revenue bond should continue to receive timely payments of principal and interest during the bankruptcy proceeding, subject to the special revenues being

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sufficient to pay debt service and the lien on the special revenues being subordinate to the necessary operating expenses of the project or system from which the revenues are derived. While "special revenues" acquired by the obligor after bankruptcy remain subject to the pre-petition pledge, special revenue bonds may be adjusted if their claim is determined to be "undersecured."

**Non-U.S. Public Finance Obligations** The Company insures and reinsures a number of different types of non-U.S. public finance obligations, which consist of both infrastructure projects and other projects essential for municipal function such as regulated utilities. Credit support for the exposures written by the Company may come from a variety of sources, including some combination of subordinated tranches, excess spread, over-collateralization or cash reserves. Additional support also may be provided by transaction provisions intended to benefit noteholders or credit enhancers. The types of non-U.S. public finance securities the Company insures and reinsures include the following:

**Infrastructure Finance Obligations** are obligations issued by a variety of entities engaged in the financing of international infrastructure projects, such as roads, airports, ports, social infrastructure, and other physical assets delivering essential services supported either by long-term concession arrangements with a public sector entity or a regulatory regime. The majority of the Company's international infrastructure business is conducted in the U.K.

**Regulated Utilities Obligations** are issued by government-regulated providers of essential services and commodities, including electric, water and gas utilities. The majority of the Company's international regulated utility business is conducted in the U.K.

**Pooled Infrastructure Obligations** are synthetic asset-backed obligations that take the form of CDS obligations or credit-linked notes that reference either infrastructure finance obligations or a pool of such obligations, with a defined deductible to cover credit risks associated with the referenced obligations.

**Other Public Finance Obligations** include obligations of local, municipal, regional or national governmental authorities or agencies.

**U.S. and Non-U.S. Structured Finance Obligations** The Company insures and reinsures a number of different types of U.S. and non-U.S. structured finance obligations. Credit support for the exposures written by the Company may come from a variety of sources, including some combination of subordinated tranches, excess spread, over-collateralization or cash reserves. Additional support also may be provided by transaction provisions intended to benefit noteholders or credit enhancers. The types of U.S. and Non-U.S. Structured Finance obligations the Company insures and reinsures include the following:

**Pooled Corporate Obligations** are securities primarily backed by various types of corporate debt obligations, such as secured or unsecured bonds, bank loans or loan participations and trust preferred securities ("TruPS"). These securities are often issued in "tranches," with subordinated tranches providing credit support to the more senior tranches. The Company's financial guaranty exposures generally are to the more senior tranches of these issues.

**Residential Mortgage-Backed Securities ("RMBS")** are obligations backed by closed-end and open-end first and second lien mortgage loans on one-to-four family residential properties, including condominiums and cooperative apartments. First lien mortgage loan products in these transactions include fixed rate, adjustable rate and option adjustable-rate mortgages. The credit quality of borrowers covers a broad range, including "prime", "subprime" and "Alt-A". A prime borrower is generally defined as one with strong risk characteristics as measured by factors such as payment history, credit score, and debt-to-income ratio. A subprime borrower is a borrower with higher risk characteristics, usually as determined by credit score and/or credit history. An Alt-A borrower is generally defined as a prime quality borrower that lacks certain ancillary characteristics, such as fully documented income. The Company has not insured a RMBS transaction since January 2008.



Financial Products is the way in which the Company refers to the guaranteed investment contracts ("GICs") portion of a line of business previously conducted by AGMH that the Company did not acquire when it purchased AGMH in 2009 from Dexia SA. That line of business, which the Company refers to as the former "Financial Products Business" of AGMH, was comprised of its guaranteed investment contracts business, its medium term notes business and the equity payment agreements associated with AGMH's leveraged lease business. When AGMH was still conducting Financial Products Business, AGM issued financial guaranty insurance policies on GICs and in respect of the GIC business; those policies cannot be revoked or canceled. Assured Guaranty is indemnified by Dexia SA and certain of its affiliates ("Dexia") against loss from the former Financial Products Business. The Financial Products Business is currently being run off by Dexia.

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Consumer Receivables Securities are obligations backed by non-mortgage consumer receivables, such as student loans, automobile loans and leases, manufactured home loans and other consumer receivables.

Commercial Mortgage-Backed Securities ("CMBS") are obligations backed by pools of commercial mortgages on office, multi-family, retail, hotel, industrial and other specialized or mixed-use properties.

Commercial Receivables Securities are obligations backed by equipment loans or leases, aircraft and aircraft engine financings, business loans and trade receivables. Credit support is derived from the cash flows generated by the underlying obligations, as well as property or equipment values as applicable.

Insurance Securitization Obligations are obligations secured by the future earnings from pools of various types of insurance/reinsurance policies and income produced by invested assets.

Other Structured Finance Obligations are obligations backed by assets not generally described in any of the other described categories. One such type of asset is a tax benefit to be realized by an investor in one of the Federal or state programs that permit such investor to receive a credit against taxes (such as Federal corporate income tax or state insurance premium tax) for making qualified investments in specified enterprises, typically located in designated low-income areas.

## Credit Policy and Underwriting Procedure

### Credit Policy

The Company establishes exposure limits and underwriting criteria for sectors, countries, single risks and, in the case of structured finance obligations, servicers. Single risk limits are established in relation to the Company's capital base and are based on the Company's assessment of potential frequency and severity of loss as well as other factors, such as historical and stressed collateral performance. Sector limits are based on the Company's assessment of intra-sector correlation, as well as other factors. Country limits are based on long term foreign currency ratings, history of political stability, size and stability of the economy and other factors.

Critical risk factors that the Company would analyze for proposed public finance exposures include, for example, the credit quality of the issuer, the type of issue, the repayment source, the security pledged, the presence of restrictive covenants and the issue's maturity date. The Company also focuses on the ability of obligors to file for bankruptcy or receivership under applicable statutes (and on related statutes that provide for state oversight or fiscal control over financially troubled obligors); the amount of liquidity available to the obligors for debt payment, including the obligors' exposure to derivative contracts and to debt subject to acceleration; and the ability of the obligors to increase revenue. In addition, the Company recently has emphasized an obligor's pension and other post-employment benefits funding policies and practices, the potential impact of the Affordable Care Act, and the risk of a rating agency downgrade of an obligation's underlying uninsured rating. Underwriting considerations also include (1) the classification of the transaction, reflecting economic and social factors affecting that bond type, including the importance of the proposed project to the community, (2) the financial management of the project and of the issuer, (3) the potential refinancing risk, and (4) various legal and administrative factors. In cases where the primary source of repayment is the taxing or rate setting authority of a public entity, such as general obligation bonds, transportation bonds and municipal utility bonds, emphasis is placed on the overall financial strength of the issuer, the economic and demographic characteristics of the taxpayer or ratepayer and the strength of the legal obligation to repay the debt. In cases of not-for-profit institutions, such as healthcare issuers and private higher education issuers, emphasis is placed on the financial stability of the institution, its competitive position and its management experience.



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Structured finance obligations generally present three distinct forms of risk: (1) asset risk, pertaining to the amount and quality of assets underlying an issue; (2) structural risk, pertaining to the extent to which an issue's legal structure provides protection from loss; and (3) execution risk, which is the risk that poor performance by a servicer contributes to a decline in the cash flow available to the transaction. Each risk is addressed in turn through the Company's underwriting process. Generally, the amount and quality of asset coverage required with respect to a structured finance exposure is dependent upon the historic performance of the subject asset class, or those assets actually underlying the risk proposed to be insured or assumed through reinsurance. Future performance expectations are developed from this history, taking into account economic, social and political factors affecting that asset class as well as, to the extent feasible, the subject assets themselves. Conclusions are then drawn about the amount of over-collateralization or other credit enhancement necessary in a particular transaction in order to protect investors (and therefore the insurer or reinsurer) against poor asset performance. In addition, structured securities usually are designed to protect investors (and therefore the guarantor) from the bankruptcy or insolvency of the entity which originated the underlying assets, as well as the bankruptcy or insolvency of the servicer of those assets. The Company conducts extensive due diligence on the assets in its insured transactions.

For international transactions, an analysis of the country or countries in which the risk resides is performed. Such analysis includes an assessment of the political risk as well as the economic and demographic characteristics of the country or countries. For each transaction, the Company performs an assessment of the legal jurisdiction governing the transaction and the laws affecting the underlying assets supporting the obligations.

### Underwriting Procedure

Each transaction underwritten by the Company involves persons with different expertise across various departments within the Company. The Company's transaction underwriting teams include both underwriting and legal personnel, who analyze the structure of a potential transaction and the credit and legal issues pertinent to the particular line of business or asset class, and accounting and finance personnel, who review the more complex transactions for compliance with applicable accounting standards and investment guidelines.

In the public finance portion of the Company's financial guaranty direct business, underwriters generally analyze the issuer's historical financial statements and, where warranted, develop stress case projections to test the issuers' ability to make timely debt service payments under stressful economic conditions. In the structured and infrastructure finance portions of the Company's financial guaranty direct business, underwriters generally use computer-based financial models in order to evaluate the ability of the transaction to generate adequate cash flow to service the debt under a variety of scenarios. The models include economically stressed scenarios that the underwriters use for their assessment of the potential credit risk inherent in a particular transaction. Stress models developed internally by the Company's underwriters and reflect both empirical research as well as information gathered from third parties, such as rating agencies or investment banks. The Company may also engage advisors such as consultants and external counsel to assist in analyzing a transaction's financial or legal risks. The Company may also conduct a due diligence review that includes, among other things, a site visit to the project or facility, meetings with issuer management, review of underwriting and operational procedures, file reviews, and review of financial procedures and computer systems.

Upon completion of the underwriting analysis, the underwriter prepares a formal credit report that is submitted to a credit committee for review. An oral presentation is usually made to the committee, followed by questions from committee members and discussion among the committee members and the underwriters. In some cases, additional information may be presented at the meeting or required to be submitted prior to approval. Each credit committee decision is documented and any further requirements, such as specific terms or evidence of due diligence, are noted. The Company currently has four credit committees composed of senior officers of the Company. The committees are organized by asset class, such as for public finance or structured finance, or along regulatory lines, to assess the various potential exposures.

## Risk Management Procedures

### Organizational Structure

The Company's policies and procedures relating to risk assessment and risk management are overseen by its Board of Directors. The Board takes an enterprise-wide approach to risk management that is designed to support the Company's business plans at a reasonable level of risk. A fundamental part of risk assessment and risk management is not only understanding the risks a company faces and what steps management is taking to manage those risks, but also understanding what level of risk is appropriate for the Company. The Board of Directors annually approves the Company's business plan, factoring risk management into account. It also approves the Company's risk appetite statement, which articulates the Company's tolerance for risk and describes the general types of risk that the Company accepts or attempts to avoid. The involvement of the Board in

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setting the Company's business strategy is a key part of its assessment of management's risk tolerance and also a determination of what constitutes an appropriate level of risk for the Company.

While the Board of Directors has the ultimate oversight responsibility for the risk management process, various committees of the Board also have responsibility for risk assessment and risk management. The Risk Oversight Committee of the Board of Directors oversees the standards, controls, limits, underwriting guidelines and policies that the Company establishes and implements in respect of credit underwriting and risk management. It focuses on management's assessment and management of both (i) credit risks and (ii) other risks, including, but not limited to, financial, legal and operational risks, and risks relating to the Company's reputation and ethical standards. In addition, the Audit Committee of the Board of Directors is responsible for, among other matters, reviewing policies and processes related to the evaluation of risk assessment and risk management, including the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures. It also reviews compliance with legal and regulatory requirements. The Compensation Committee of the Board of Directors reviews compensation-related risks to the Company. The Finance Committee of the Board of Directors oversees the investment of the Company's investment portfolio and the Company's capital structure, financing arrangements and any corporate development activities in support of the Company's financial plan. The Nominating and Governance Committee of the Board of Directors oversees risk at the Company by developing appropriate corporate governance guidelines and identifying qualified individuals to become board members.

The Company has established a number of management committees to develop underwriting and risk management guidelines, policies and procedures for the Company's insurance and reinsurance subsidiaries that are tailored to their respective businesses, providing multiple levels of credit review and analysis.

**Portfolio Risk Management Committee**—This committee establishes company-wide credit policy for the Company's direct and assumed business. It implements specific underwriting procedures and limits for the Company and allocates underwriting capacity among the Company's subsidiaries. The Portfolio Risk Management Committee focuses on measuring and managing credit, market and liquidity risk for the overall company. All transactions in new asset classes or new jurisdictions must be approved by this committee.

**U.S. Management Committee**—This committee establishes strategic policy and reviews the implementation of strategic initiatives and general business progress in the U.S. The U.S. Management Committee approves risk policy at the U.S. operating company level.

**Risk Management Committees**—The U.S., U.K. and AG Re risk management committees conduct an in-depth review of the insured portfolios of the relevant subsidiaries, focusing on varying portions of the portfolio at each meeting. They assign internal ratings of the insured transactions and review sector reports, monthly product line surveillance reports and compliance reports.

**Workout Committee**—This committee receives reports from Surveillance and Workout personnel on transactions that might benefit from active loss mitigation and develops and approves loss mitigation strategies for such transactions.

**Reserve Committees**—Oversight of reserving risk is vested in the U.S. Reserve Committee, the AG Re Reserve Committee and the U.K. Reserve Committee. The committees review the reserve methodology and assumptions for each major asset class or significant below-investment grade ("BIG") transaction, as well as the loss projection scenarios used and the probability weights assigned to those scenarios. The reserve committees establish reserves for the relevant subsidiaries, taking into consideration supporting information provided by Surveillance personnel.

The Company's surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio, including exposures in both the financial guaranty direct and assumed businesses. 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 remedial actions to management. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel recommend adjustments to those ratings to reflect changes in transaction credit quality.

The Company's workout personnel are responsible for managing workout and loss mitigation situations. They work together with the Company's surveillance personnel to develop and implement strategies on transactions that are experiencing loss or could possibly experience loss. They develop strategies designed to enhance the ability of the Company to enforce its contractual rights and remedies and mitigate potential losses. The Company's workout personnel also engage in negotiation discussions with transaction participants and, when necessary, manage (along with legal personnel) the Company's litigation

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proceedings. They may also make open market purchases of securities that the Company has insured. The Company's workout personnel work with servicers of residential mortgage-backed securities transactions to enhance their performance.

### Direct Business

The Company monitors the performance of each risk in its portfolio and tracks aggregation of risk. The review cycle and scope vary based upon transaction type and credit quality. In general, the review process includes the collection and analysis of information from various sources, including trustee and servicer reports, financial statements, general industry or sector news and analyses, and rating agency reports. For public finance risks, the surveillance process includes monitoring general economic trends, developments with respect to state and municipal finances, and the financial situation of the issuers. For structured finance transactions, the surveillance process can include monitoring transaction performance data and cash flows, compliance with transaction terms and conditions, and evaluation of servicer or collateral manager performance and financial condition. Additionally, the Company uses various quantitative tools and models to assess transaction performance and identify situations where there may have been a change in credit quality. For all transactions, surveillance activities may include discussions with or site visits to issuers, servicers or other parties to a transaction.

### Assumed Business

For transactions that the Company has assumed, the ceding insurers are responsible for conducting ongoing surveillance of the exposures that have been ceded to the Company. The Company's surveillance personnel monitor the ceding insurer's surveillance activities on exposures ceded to the Company through a variety of means, including reviews of surveillance reports provided by the ceding insurers, and meetings and discussions with their analysts. The Company's surveillance personnel also monitor general news and information, industry trends and rating agency reports to help focus surveillance activities on sectors or credits of particular concern. For certain exposures, the Company also will undertake an independent analysis and remodeling of the exposure. In the event of credit deterioration of a particular exposure, more frequent reviews of the ceding company's risk mitigation activities are conducted. The Company's surveillance personnel also take steps to ensure that the ceding insurer is managing the risk pursuant to the terms of the applicable reinsurance agreement. To this end, the Company conducts periodic reviews of ceding companies' surveillance activities and capabilities. That process may include the review of the insurer's underwriting, surveillance and claim files for certain transactions.

### Ceded Business

As part of its risk management strategy, the Company has sought in the past to obtain third party reinsurance or retrocessions and may also periodically enter into other arrangements to reduce its exposure to risk concentrations, such as for single risk limits, portfolio credit rating or exposure limits, geographic limits or other factors. At December 31, 2013, the Company had ceded approximately 6% of its principal amount outstanding to third party reinsurers.

The Company has obtained reinsurance to increase its underwriting capacity, both on an aggregate-risk and a single-risk basis, to meet internal, rating agency and regulatory risk limits, diversify risks, reduce the need for additional capital, and strengthen financial ratios. The Company receives capital credit for ceded reinsurance based on the reinsurer's ratings in the capital models used by the rating agencies to evaluate the Company's capital position for its financial strength ratings. In addition, a number of the Company's reinsurers are required to pledge collateral to secure their reinsurance obligations to the Company. In some cases, the pledged collateral augments the rating agency credit for the reinsurance provided. In recent years, most of the Company's reinsurers have been downgraded by one or more rating agency, and consequently, the financial strength ratings of many of the reinsurers are below those of



the Company's insurance subsidiaries. While ceding commissions or premium allocation adjustments may compensate in part for such downgrades, the effect of such downgrades, in general, is to decrease the financial benefits of using reinsurance under rating agency capital adequacy models. However, to the extent a reinsurer still has the financial wherewithal to pay, the Company could still benefit from the reinsurance provided.

The Company's ceded reinsurance may be on a quota share, first-loss or excess-of-loss basis. Quota share reinsurance generally provides protection against a fixed specified percentage of all losses incurred by the Company. First-loss reinsurance generally provides protection against a fixed specified percentage of losses incurred up to a specified limit. Excess-of-loss reinsurance generally provides protection against a fixed percentage of losses incurred to the extent that losses incurred exceed a specified limit. Reinsurance arrangements typically require the Company to retain a minimum portion of the risks reinsured.

In past, the Company had both facultative (transaction-by-transaction) and treaty ceded reinsurance contracts with third party reinsurers, generally arranged on an annual basis for new business. The Company also employed "automatic facultative" reinsurance that permitted the Company to apply reinsurance with third party reinsurance to transactions it selected subject to certain limitations. The remainder of the Company's treaty reinsurance provided coverage for a portion, subject in

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certain cases to adjustment at the Company's election, of the exposure from all qualifying policies issued during the term of the treaty. The reinsurer's participation in a treaty was either cancellable annually upon 90 days' prior notice by either the Company or the reinsurer, or had a one-year term. Treaties generally provide coverage for the full term of the policies reinsured during the annual treaty period, except that, upon a financial deterioration of the reinsurer or the occurrence of certain other events, the Company generally has the right to reassume all or a portion of the business reinsured. Reinsurance agreements may be subject to other termination conditions as required by applicable state law.

The Company's treaty and automatic facultative program covering new business with third party reinsurers ended in 2008, but such reinsurance continues to cover ceded business until the expiration of exposure, except that the Company has entered into commutation agreements reassuming portions of the ceded business from certain reinsurers. The Company continues to reinsure occasionally new business on a facultative basis.

AGC, AGM and MAC have entered into an aggregate excess of loss reinsurance facility with a number of reinsurers, effective as of January 1, 2014. The facility covers losses occurring either from January 1, 2014 through December 31, 2021, or January 1, 2015 through December 31, 2022, at the option of AGC, AGM and MAC. It terminates on January 1, 2016, unless AGC, AGM and MAC choose to extend it. The facility covers certain U.S. public finance credits insured or reinsured by AGC, AGM and MAC as of September 30, 2013, excluding credits that were rated non-investment grade as of December 31, 2013 by Moody's or S&P or internally by AGC, AGM or MAC and is subject to certain per credit limits. Among the credits excluded are those associated with the Commonwealth of Puerto Rico and its related authorities and public corporations. The facility attaches when AGC's, AGM's and MAC's net losses (net of AGC's and AGM's reinsurance (including from affiliates) and net of recoveries) exceed \$1.5 billion in the aggregate. The facility covers a portion of the next \$500 million of losses, with the reinsurers assuming pro rata in the aggregate \$450 million of the \$500 million of losses and AGC, AGM and MAC jointly retaining the remaining \$50 million of losses. The reinsurers are required to be rated at least AA- or to post collateral sufficient to provide AGM, AGC and MAC with the same reinsurance credit as reinsurers rated AA-. AGM, AGC and MAC are obligated to pay the reinsurers their share of recoveries relating to losses during the coverage period in the covered portfolio. AGC, AGM and MAC have paid approximately \$19 million of premiums during 2014 for the term January 1, 2014 through December 31, 2014 and deposited approximately \$19 million of securities into trust accounts for the benefit of the reinsurers to be used to pay the premium for January 1, 2015 through December 31, 2015. This facility replaces the \$435 million aggregate excess of loss reinsurance facility that AGC and AGM had entered into on January 22, 2012.

## Importance of Financial Strength Ratings

Low financial strength ratings or uncertainty over the Company's ability to maintain its financial strength ratings would have a negative impact on issuers' and investors' perceptions of the value of the Company's insurance product. Therefore, the Company manages its business with the goal of achieving high financial strength ratings, preferably the highest that an agency will assign. However, the models used by rating agencies differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. In addition, the models are not fully transparent, contain subjective factors and change frequently.

Historically, insurance financial strength ratings reflect an insurer's ability to pay under its insurance policies and contracts in accordance with their terms. The rating is not specific to any particular policy or contract. Insurance financial strength ratings do not refer to an insurer's ability to meet non-insurance obligations and are not a recommendation to purchase any policy or contract issued by an insurer or to buy, hold, or sell any security insured by an insurer. The insurance financial strength ratings assigned by the rating agencies are based upon factors relevant to policyholders and are not directed toward the protection of investors in AGL's common shares. Ratings reflect only the views of the respective rating agencies and are subject to continuous review and revision or withdrawal at any time.

Following the financial crisis, the rating process has become increasingly challenging for the Company due to a number of factors, including:

**Instability of Rating Criteria and Methodologies.** Rating agencies purport to issue ratings pursuant to published rating criteria and methodologies. In recent years, the rating agencies have made material changes to their rating criteria and methodologies applicable to financial guaranty insurers, sometimes through formal changes and other times through ad hoc adjustments to the conclusions reached by existing criteria. Furthermore, these criteria and methodology changes are typically implemented without any transition period, making it difficult for an insurer to comply quickly with new standards.

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Increasingly Severe Stress Case Loss Assumptions. A major component in arriving at a financial guaranty insurer's rating has been the rating agency's assessment of the insurer's capital adequacy, with each rating agency employing its own proprietary model. These capital adequacy models include "stress case" loss assumptions for various risks or risk categories. In reaction to the financial crisis, the rating agencies materially increased stress case loss assumptions across numerous risk categories. However, the stress case loss assumptions applied to financial guaranty insurers do not always appear consistent with, and can appear to be materially more severe than, the assumptions the rating agencies use when rating securities in those risk categories.

More Reliance on Qualitative Rating Criteria. In prior years, the financial strength ratings of the Company's insurance company subsidiaries were largely consistent with the rating agency's assessment of the insurers' capital adequacy, such that a rating downgrade could generally be avoided by raising additional capital or otherwise improving capital adequacy under the rating agency's model. In recent years, however, both S&P and Moody's have applied other factors, some of which are subjective, such as the insurer's business strategy and franchise value or the anticipated future demand for its product, to justify ratings for the Company's insurance company subsidiaries significantly below the ratings implied by their own capital adequacy models. Currently, for example, S&P has concluded that AGM has "AAA" capital adequacy under the S&P model (but subject to a downward adjustment due to a "large obligor test" and Moody's has concluded that AGM has "Aa" capital adequacy under the Moody's model (offset by other factors including the rating agency's assessment of competitive profile, future profitability and market share).

Despite the difficult rating agency process following the financial crisis, the Company has been able to maintain strong financial strength ratings. However, if a substantial downgrade of the financial strength ratings of the Company's insurance subsidiaries were to occur in the future, such downgrade would adversely affect its business and prospects and, consequently, its results of operations and financial condition. The Company believes that if the financial strength ratings of AGM, AGC and/or MAC were downgraded from their current levels, such downgrade could result in downward pressure on the premium that such insurance subsidiary would be able to charge for its insurance. Currently, AGM, AGC and MAC all have financial strength ratings in the double-A category from S&P (AA- (Stable Outlook)). MAC also has a AA+ (Stable) financial strength rating from Kroll, while AGM and AGC have financial strength ratings in the single-A category from Moody's (A2 (Stable Outlook) and A3 (Stable Outlook), respectively). The Company believes that so long as AGM, AGC and/or MAC continues to have financial strength ratings in the double-A category from at least one of the legacy rating agencies (S&P or Moody's), they are likely to be able to continue writing financial guaranty business with a credit quality similar to that historically written. However, if both legacy rating agencies were to reduce the financial strength ratings of AGM, AGC and/or MAC to the single-A level or below, or if either legacy rating agency were to downgrade AGM, AGC and/or MAC below the single-A level, it could be difficult for the Company to originate the current volume of new business with comparable credit characteristics. See "Item 1A. Risk Factors—Risks Related to the Company's Financial Strength and Financial Enhancement Ratings" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information about the Company's ratings.

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### Investments

Investment income from the Company's investment portfolio is one of the primary sources of cash flows supporting its operations and claim payments. The Company's total investment portfolio was \$10.8 billion and \$11.1 billion as of December 31, 2013 and 2012, respectively, and generated net investment income of \$393 million, \$404 million and \$396 million in 2013, 2012 and 2011, respectively.

The Company's principal objectives in managing its investment portfolio are to preserve the highest possible ratings for each operating company; maintain sufficient liquidity to cover unexpected stress in the insurance portfolio; and maximize total after-tax net investment income. If the Company's calculations with respect to its policy liabilities are incorrect or other unanticipated payment obligations arise, or if the Company improperly structures its investments to meet these liabilities, it could have unexpected losses, including losses resulting from forced liquidation of investments before their maturity. The investment policies of the Company's insurance subsidiaries are subject to insurance law requirements, and may change depending upon regulatory, economic and market conditions and the existing or anticipated financial condition and operating requirements, including the tax position, of the Company's businesses.

Approximately 83% of the Company's investment portfolio is externally managed. The performance of the Company's invested assets is subject to the performance of BlackRock Financial Management, Inc., Deutsche Investment Management Americas Inc., General Re-New England Asset Management, Inc. and Wellington Management Company, LLP, its investment managers, in selecting and managing appropriate investments. The Company's portfolio is allocated approximately equally among the four investment managers. The Company's investment managers have discretionary authority over the Company's investment portfolio within the limits of the Company's investment guidelines approved by the Company's Board of Directors. The Company compensates each of these managers based upon a fixed percentage of the market value of the Company's portfolio. During the years ended December 31, 2013, 2012 and 2011, the Company recorded investment management fee expenses of \$8 million, \$9 million, and \$8 million, respectively, related to these managers.

The Company also manages 9% of its investment portfolio internally, either in connection with its loss mitigation or risk management strategy, or because the Company believes a particular security or asset presents an attractive investment opportunity.

The largest component of the Company's internally managed portfolio consists of obligations that the Company purchases in connection with its loss mitigation or risk management strategy for its insured exposure. Purchasing such obligations enables the Company to exercise rights available to holders of the obligations. As part of the loss mitigation strategy, the Board of Directors of the Company approved net purchases of up to \$1.1 billion of securities for loss mitigation purchases. The Company also holds other invested assets that were obtained or purchased as part of negotiated settlements with insured counterparties or under the terms of its financial guaranties. The Company held approximately \$843 million and \$681 million of securities based on their fair value that were obtained for loss mitigation or risk management purposes in its internally managed investment accounts as of December 31, 2013 and December 31, 2012, respectively.

The Company also purchases obligations and assets that it believes constitute good investment opportunities. For example, the Board of Directors of the Company has approved the Company purchasing obligations that have been approved for insurance by the Company's credit committee, up to a maximum of \$200 million for U.S. public finance obligations and of \$100 million for structured finance obligations. These credit-approved obligations may be insured by the Company or uninsured. During 2013, the Company purchased \$630 million par amount outstanding of such credit approved obligations and sold \$619 million in par. During 2012, the Company purchased \$782 million par amount outstanding of such credit approved obligations and sold \$728 million in par. As of December 31, 2013 and 2012, the Company held \$76 million and \$65 million par amount outstanding of such credit approved obligations, respectively.

## Competition

Assured Guaranty is the market leader in the financial guaranty industry. Assured Guaranty believes its financial strength, default protection products, credit selection policies, underwriting standards and surveillance procedures make it an attractive provider of financial guaranties.

Its principal competition is in the form of obligations that issuers decide to issue on an uninsured basis. In the U.S. public finance market, when interest rates are low, investors may prefer greater yield over insurance protection, and issuers may find the cost savings from insurance less compelling. In 2013, interest rates were volatile and low by historical standards. In 2012, they were at record lows. In the U.S. public finance market in 2013, only approximately 3.9% of the total volume of issuance was issued on an insured basis. In the international infrastructure finance market, Assured Guaranty competes primarily with privately

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funded executions where no bonds are sold in the public markets. In the asset-backed market, the principal competition comes from credit or structural enhancement embedded in transactions, such as through overcollateralization, first loss insurance, excess spread or other terms and conditions that provide investors with additional collateral or cash flow.

Assured Guaranty is the only financial guaranty company active before the global financial crisis of 2008 that has maintained sufficient financial strength to write new business continuously since the crisis began. As a result of rating agency downgrades of the financial strength ratings of financial guaranty companies that had previously been active in the market, Assured Guaranty faced virtually no bond insurer competition since it acquired AGM, in 2009, through 2012.

Based on industry statistics, the Company estimates that, of the U.S. public finance bonds issued with insurance in 2013, the Company insured approximately 62.3% of the par, while Build America Mutual Assurance Company ("BAM"), which commenced business in 2012, insured approximately 36.8% of the par. BAM is effective in competing with the Company for small to medium sized U.S. public finance transactions in certain sectors and its pricing and underwriting strategies may have a negative impact on the amount of premium the Company is able to charge for its insurance. However, the Company believes it has competitive advantages over BAM due to: AGM's and MAC's larger capital base; AGM's ability to insure larger transactions and issuances in more diverse U.S. bond sectors; and AGM's and MAC's strong financial strength ratings from multiple rating agencies (in the case of AGM, AA- from S&P and A2 from Moody's, and in the case of MAC, AA+ from Kroll and AA- from S&P, compared with BAM's AA solely from S&P).

Another potential competitor to the Company on U.S. public finance transactions is National Public Finance Guarantee Corporation ("National"). In 2009, MBIA Insurance Corporation ("MBIA"), one of the legacy insurers that is not writing new business, transferred its U.S. public finance exposures to its affiliate National. The transfer was challenged in litigation that was not settled until May 2013. Subsequently, S&P has raised National's financial strength rating from BBB to A, noting that S&P no longer viewed MBIA's rating as a limitation on National's rating, and Moody's has upgraded National's financial strength rating from Baa2 to Baa1. National has publicly stated its intention to resume insuring municipal bonds and it is possible it may do so in 2014.

In the global structured finance and infrastructure markets, Assured Guaranty is the only financial guaranty insurance company currently guaranteeing structured financings. Management considers this diversification to be a competitive advantage in the long run because it means the Company is not wholly dependent on conditions in any one market.

In the future, additional new entrants into the financial guaranty industry could reduce the Company's future new business prospects, including by furthering price competition or offering financial guaranty insurance on transactions with structural and security features that are more favorable to the issuers than those required by Assured Guaranty.

In addition to monoline insurance companies, Assured Guaranty competes with other forms of credit enhancement, such as letters of credit or credit derivatives provided by banks and other financial institutions, some of which are governmental enterprises, or direct guaranties of municipal, structured finance or other debt by federal or state governments or government sponsored or affiliated agencies. Alternative credit enhancement structures, and in particular federal government credit enhancement or other programs, can interfere with the Company's new business prospects, particularly if they provide direct governmental-level guaranties, restrict the use of third-party financial guaranties or reduce the amount of transactions that might qualify for financial guaranties.

## Regulation

## General

The business of insurance and reinsurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. Reinsurers are generally subject to less direct regulation than primary insurers. The Company is subject to regulation under applicable statutes in the U.S., the U.K. and Bermuda, as well as applicable statutes in Australia.

United States

AGL has three operating insurance subsidiaries domiciled in the U.S., which the Company refers to collectively as the "Assured Guaranty U.S. Subsidiaries."



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AGM is a New York domiciled insurance company licensed to write financial guaranty insurance and reinsurance in 50 U.S. states, the District of Columbia, Guam, Puerto Rico and the U.S. Virgin Islands. It also does business in Sydney, through a service company.

MAC is a New York domiciled insurance company licensed to write financial guaranty insurance and reinsurance in 47 U.S. jurisdictions, including the District of Columbia (with license applications pending in the remaining states). MAC will only insure U.S. public finance debt obligations, focusing on investment grade bonds in select sectors of that market.

AGC is a Maryland domiciled insurance company licensed to write financial guaranty insurance and reinsurance (which is classified in some states as surety or another line of insurance) in 50 U.S. states, the District of Columbia and Puerto Rico. It is registered as a foreign company in Australia and currently operates through a representative office in Sydney. AGC currently intends for the representative office to conduct activities so that it does not have a permanent establishment in Australia.

The Company also owned Assured Guaranty Municipal Insurance Company ("AGMIC"), a New York domiciled insurance company (formerly FSA Insurance Company) that was redomesticated to New York from Oklahoma in 2010. AGMIC never issued any direct policies and its only outstanding business in 2013 was as reinsurer, pursuant to an intercompany reinsurance pooling agreement, of direct business written by AGM. Effective as of July 1, 2013, AGM reassumed such business from AGMIC and the parties terminated such pooling agreement. Effective as of July 16, 2013, AGMIC merged with and into AGM, with AGM as the surviving company of the merger.

In addition, the Company owned Assured Guaranty Mortgage Insurance Company ("AG Mortgage"), a New York domiciled insurance company that was authorized solely to transact mortgage guaranty insurance and reinsurance. AG Mortgage was licensed as a mortgage guaranty insurer in the State of New York and in the District of Columbia, and was an approved or accredited reinsurer in the States of California and Illinois. In 2012, the last policy to which AG Mortgage had exposure expired. In the third quarter of 2013, AG Mortgage surrendered or cancelled, as applicable, its insurance license in the District of Columbia and its accredited reinsurer status in California and Illinois. It is intended that AG Mortgage will be merged with and into AGM, with AGM as the surviving company of the merger, effective as of March 3, 2014.

## Insurance Holding Company Regulation

AGL and the Assured Guaranty U.S. Subsidiaries are subject to the insurance holding company laws of their jurisdiction of domicile, as well as other jurisdictions where these insurers are licensed to do insurance business. These laws generally require each of the Assured Guaranty U.S. Subsidiaries to register with its respective domestic state insurance department and annually to furnish financial and other information about the operations of companies within their holding company system. Generally, all transactions among companies in the holding company system to which any of the Assured Guaranty U.S. Subsidiaries is a party (including sales, loans, reinsurance agreements and service agreements) must be fair and, if material or of a specified category, such as reinsurance or service agreements, require prior notice and approval or non-disapproval by the insurance department where the applicable subsidiary is domiciled.

## Change of Control

Before a person can acquire control of a U.S. domestic insurance company, prior written approval must be obtained from the insurance commissioner of the state where the domestic insurer is domiciled. Generally, state statutes provide that control over a domestic insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10% or more of the voting securities of the domestic

insurer. Prior to granting approval of an application to acquire control of a domestic insurer, the state insurance commissioner will consider such factors as the financial strength of the applicant, the integrity and management of the applicant's board of directors and executive officers, the acquirer's plans for the management of the applicant's board of directors and executive officers, the acquirer's plans for the future operations of the domestic insurer and any anti-competitive results that may arise from the consummation of the acquisition of control. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control involving AGL that some or all of AGL's stockholders might consider to be desirable, including in particular unsolicited transactions.

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### State Insurance Regulation

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. State insurance laws and regulations require the Assured Guaranty U.S. Subsidiaries to file financial statements with insurance departments everywhere they are licensed, authorized or accredited to conduct insurance business, and their operations are subject to examination by those departments at any time. The Assured Guaranty U.S. Subsidiaries prepare statutory financial statements in accordance with Statutory Accounting Practices, or SAP, and procedures prescribed or permitted by these departments. State insurance departments also conduct periodic examinations of the books and records, financial reporting, policy filings and market conduct of insurance companies domiciled in their states, generally once every three to five years. Market conduct examinations by regulators other than the domestic regulator are generally carried out in cooperation with the insurance departments of other states under guidelines promulgated by the National Association of Insurance Commissioners.

The Maryland Insurance Administration (the "MIA"), the regulatory authority of the domiciliary jurisdiction of AGC, conducts a periodic examination of insurance companies domiciled in Maryland every five years. In 2013, the MIA issued an Examination Report with respect to AGC for the five year period ending December 31, 2011; no significant regulatory issues were noted in such report.

The New York State Department of Financial Services (the "NY DFS"), the regulatory authority of the domiciliary jurisdiction of AGM and MAC, and of AGMIC and AG Mortgage (prior to each such company's merger with AGM), also conducts a periodic examination of insurance companies domiciled in New York, also usually at five-year intervals. In 2012, the NY DFS commenced examinations of AGM, MAC, AGMIC and AG Mortgage in order for its examinations of these companies to coincide with the MIA's examination of AGC. In 2013, the NY DFS completed its examinations and issued Reports on Examination of (i) AGM and AG Mortgage for the four-year period ending December 31, 2011; (ii) AGMIC for the five-year period ending December 31, 2011; and (iii) MAC for the period September 26, 2008 through June 30, 2012. The reports also did not note any significant regulatory issues concerning those companies.

### State Dividend Limitations

New York. One of the primary source of cash for the payment of debt service and dividends by the Company is the receipt of dividends from AGM. Under the New York Insurance Law, AGM may only pay dividends out of "earned surplus," which is that portion of the company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends 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 dividends without the prior approval of the New York Superintendent of Financial Services ("New York Superintendent") that, together with all dividends declared or distributed by it during the preceding 12 months, does not exceed 10% of its policyholders' surplus (as of its last annual or quarterly statement filed with the New York Superintendent) or 100% of its adjusted net investment income during that period. The maximum amount available during 2014 for AGM to pay dividends to its parent AGMH without regulatory approval, after giving effect to dividends paid in the prior 12 months, will be approximately \$173 million. AGM paid dividends of \$163 million and \$30 million during 2013 and 2012, respectively, to AGMH. It did not declare or pay any dividends in 2011 because in connection with the Company's acquisition of AGMH in 2009, it had committed to the NY DFS that AGM would not pay any dividends for a two year period without the prior approval of the New York Superintendent. This constraint has expired.

Maryland. Another primary source of cash for the payment of debt service and dividends by the Company is the receipt of dividends from AGC. Under Maryland's insurance law, AGC may, with prior notice to the MIA, pay an ordinary dividend that, together with all dividends paid in the prior 12 months, does not exceed 10% of its policyholders' surplus (as of the prior December 31) or 100% of its adjusted net investment income during that period. The maximum amount available during 2014 for AGC to pay ordinary dividends to its parent Assured Guaranty US Holdings Inc. ("AGUS"), after giving effect to dividends paid in the prior 12 months, will be approximately \$69 million. A dividend or distribution to a stockholder in excess of this limitation would constitute an "extraordinary dividend," which must be paid out of "earned surplus" and reported to, and approved by, the MIA prior to payment. "Earned surplus" is that portion of the company's surplus that represents the net earnings, gains or profits (after deduction of all losses) that have not been distributed to shareholders as dividends or transferred to stated capital or capital surplus, or applied to other purposes permitted by law, but does not include unrealized capital gains and appreciation of assets. Currently, AGC does not have any earned surplus and therefore the Company expects AGC only to pay ordinary dividends in 2014. AGC may not pay any dividend or make any distribution, including ordinary dividends, unless

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it notifies the MIA of the proposed payment within five business days following declaration and at least ten days before payment. The MIA may declare that such dividend not be paid if it finds that AGC's policyholders' surplus would be inadequate after payment of the dividend or the dividend could lead AGC to a hazardous financial condition. AGC paid dividends of \$67 million, \$55 million and \$30 million during 2013, 2012 and 2011, respectively, to AGUS.

Contingency Reserves

New York. Under the New York Insurance Law, each of AGM and MAC must establish a contingency reserve to protect policyholders. As financial guaranty insurers, each is required to maintain a contingency reserve:

with respect to policies written prior to July 1, 1989, in an amount equal to 50% of earned premiums less permitted reductions; and

with respect to policies written on and after July 1, 1989, quarterly on a pro rata basis over a period of 20 years for municipal bonds and 15 years for all other obligations, in an amount equal to the greater of 50% of premiums written for the relevant category of insurance or a percentage of the principal guaranteed, varying from 0.55% to 2.50%, depending on the type of obligation guaranteed, until the contingency reserve amount for the category equals the applicable percentage of net unpaid principal. The contingency reserve is then taken down over the same period of time that it was established.

Maryland. In accordance with Maryland insurance law and regulations, AGC also maintains a statutory contingency reserve for the protection of policyholders. The contingency reserve is maintained quarterly on a pro rata basis over a period of 20 years for municipal bonds and 15 years for all other obligations, in an amount equal to the greater of 50% of premiums written for the relevant category of insurance or a percentage of the principal guaranteed, varying from 0.55% to 2.50%, depending on the type of obligation guaranteed, until the contingency reserve amount for the category equals the applicable percentage of net unpaid principal. The contingency reserve is then taken down over the same period of time that it was established.

In both New York and Maryland, when considering the principal amount guaranteed, the insurer is permitted to take into account amounts that it has ceded to reinsurers. In addition, releases from the insurer's contingency reserve may be permitted under specified circumstances in the event that actual loss experience exceeds certain thresholds or if the reserve accumulated is deemed excessive in relation to the insurer's outstanding insured obligations.

From time to time, AGM and AGC have obtained approval from their regulators to release contingency reserves based on losses and, in the case of AGM, also based on the expiration of its insured exposure. In 2012, AGM obtained NY DFS approval of contingency reserve releases of approximately \$510 million based on the expiration of exposure. In addition, in July 2013, AGM obtained approval from the NY DFS, and AGC obtained approval from the MIA, to reassume in three annual installments all of the outstanding contingency reserves that AGM and AGC, respectively, ceded to its affiliate AG Re and to cease ceding further contingency reserves to AG Re. In July 2013, AGM and AGC each implemented the first of these three annual installments by reassuming approximately \$73 million and \$88 million, respectively, of ceded contingency reserves. These first reassumptions together permitted the release of assets from the AG Re trust accounts securing AG Re's reinsurance of AGM and AGC by approximately \$130 million, after adjusting for increases in the amounts required to be held in such accounts due to changes in asset values, thereby increasing the Company's liquidity. The second and third reassumption installments are intended to be completed on the one and two year anniversaries, respectively, of the first reassumption installment, and are subject to further approval by the NY DFS and MIA.

Financial guaranty insurers are also required to maintain a loss and loss adjustment expense ("LAE") reserve and unearned premium reserve on a case-by-case basis.

### Single and Aggregate Risk Limits

The New York Insurance Law and the Code of Maryland Regulations establish single risk limits for financial guaranty insurers applicable to all obligations issued by a single entity and backed by a single revenue source. For example, under the limit applicable to qualifying asset-backed securities, the lesser of:

the insured average annual debt service for a single risk, net of qualifying reinsurance and collateral, or

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the insured unpaid principal (reduced by the extent to which the unpaid principal of the supporting assets exceeds the insured unpaid principal) divided by nine, net of qualifying reinsurance and collateral, may not exceed 10% of the sum of the insurer's policyholders' surplus and contingency reserves, subject to certain conditions.

Under the limit applicable to municipal obligations, the insured average annual debt service for a single risk, net of qualifying reinsurance and collateral, may not exceed 10% of the sum of the insurer's policyholders' surplus and contingency reserves. In addition, insured principal of municipal obligations attributable to any single risk, net of qualifying reinsurance and collateral, is limited to 75% of the insurer's policyholders' surplus and contingency reserves. Single-risk limits are also specified for other categories of insured obligations, and generally are more restrictive than those listed for asset-backed or municipal obligations. Obligations not qualifying for an enhanced single-risk limit are generally subject to the "corporate" limit (applicable to insurance of unsecured corporate obligations) equal to 10% of the sum of the insurer's policyholders' surplus and contingency reserves. For example, "triple-X" and "future flow" securitizations, as well as unsecured investor-owned utility obligations, are generally subject to these "corporate" single-risk limits.

The New York Insurance Law and the Code of Maryland Regulations also establish aggregate risk limits on the basis of aggregate net liability insured as compared with statutory capital. "Aggregate net liability" is defined as outstanding principal and interest of guaranteed obligations insured, net of qualifying reinsurance and collateral. Under these limits, policyholders' surplus and contingency reserves must not be less than a percentage of aggregate net liability equal to the sum of various percentages of aggregate net liability for various categories of specified obligations. The percentage varies from 0.33% for certain municipal obligations to 4% for certain non-investment-grade obligations. As of December 31, 2013, the aggregate net liability of each of AGM, MAC and AGC utilized approximately 34.4%, 57.8% and 25.9% of their respective policyholders' surplus and contingency reserves.

The New York Superintendent has broad discretion to order a financial guaranty insurer to cease new business originations if the insurer fails to comply with single or aggregate risk limits. In practice, the New York Superintendent has shown a willingness to work with insurers to address these concerns.

## Group Regulation

In connection with AGL's establishment of tax residence in the United Kingdom, as discussed in greater detail under "Tax Matters" below, AGL has been discussing the regulation of AGL and its subsidiaries as a group with the Prudential Regulation Authority in the U.K. and with the NY DFS. The NY DFS has indicated that it will assume responsibility for regulation of the Assured Guaranty group. Group supervision by the NYDFS would result in additional regulatory oversight over Assured Guaranty, and may subject Assured Guaranty to new regulatory requirements and constraints.

## Investments

The Assured Guaranty U.S. Subsidiaries are subject to laws and regulations that require diversification of their investment portfolio and limit the amount of investments in certain asset categories, such as below investment grade fixed-maturity securities, equity real estate, other equity investments, and derivatives. Failure to comply with these laws and regulations would cause investments exceeding regulatory limitations to be treated as non-admitted assets for purposes of measuring surplus, and, in some instances, would require divestiture of such non-qualifying investments. The Company believes that the investments made by the Assured Guaranty U.S. Subsidiaries complied with such regulations as of December 31, 2013. In addition, any investment must be approved by the insurance company's board of directors or a committee thereof that is responsible for supervising or making such investment.

## Operations of the Company's Non-U.S. Insurance Subsidiaries

In addition to the regulatory requirements imposed by the jurisdictions in which they are licensed, the business operations of the Company's reinsurance subsidiaries are affected by regulatory requirements in various states of the United States governing "credit for reinsurance", which are imposed on the ceding companies of the reinsurers. The Nonadmitted and Reinsurance Reform Act ("NRRA") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") streamlined the regulation of reinsurance by applying single state regulation for credit for reinsurance. Under the NRRA, credit for reinsurance determinations are controlled by the ceding company's state of domicile and non-domiciliary states are prohibited from applying their reinsurance laws extraterritorially. In general, a ceding company which obtains reinsurance from a reinsurer that is licensed, accredited or approved by the ceding company's state of domicile is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the ceding company's liability for unearned premiums (which are that portion of premiums written which applies to the unexpired portion of the policy period), loss and loss expense reserves ceded to the reinsurer. The great majority of states, however, permit a credit on the statutory financial statements of a



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ceding insurer for reinsurance obtained from a non-licensed or non-accredited reinsurer to the extent that the reinsurer secures its reinsurance obligations to the ceding insurer by providing a letter of credit, trust fund or other acceptable security arrangement. A few states do not allow credit for reinsurance ceded to non-licensed reinsurers except in certain limited circumstances and others impose additional requirements that make it difficult to become accredited. The Company's reinsurance subsidiaries AG Re and AGRO are not licensed, accredited or approved in any state and have established trusts to secure their reinsurance obligations.

### U.S. Federal Regulation

The Company's businesses are subject to direct and indirect regulation under U.S. federal law. In particular, the Dodd-Frank Act could require certain of AGL's subsidiaries to register with the SEC as major security-based swap participants when those registration rules take effect. Major security-based swap participants would need to satisfy the SEC's regulatory capital requirements and would be subject to additional compliance requirements. In addition, certain of AGL's subsidiaries may need to post margin with respect to either future or legacy derivative transactions when rules relating to margin take effect. At this time, AGL does not believe its subsidiaries are required to register with the Commodity Futures Trading Commission ("CFTC") as major swap participants, but their status could change based on official guidance from the CFTC.

Furthermore, pursuant to the Dodd-Frank Act, the Financial Stability Oversight Council ("FSOC") has been charged with identifying certain non-bank financial companies to be subject to supervision by the Board of Governors of the Federal Reserve System. In a parallel international process, the International Association of Insurance Supervisors ("IAIS"), which has been identifying global systemically important insurers ("GSII"), published a proposed assessment methodology that deemed financial guaranty insurance to be an activity that poses increased systemic risk relative to more traditional insurance activities. The Company does not at this time expect to be designated as a Systemically Important Financial Institution ("SIFI") by the FSOC or a GSII by the IAIS, but the Company's status could change pursuant to new criteria from the FSOC or the IAIS.

### Bermuda

AG Re and AGRO are each an insurance company currently registered and licensed under the Insurance Act 1978 of Bermuda, amendments thereto and related regulations (collectively, the "Insurance Act"). AG Re is registered and licensed as a Class 3B insurer and AGRO is registered and licensed as a Class 3A insurer and a Class C long-term insurer. The Company also owned Assured Guaranty (Bermuda) Ltd. ("AGBM"), which was registered and licensed as a Class 3 insurer. Effective July 17, 2013, AGBM was merged with and into AG Re with AG Re surviving the merger.

### Bermuda Insurance Regulation

The Insurance Act imposes on insurance companies certain solvency and liquidity standards; certain restrictions on the declaration and payment of dividends and distributions; certain restrictions on the reduction of statutory capital; certain restrictions on the winding up of long-term insurers; and certain auditing and reporting requirements and also the need to have a principal representative and a principal office (as understood under the Insurance Act) in Bermuda. The Insurance Act grants to the Bermuda Monetary Authority (the "Authority") the power to cancel insurance licenses, supervise, investigate and intervene in the affairs of insurance companies and in certain circumstances share information with foreign regulators. Class 3A and Class 3B insurers are authorized to carry on general insurance business (as understood under the Insurance Act), subject to conditions attached to the license and to compliance with minimum capital and surplus requirements, solvency margin, liquidity ratio and other requirements imposed by the Insurance Act. Class C insurers are permitted to carry on long-term business (as understood under the Insurance Act) subject to conditions attached to the license and to similar compliance requirements and the requirement to maintain

its long-term business fund (a segregated fund). Each of AG Re and AGRO is required annually to file statutorily mandated financial statements and returns, audited by an auditor approved by the Authority (no approved auditor of an insurer may have an interest in that insurer, other than as an insured, and no officer, servant or agent of an insurer shall be eligible for appointment as an insurer's approved auditor), together with an annual loss reserve opinion of the Authority approved loss reserve specialist and in respect of AGRO, the required actuary's certificate with respect to the long-term business. AG Re is also required to file annual financial statements prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"), which must be available to the public. As Class 3A insurer, AGRO has received an exemption from the Authority from making such filing. In addition, AG Re is required to file a capital and solvency return that includes the company's Bermuda Solvency Capital Requirement ("BSCR") model (or an approved internal capital model in lieu thereof), a schedule of fixed income investments by rating categories, a schedule of net reserves for losses and loss expense provisions by line of business, a schedule of premiums written by line of business, a schedule of risk management, a schedule of fixed income securities, a schedule of commercial insurer's solvency self assessment ("CISSA"), a schedule of catastrophe risk return, a schedule of loss triangles or reconciliation of net loss reserves

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and a schedule of eligible capital. AG Re is also required to file quarterly financial returns which consist of quarterly unaudited financial statements and details of material intra-group transactions and risk concentrations.

AGRO is also required to file a capital and solvency return that includes, among other details, the company's Bermuda Solvency Capital Requirement—Small and Medium Entities ("BSCR-SME") model (or an approved internal capital model in lieu thereof), the CISSA and a schedule of eligible capital.

### Shareholder Controllers

Pursuant to provisions in the Insurance Act, any person who becomes a holder of 10% or more, 20% or more, 33% or more or 50% or more of the Company's common shares must notify the Authority in writing within 45 days of becoming such a holder. The Authority has the power to object to such a person if it appears to the Authority that the person is not fit and proper to be such a holder. In such a case, the Authority may require the holder to reduce their shareholding in the Company and may direct, among other things, that the voting rights attaching to their common shares shall not be exercisable. A person that does not comply with such a notice or direction from the Authority will be guilty of an offense.

### Notification of Material Changes

All registered insurers are required to give notice to the Authority of their intention to effect a material change within the meaning of the Insurance Act. For the purposes of the Insurance Act, the following changes are material: (i) the transfer or acquisition of insurance business being part of a scheme falling under section 25 of the Insurance Act or section 99 of the Companies Act 1981 of Bermuda (the "Companies Act"), (ii) the amalgamation with or acquisition of another firm, (iii) engaging in unrelated business that is retail business, (iv) the acquisition of a controlling interest in an undertaking that is engaged in non-insurance business which offers services or products to non-affiliated persons, (v) outsourcing all or substantially all of the functions of actuarial, risk management, compliance and internal audit, (vi) outsourcing all or a material part of an insurer's underwriting activity, (vii) transferring other than by way of reinsurance all or substantially all of a line of business and (viii) expanding into a material new line of business.

No registered insurer shall take any steps to give effect to a material change unless it has first served notice on the Authority that it intends to effect such material change and, before the end of 14 days, either the Authority has notified such company in writing that it has no objection to such change or that period has lapsed without the Authority having issued a notice of objection. A person who fails to give the required notice or who effects a material change, or allows such material change to be effected, before the prescribed period has elapsed or after having received a notice of objection shall be guilty of an offence.

### Minimum Solvency Margin and Enhanced Capital Requirements

Under the Insurance Act, AG Re and AGRO must each ensure that the value of its general business assets exceeds the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin and each company's applicable enhanced capital requirement.

The minimum solvency margin for Class 3A and Class 3B insurers is the greater of (i) \$1 million, or (ii) 20% of the first \$6 million of net premiums written; if in excess of \$6 million, the figure is \$1.2 million plus 15% of net premiums written in excess of \$6 million, or (iii) 15% of net discounted aggregate loss and loss expense provisions and other insurance reserves, or (iv) 25% of that insurers applicable enhanced capital requirement reported at the end of its relevant year.

In addition, as a Class C long-term insurer, AGRO is required, with respect to its long-term business, to maintain a minimum solvency margin equal to the greater of \$500,000 or 1.5% of its assets for the 2013 financial year. For the purpose of this calculation, assets are defined as the total assets pertaining to its long-term business reported on the balance sheet in the relevant year less the amounts held in a segregated account. AGRO is also required to keep its accounts in respect of its long-term business separate from any accounts kept in respect of any other business and all receipts of its long-term business form part of its long-term business fund.

Each of AG Re and AGRO is required to maintain available statutory capital and surplus at a level equal to or in excess of its applicable enhanced capital requirement, which is established by reference to either its BSCR model or an approved internal capital model. The BSCR model is a risk-based capital model which provides a method for determining an insurer's capital requirements (statutory capital and surplus) by taking into account the risk characteristics of different aspects of the insurer's business. The BSCR formula establish capital requirements for eight categories of risk: fixed income investment risk, equity investment risk, interest rate/liquidity risk, premium risk, reserve risk, credit risk, catastrophe risk and operational

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risk. For each category, the capital requirement is determined by applying factors to asset, premium, reserve, creditor, probable maximum loss and operation items, with higher factors applied to items with greater underlying risk and lower factors for less risky items.

While not specifically referred to in the Insurance Act, the Authority has also established a target capital level ("TCL") for each insurer subject to an enhanced capital requirement equal to 120% of its enhanced capital requirement. While such an insurer is not currently required to maintain its statutory capital and surplus at this level, the TCL serves as an early warning tool for the Authority and failure to maintain statutory capital at least equal to the TCL will likely result in increased regulatory oversight.

For each insurer subject to an enhanced capital requirement, the Authority has introduced a three-tiered capital system designed to assess the quality of capital resources that a company has available to meet its capital requirements. Under this system, all of an insurer's capital instruments will be classified as either basic or ancillary capital which in turn will be classified into one of three tiers based on their "loss absorbency" characteristics. Highest quality capital is classified as Tier 1 Capital; lesser quality capital is classified as either Tier 2 Capital or Tier 3 Capital. Under this regime, up to certain specified percentages of Tier 1, Tier 2 and Tier 3 Capital (determined by registration classification) may be used to support the company's minimum solvency margin, enhanced capital requirement and TCL.

### Restrictions on Dividends and Distributions

The Insurance Act limits the declaration and payment of dividends and other distributions by AG Re and AGRO. Under the Insurance Act:

The minimum share capital must be always issued and outstanding and cannot be reduced. For AG Re, which is registered as a Class 3B insurer, the minimum share capital is \$120,000. For AGRO, which is registered both as a Class 3A and a Class C long-term insurer, the minimum share capital is \$370,000.

With respect to the distribution (including repurchase of shares) of any share capital, contributed surplus or other statutory capital:

(a) any such distribution that would reduce AG Re's or AGRO's total statutory capital by 15% or more of their respective total statutory capital as set out in their previous year's financial statements requires the prior approval of the Authority. Any application for such approval must include an affidavit stating that the company will continue to meet the required margins; and

(b) as a Class C long-term insurer, AGRO may not use the funds allocated to its long-term business fund, directly or indirectly, for any purpose other than a purpose of its long-term business except in so far as such payment can be made out of any surplus certified by AGRO's approved actuary to be available for distribution otherwise than to policyholders;

With respect to the declaration and payment of dividends:

(a) each of AG Re and AGRO is prohibited from declaring or paying any dividends during any financial year if it is in breach of its solvency margin, minimum liquidity ratio or enhanced capital requirement, or if the declaration or payment of such dividends would cause such a breach (if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year, the insurer will be prohibited, without the approval of the Authority, from declaring or paying any dividends during the next financial year). Dividends, are paid out of each insurer's statutory surplus and, therefore, dividends cannot exceed such surplus. See "—Minimum Solvency

Margin and Enhanced Capital Requirements" above and "—Minimum Liquidity Ratio" below;

(b) an insurer which at any time fails to meet its minimum solvency margin or comply with the enhanced capital requirement may not declare or pay any dividend until the failure is rectified, and also in such circumstances the insurer must report, within 14 days after becoming aware of its failure or having reason to believe that such failure has occurred, to the Authority in writing giving particulars of the circumstances leading to the failure and giving a plan detailing the manner, specific actions to be taken and time frame in which the insurer intends to rectify the failure. A failure to comply with the enhanced capital requirement will also result in the insurer furnishing certain other information to the Authority within 45 days after becoming aware of its failure or having reason to believe that such failure has occurred;

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as a Class 3B insurer, AG Re may not declare or pay, in any financial year, dividends of more than 25% of its total statutory capital and surplus (as set out on its previous year's financial statements) unless it files (at least seven days) before payment of such dividends) with the Authority an affidavit stating that it will continue to meet the required margins; and

as a Class C long-term insurer, AGRO may not declare or pay a dividend to any person other than a policyholder unless the value of the assets of its long-term business fund, as certified by AGRO's approved actuary, exceeds the extent (as so certified) of the liabilities of AGRO's long-term business, and the amount of any such dividend shall not exceed the aggregate of (1) that excess; and (2) any other funds properly available for the payment of dividends being funds arising out of AGRO's business other than its long-term business.

The Companies Act also limits the declaration and payment of dividends and other distributions by Bermuda companies such as AGL and its Bermuda subsidiaries (including AG Re and AGRO). Such companies may only declare and pay a dividend or make a distribution out of contributed surplus (as understood under the Companies Act) if there are reasonable grounds for believing that the company is and after the payment will be able to meet and pay its liabilities as they become due and the realizable value of the company's assets will not be less than its liabilities. The Companies Act also regulates and restricts the reduction and return of capital and paid in share premium, including the repurchase of shares and imposes minimum issued and outstanding share capital requirements.

Based on the limitations above, in 2014 AG Re has the capacity to (i) make capital distributions in an aggregate amount up to \$126 million without the prior approval of the Authority and (ii) declare and pay dividends in an aggregate amount up to the limit of its outstanding statutory surplus, which is \$278 million. Such dividend capacity is further limited by the actual amount of AG Re's unencumbered assets, which amount changes from time to time due in part to collateral posting requirements. For more information concerning AG Re's capacity to pay dividends and or other distributions, see Note 12, Insurance Company Regulatory Requirements, of the Financial Statements and Supplementary Data. The Company does not expect AGRO to declare or pay any dividends or other distributions at this time.

Minimum Liquidity Ratio

The Insurance Act provides a minimum liquidity ratio for general business. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable, reinsurance balances receivable and funds held by ceding reinsurers. There are certain categories of assets which, unless specifically permitted by the Authority, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans.

The relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (by interpretation, those not specifically defined) and letters of credit and corporate guarantees.

Insurance Code of Conduct

Each of AG Re and AGRO is subject to the Insurance Code of Conduct, which establishes duties, standards, procedures and sound business principles which must be complied with by all insurers registered under the Insurance Act. Failure to comply with the requirements under the Insurance Code of Conduct will be a factor taken into account by the Authority in determining whether an insurer is conducting its business in a sound and prudent manner as prescribed by the Insurance Act. Such failure to comply with the requirements of the Insurance Code of Conduct

could result in the Authority exercising its powers of intervention and investigation and will be a factor in calculating the operational risk charge applicable in accordance with the insurer's BSCR model.

#### Certain Other Bermuda Law Considerations

Although AGL is incorporated in Bermuda, it is classified as a non-resident of Bermuda for exchange control purposes by the Authority. Pursuant to its non-resident status, AGL may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on its ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda or to pay dividends to U.S. residents who are holders of its common shares.



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Under Bermuda law, "exempted" companies are companies formed for the purpose of conducting business outside Bermuda from a principal place of business in Bermuda. As an "exempted" company, AGL (as well as each of AG Re and AGRO) may not, without the express authorization of the Bermuda legislature or under a license or consent granted by the Minister of Education and Economic Development, participate in certain business and other transactions, including: (1) the acquisition or holding of land in Bermuda (except that held by way of lease or tenancy agreement which is required for its business and held for a term not exceeding 50 years, or which is used to provide accommodation or recreational facilities for its officers and employees and held with the consent of the Bermuda Minister of Education and Economic Development, for a term not exceeding 21 years), (2) the taking of mortgages on land in Bermuda to secure a principal amount in excess of \$50,000 unless the Minister of Education and Economic Development consents to a higher amount, and (3) the carrying on of business of any kind or type for which it is not duly licensed in Bermuda, except in certain limited circumstances, such as doing business with another exempted undertaking in furtherance of AGL's business carried on outside Bermuda.

The Bermuda government actively encourages foreign investment in "exempted" entities like AGL that are based in Bermuda, but which do not operate in competition with local businesses. AGL is not currently subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation. Bermuda companies pay, as applicable, annual government fees, business fees, payroll tax and other taxes and duties. See "—Tax Matters—Taxation of AGL and Subsidiaries—Bermuda."

Special considerations apply to the Company's Bermuda operations. Under Bermuda law, non-Bermudians, other than spouses of Bermudians and individuals holding permanent resident certificates or working resident certificates, are not permitted to engage in any gainful occupation in Bermuda without a work permit issued by the Bermuda government. A work permit is only granted or extended if the employer can show that, after a proper public advertisement, no Bermudian, spouse of a Bermudian or individual holding a permanent resident certificate or working resident certificate is available who meets the minimum standards for the position. Currently, all of the Company's Bermuda based professional employees who require work permits have been granted work permits by the Bermuda government.

### United Kingdom

This section concerns AGE and its affiliates, Assured Guaranty (UK) Ltd. ("AGUK") and Assured Guaranty Finance Overseas Ltd ("AGFOL"), each of which is regulated in the U.K., as well as Assured Guaranty Credit Protection Ltd. ("AGCPL"), which is an authorized representative of AGE. AGUK is a U.K. insurance company that the Company elected to place into runoff.

### General

Financial services relating to deposits, insurance, investments and certain other financial products fall under the U.K.'s Financial Services and Markets Act 2000 ("FSMA"), and the entities that provide them are authorized and regulated by the PRA and the Financial Conduct Authority ("FCA"). In addition, the regulatory regime in the U.K. must be consistent with relevant European Union ("EU") legislation, which is either directly applicable in, or must be implemented into national law by, all EU member states. Key EU legislation includes the Markets in Financial Instruments Directive ("MiFID"), which harmonizes the regulatory regime for investment services and activities across the EEA, the Insurance Directives, which harmonize the regulatory regime for, respectively, life (long term) and non-life (general) insurance and the Banking Consolidation Directive, which harmonizes the regulatory regime for credit institutions. The Capital Adequacy Directive ("CAD") contains capital requirements for MiFID firms. Under FSMA, effecting or carrying out contracts of insurance, within a class of general or long-term insurance, by way of business in the U.K., each constitute a "regulated activity" requiring authorization. An authorized insurance company must have permission for each class of insurance business it intends to write.

The PRA and the FCA were established on April 1, 2013 as part of the reform of financial regulation in the U.K. Immediately prior to that date, there was a single statutory regulator for financial services in the U.K., called the Financial Services Authority (“FSA U.K.”). The new regulatory framework was established by the U.K. Financial Services Act 2012. These two new regulatory bodies cover the following areas:

- the PRA, a subsidiary of the Bank of England, is responsible for prudential regulation of key systemically important firms (which includes insurance companies, among others), and
- the FCA is responsible for the prudential regulation of all non-PRA firms, the conduct of business regulation of all firms and the regulation of market conduct.

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These two new regulators inherited the majority of the FSA U.K.'s existing functions. While they co-ordinate and co-operate in some areas, they have separate and independent mandates and separate rule-making and enforcement powers. AGE and AGUK are regulated by both the PRA and the FCA.

The PRA carries out the prudential supervision of insurance companies through a variety of methods, including the collection of information from statistical returns, review of accountants' reports, visits to insurance companies and regular formal interviews. Like the FSA U.K. before it, the PRA has adopted a risk-based approach to the supervision of insurance companies.

The PRA's rules are intended to align capital requirements with the risk profile of each insurance company and ensure adequate diversification of an insurer's or reinsurer's exposures to any credit risks of its reinsurers. AGE has calculated its minimum required capital according to the PRA's individual capital adequacy criteria and is in compliance.

The PRA applies threshold conditions, which insurers must meet, and against which the PRA assesses them on a continuous basis. These conditions are that:

- an insurer's head office, and in particular its mind and management, must be in the United Kingdom if it is incorporated in the United Kingdom;

- an insurer's business must be conducted in a prudent manner — in particular the insurer must maintain appropriate financial and non-financial resources;

- the insurer must be fit and proper, and be appropriately staffed; and

- the insurer and its group must be capable of being effectively supervised.

The PRA supervises insurers to judge whether they are acting in a manner consistent with safety and soundness and appropriate policyholder protection, and so whether they meet, and are likely to continue to meet, the threshold conditions. It weights its supervision towards those issues and those insurers that, in its judgment, pose the greatest risk to its objectives. It is forward-looking, assessing its objectives not just against current risks, but also against those that could plausibly arise further ahead and will rely significantly on the judgment of its supervisors. Its risk assessment framework will look at the potential impact of failure of the insurer, its risk context and mitigating factors. Solvency II (discussed below) will bring further changes to the supervisory framework for insurers. The PRA believes its plans are consistent with Solvency II requirements.

### Position of U.K. Regulated Entities within the AGL Group

AGE is authorized to effect and carry out certain classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss) for commercial customers. This scope of permission is sufficient to enable AGE to effect and carry out financial guaranty insurance and reinsurance. The insurance and reinsurance businesses of AGE are subject to close supervision by the PRA. AGE also has permission to arrange and advise on transactions it guarantees, and to take deposits in the context of its insurance business.

Following the Company's decision in 2010 to place AGUK into run-off, the Company has been utilizing AGE as the entity from which to write business in the EEA. It was agreed between management and the then regulator, the FSA U.K., that any new business written by AGE would be guaranteed using a co-insurance structure pursuant to which AGE would co-insure municipal and infrastructure transactions with AGM, and structured finance transactions with AGC. AGE must obtain the approval of the PRA before it can guarantee any new structured finance transaction. AGE's financial guaranty will cover 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, will also issue a second-to-pay guaranty to cover AGE's financial guarantee. AGE also is the principal of AGCPL. AGCPL is not PRA or FCA authorized, but is an appointed representative of AGE. This means AGCPL can carry on advising and arranging activities without a license, because AGE has regulatory responsibility for it.

AGFOL, a subsidiary of AGL, is authorized by the FCA to carry out designated investment business activities in that it may “advise on investments (except on pension transfers and pension opt outs)” relating to most investment instruments. In addition, it may arrange or bring about transactions in investments and make “arrangements with a view to transactions in investments.” In all cases, it may deal only with clients who are eligible counterparties or professional customers (so no retail clients), or, when arranging in relation to insurance contracts, commercial customers. It should be noted that AGFOL is not authorized as an insurer and does not itself take risk in the transactions it arranges or

places, and may not hold funds on behalf

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of its customers. AGFOL's permissions also allow it to introduce business to AGC and AGM, so that AGFOL can arrange financial guaranties underwritten by AGC and AGM, even though AGFOL's role will be limited to acting as a pure introducer of business to AGC and AGM. AGFOL is an "Exempt CAD" firm: although it is a MiFID investment firm, it does not have to comply with the CAD. Its activities are limited to receiving and transmitting orders and giving investment advice and it cannot hold client money.

AGCPL is subject to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR") which, as a European regulation, is directly applicable in all the member states of the European Union. AGCPL has notified the European Securities and Markets Authority ("ESMA") and the FCA of its status under EMIR as a non-financial counterparty which has exceeded the clearing threshold (an "NFC+") as described in Article 10 of EMIR. As an NFC+, AGCPL is subject to certain requirements under EMIR with respect to its portfolio of derivative contracts including recordkeeping and risk mitigation techniques. Certain requirements have been applicable since March 15, 2013 (timely confirmations and daily valuations), while others have been applicable since September 15, 2013 (dispute resolution, portfolio reconciliation and portfolio compression requirements). In addition, AGCPL will be subject to certain reporting requirements under EMIR with respect to its outstanding portfolio of derivative contracts. Although the start date in respect of the reporting obligation was February 12, 2014, a ninety day grace period applies to the reporting of derivative contracts which were outstanding before August 16, 2012 and which were still outstanding on February 12, 2014. Because all of AGCPL's outstanding derivative contracts fall within this category, AGCPL will not be required to report its derivative contracts until mid-May 2014. AGCPL is the only European entity within the AGL group which has entered into derivative contracts and as such it is the only entity in the group which is directly subject to EMIR. The Company is aware that circumstances exist in which EMIR may apply directly to non-European entities when transacting derivatives, but has determined that these circumstances do not apply to the non-European entities in AGL's group.

### Solvency Requirements

The Prudential Sourcebooks require that non-life insurance companies such as AGUK and AGE maintain a margin of solvency at all times in respect of the liabilities of the insurance company, the calculation of which depends on the type and amount of insurance business a company writes. The method of calculation of the solvency margin (known as the minimum capital requirement) is set out in the Prudential Sourcebooks, and for these purposes, the insurer's assets and liabilities are subject to specified valuation rules. If and to the extent that the premiums it collects for specified categories of insurance, such as credit and property, exceed certain specified minimum thresholds, a non-life insurance company must have extra technical provisions, called an equalization reserve, in addition to its minimum capital requirements. The purpose of the equalization reserve, calculated in accordance with the Prudential Sourcebooks, is to ensure that insurers retain additional assets to provide some extra protection against uncertainty as to the amount of claims.

The Prudential Sourcebooks also require that AGUK and AGE calculate and share with the PRA their "enhanced capital requirement" based on risk-weightings applied to assets held and lines of business written. In 2007, the FSA U.K. replaced the individual capital assessment for financial guaranty insurers with a "benchmarker" capital adequacy model devised by the FSA U.K. Should the level of capital of AGUK or AGE fall below the capital requirement as indicated by the benchmarker, the PRA may require the Company 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 PRA 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 due to be implemented on January 1, 2016. The solvency requirements described above will be replaced at that point. Among other things, Solvency II introduces a revised risk-based prudential regime which includes the following features:

- assets and liabilities are generally to be valued at their market value;
- the amount of required economic capital is intended to ensure, with a probability of 99.5%, that regulated firms are able to meet their obligations to policyholders and beneficiaries over the following 12 months; and

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 a somewhat increased amount of capital to satisfy the new solvency capital requirements. AGE was accepted by the then regulator, the FSA U.K., into the pre-application process and has begun the process to apply for approval from the PRA for use of the “Partial Internal Model” methodology for calculation

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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. AGE remains in the pre-application process (now being run by the PRA); however, the formal application process has been delayed due to the delay in the implementation of Solvency II.

In anticipation of Solvency II, the PRA has issued a Supervisory Statement (“Solvency II: applying EIOPA's preparatory guidelines to PRA-authorized firms”, Supervisory Statement 4/13, dated December 12, 2013) requiring certain information to be submitted to it before the 2016 commencement date. AGE and AGUK are among the firms required to submit information to the PRA under this Supervisory Statement.

In addition, a U.K. insurer (which includes a company conducting only reinsurance business) is required to perform and submit to the PRA a group capital adequacy return in respect of its ultimate insurance parent. For groups with an EEA insurance parent, the calculation must show a positive result. AGE and AGUK do not have an EEA insurance parent and, accordingly, do not need to comply with this requirement. However, they do still need to report to the PRA on group capital adequacy at the level of the ultimate insurance parent outside the EEA and, if the report at that level raises concerns, the PRA may take regulatory action.

Further, an insurer is required to report in its annual returns to the PRA all material connected-party transactions (such as intra-group reinsurance whose value is more than the sum of Euro 20,000 and 5% of the insurer's liabilities arising from its general insurance business, net of reinsurance).

### Restrictions on Dividend Payments

U.K. company law prohibits each of AGE and AGUK from declaring a dividend to its shareholders unless it has “profits available for distribution.” The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the U.K. insurance regulatory laws impose no statutory restrictions on a general insurer's ability to declare a dividend, the PRA's capital requirements may in practice act as a restriction on dividends. The Company does not expect AGE or AGUK to distribute any dividends at this time.

### Reporting Requirements

U.K. insurance companies must prepare their financial statements under the Companies Act 2006, which requires the filing with Companies House of audited financial statements and related reports. In addition, U.K. insurance companies are required to file regulatory returns with the PRA, which include a revenue account, a profit and loss account and a balance sheet in prescribed forms. Under the Prudential Sourcebooks, audited regulatory returns must be filed with the PRA within two months and 15 days of the financial year end (or three months where the delivery of the return is made electronically). As noted above, AGE and AGUK also will submit information to the PRA pursuant to Supervisory Statement 4/13, in anticipation of Solvency II requirements.

### Supervision of Management

Individuals who perform one or more “controlled functions” such as significant influence functions or the customer function within authorized firms must be approved by PRA or FCA (as appropriate) to carry out that function. The management of insurance companies falls within the scope of significant influence functions, which require approval from the PRA. Individuals performing these functions are “Approved Persons” for the purpose of Part V of FSMA and staff performing these specified “controlled functions” within an authorized firm must be approved by the PRA.

### Change of Control

Under FSMA, when a person decides to acquire or increase “control” of a U.K. authorized firm (including an insurance company) they must give the PRA notice in writing before making the acquisition. The PRA has up to 60 working days (without including any period of interruption) in which to assess a change of control case. Any person (a company or individual) that directly or indirectly acquires 10% or 20% (depending on the type of firm, the “Control Percentage Threshold”) or more of the shares, or is entitled to exercise or control the exercise of the Control Percentage Threshold or more of the voting power, in a U.K. authorized firm or its parent undertaking is considered to “acquire control” of the authorized firm. Broadly speaking, the 10% threshold applies to banks, insurers and reinsurers (but not brokers) and MiFID investment firms, and the 20% threshold to insurance brokers and certain other firms that are non-directive firms.





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### Intervention and Enforcement

The PRA has extensive powers to intervene in the affairs of an authorized firm, culminating in the sanction of the suspension of authorization to carry on a regulated activity. The PRA can also vary or cancel a firm's permissions under its own initiative if it considers that the firm is failing, or is likely to fail, to satisfy the Threshold Conditions. FSMA gives the PRA significant investigation and enforcement powers. It also gives the PRA a rule-making power, under which it makes the various rules that constitute its Handbook of Rules.

The PRA also has the power to prosecute criminal offenses arising under FSMA, and the FCA has the power to prosecute offences under FSMA and to prosecute insider dealing under Part V of the Criminal Justice Act of 1993, and breaches by authorized firms of money laundering and terrorist financing regulations.

### “Passporting”

EU directives allow AGFOL, AGUK and AGE to conduct business in EU states other than the U.K. where they are authorized by the PRA or FCA under a single market directive. This right extends to the EEA. A firm taking advantage of a right under a single market directive to conduct business in another EEA state can rely on its "home state" authorization. This ability to operate in other jurisdictions of the EEA on the basis of home state authorization and supervision is sometimes referred to as “passporting.” Passporting is not applicable to firms not authorized in the EEA, such as AGM and AGC. Accordingly, the co-insurance model described above cannot be “passported” throughout the EEA. Instead, it is a question of local law in each EEA member state as to whether AGM's or AGC's participation in a co-insurance structure, protecting insureds or risks located in that jurisdiction, would amount to the conduct of insurance business in that jurisdiction.

### Fees and Levies

Each of AGUK, AGE and AGFOL is subject to regulatory fees and levies based on its gross premium income and gross technical liabilities. These fees are collected by the FCA (though they relate to regulation by both the PRA and the FCA). The PRA also requires authorized firms, including authorized insurers, to participate in an investors' protection fund, known as the Financial Services Compensation Scheme. The Financial Services Compensation Scheme was established to compensate consumers of financial services firms, including the buyers of insurance, against failures in the financial services industry. Eligible claimants (identified in the Compensation Sourcebook of the PRA Handbook) may be compensated by the Financial Services Compensation Scheme when an authorized insurer is unable, or likely to be unable, to satisfy policyholder claims. General insurance in class 14 (credit) is not protected by the Financial Services Compensation Scheme, nor is reinsurance in any class; however, other direct insurance classes written by AGUK and AGE are covered (namely, classes 15 (suretyship) and 16 (miscellaneous financial loss)).

### Material Contracts

AGE's New York affiliate, AGM, currently 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% 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. AGM's ability to provide such direct guarantees outside of the U.K. is uncertain. See "Passporting" above.

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 AGE's annual net earned premium plus any amounts deducted from AGE's equalization reserve during the year. The stop loss cover has an annual limit of liability equal to 20% 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% of the greatest of the amounts as may be required by the PRA as a condition for maintaining its authorization to carry on a financial

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guarantee business in the U.K., provided that contributions (a) do not exceed 35% 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 NY DFS 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.

AGE and AGM have pending a second amended and restated quota share and stop loss reinsurance agreement (the "Second A&R Reinsurance Agreement") and an second amended and restated net worth maintenance agreement (the "Second A&R Net Worth Agreement"). These agreements have been approved by the PRA, and Moody's and S&P have confirmed that their implementation will not adversely impact AGE's or AGM's ratings. The agreements are under review by the NY DFS, and implementation awaits NY DFS non-disapproval.

The quota share cover of the Second A&R Reinsurance Agreement is unchanged from that in the Reinsurance Agreement. The stop loss cover is replaced entirely by an excess of loss cover. Under the excess of loss cover, AGM will pay AGE quarterly the amount by which AGE's incurred losses calculated in accordance with UK GAAP as reported by AGE in its financial returns filed with the PRA and AGE's paid losses and loss adjustment expenses, in both cases net of all other performing reinsurance, exceed AGE's capital resources under UK law minus of the greatest of the amounts as may be required by the PRA as a condition for maintaining its authorization to carry on a financial guarantee business in the U.K. In addition, the Second A&R Reinsurance Agreement adds the following events permitting AGE to terminate to the existing termination event of a downgrade of AGM's ratings by Moody's below Aa3 or by S&P below AA-: AGM's insolvency, failure to maintain the minimum capital required under AGM's domiciliary jurisdiction, filing a petition in bankruptcy, going into liquidation or rehabilitation or having a receiver appointed. The agreement provides that no amounts are owing under the excess of loss cover or the stop loss cover under the Reinsurance Agreement with respect to any quarter ending prior to the effective date of the Second A&R Reinsurance Agreement.

AGM's obligation to pay under the Second A&R Net Worth Agreement is unchanged from that in the Net Worth Maintenance Agreement, except for the addition of a provision clarifying that any amounts due under this agreement shall take into account all amounts paid or reasonably expected to be paid under the Second A&R Reinsurance Agreement. In addition, termination provisions substantially similar to those in the Second A&R Reinsurance Agreement have been added.

## Tax Matters

### Taxation of AGL and Subsidiaries

#### Bermuda

Under current Bermuda law, there is no Bermuda income, corporate or profits tax or withholding tax, capital gains tax or capital transfer tax payable by AGL or its Bermuda subsidiaries. AGL, AG Re and AGRO have each obtained from the Minister of Finance under the Exempted Undertakings Tax Protection Act 1966, as amended, an assurance that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance, then the imposition of any such tax shall not be applicable to AGL, AG Re or AGRO or to any of their operations or their shares, debentures or other obligations, until March 31, 2035. This assurance is subject to the proviso that it is not to be construed so as to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda, or to prevent the application of any tax payable in accordance with the provisions of the Land Tax Act 1967 or otherwise payable in relation to any land leased to AGL, AG Re or AGRO. AGL, AG Re and AGRO each pays annual Bermuda government fees, and AG Re and AGRO pay annual insurance license fees. In addition, all entities employing individuals in Bermuda are required

to pay a payroll tax and there are other sundry taxes payable, directly or indirectly, to the Bermuda government.

United States

AGL has conducted and intends to continue to conduct substantially all of its foreign operations outside the U.S. and to limit the U.S. contacts of AGL and its foreign subsidiaries (except AGRO and AGE, which have elected to be taxed as U.S. corporations) so that they should not be engaged in a trade or business in the U.S. A foreign corporation, such as AG Re, that is deemed to be engaged in a trade or business in the United States would be subject to U.S. income tax at regular corporate rates, as well as the branch profits tax, on its income which is treated as effectively connected with the conduct of that trade or business, unless the corporation is entitled to relief under the permanent establishment provision of an applicable tax treaty, as discussed below. Such income tax, if imposed, would be based on effectively connected income computed in a manner generally analogous to that applied to the income of a U.S. corporation, except that a foreign corporation would generally be

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entitled to deductions and credits only if it timely files a U.S. federal income tax return. AGL, AG Re and certain of the other foreign subsidiaries have and will continue to file protective U.S. federal income tax returns on a timely basis in order to preserve the right to claim income tax deductions and credits if it is ever determined that they are subject to U.S. federal income tax. The highest marginal federal income tax rates currently are 35% for a corporation's effectively connected income and 30% for the "branch profits" tax.

Under the income tax treaty between the U.S. and the U.K. (the "U.K. Treaty"), AGL would not be subject to U.S. income tax on any income found to be effectively connected with a U.S. trade or business unless that trade or business is conducted through a permanent establishment in the United States. AGL intends to conduct its activities so that it does not have a permanent establishment in the United States. It is AGL's opinion that it will qualify for the benefits of the U.K. Treaty.

Under the income tax treaty between Bermuda and the U.S. (the "Bermuda Treaty"), a Bermuda insurance company would not be subject to U.S. income tax on income found to be effectively connected with a U.S. trade or business unless that trade or business is conducted through a permanent establishment in the U.S. AG Re and AGRO currently intend to conduct their activities so that they do not have a permanent establishment in the U.S.

An insurance enterprise resident in Bermuda generally will be entitled to the benefits of the Bermuda Treaty if (i) more than 50% of its shares are owned beneficially, directly or indirectly, by individual residents of the U.S. or Bermuda or U.S. citizens and (ii) its income is not used in substantial part, directly or indirectly, to make disproportionate distributions to, or to meet certain liabilities of, persons who are neither residents of either the U.S. or Bermuda nor U.S. citizens.

Foreign insurance companies carrying on an insurance business within the U.S. have a certain minimum amount of effectively connected net investment income, determined in accordance with a formula that depends, in part, on the amount of U.S. risk insured or reinsured by such companies. If AG Re or another of the Company's Bermuda subsidiaries is considered to be engaged in the conduct of an insurance business in the U.S. and is not entitled to the benefits of the Bermuda Treaty in general (because it fails to satisfy one of the limitations on treaty benefits discussed above), the Internal Revenue Code of 1986, as amended (the "Code"), could subject a significant portion of AG Re's or another of the Company's Bermuda subsidiary's investment income to U.S. income tax.

Foreign corporations not engaged in a trade or business in the U.S., and those that are engaged in a U.S. trade or business with respect to their non-effectively connected income are nonetheless subject to U.S. withholding tax on certain "fixed or determinable annual or periodic gains, profits and income" derived from sources within the U.S. (such as dividends and certain interest on investments), subject to exemption under the Code or reduction by applicable treaties. The standard non-treaty rate of U.S. withholding tax is currently 30%. The Bermuda Treaty does not reduce the U.S. withholding rate on U.S.-sourced investment income. The U.K. Treaty reduces or eliminates U.S. withholding tax on certain U.S. sourced investment income (to 5% or 0%), including dividends from U.S. companies to U.K. resident persons entitled to the benefit of the U.K. Treaty.

The U.S. also imposes an excise tax on insurance and reinsurance premiums paid to foreign insurers with respect to risk of a U.S. person located wholly or partly within the U.S. or risks of a foreign person engaged in a trade or business in the U.S. which are located within the U.S. The rates of tax applicable to premiums paid are 4% for direct casualty insurance premiums and 1% for reinsurance premiums.

AGRO and AGE have elected to be treated as U.S. corporations for all U.S. federal tax purposes and, as such, each of AGRO and AGE, together with AGL's U.S. subsidiaries, is subject to taxation in the U.S. at regular corporate rates.

If AGRO were to pay dividends to its U.S. holding company parent and that U.S. holding company were to pay dividends to its Bermudian parent AG Re, such dividends would be subject to U.S. withholding tax at a rate of 30%.

None of AGL or its principal subsidiaries will be subject to any additional U.S. taxes, including withholding tax, as a result of AGL becoming a U.K. tax resident.

#### United Kingdom

In November 2013, AGL became tax resident in the U.K. AGL will remain a Bermuda-based company and its administrative and head office functions will continue to be carried on in Bermuda. The AGL common shares will not change and will continue to be listed on the New York Stock Exchange.

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As a company that is not incorporated in the U.K., AGL will be considered tax resident in the U.K. only if it is “centrally managed and controlled” in the U.K. Central management and control constitutes the highest level of control of a company’s affairs. Effective November 6, 2013, the AGL board of directors currently intends to manage the affairs of AGL in such a way as to establish and maintain its status as a company that is tax resident in the U.K.

As a U.K. tax resident company, AGL is subject to the tax rules applicable to companies resident in the U.K., including the benefits afforded by the U.K.’s tax treaties.

As a U.K. tax resident, AGL is required to file a corporation tax return with Her Majesty’s Revenue & Customs (“HMRC”). AGL will be subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to any applicable exemptions. The main rate of corporation tax is 23% currently; such rate will fall to 21% as of April 1, 2014 and to 20% as of April 1, 2015. AGL has also registered in the U.K. to report its value added tax (“VAT”) liability. The current rate of VAT is 20%.

Assured Guaranty does not expect that becoming U.K. tax resident will result in any material change in the group’s overall current tax charge. Assured Guaranty expects that the dividends AGL receives from its direct subsidiaries will be exempt from U.K. corporation tax due to the exemption in section 931D of the U.K. Corporation Tax Act 2009. In addition, any dividends paid by AGL to its shareholders should not be subject to any withholding tax in the U.K. The U.K. government implemented a new tax regime for “controlled foreign companies” (“CFC regime”) effective January 1, 2013, stating an intention to target more accurately profits that should be subject to U.K. taxation and to improve the attractiveness of the U.K. as a location for a holding company of a multinational group. The non-U.K. resident subsidiaries intend to operate in such a manner that their profits are outside the scope of the CFC regime charge. Accordingly, Assured Guaranty does not expect any profits of non-U.K. resident members of the group to be attributed to AGL and taxed in the U.K. under the CFC regime and has obtained clearance from HMRC confirming this on the basis of current facts and intentions.

## Taxation of Shareholders

### Bermuda Taxation

Currently, there is no Bermuda capital gains tax, or withholding or other tax payable on principal, interest or dividends paid to the holders of the AGL common shares.

### United States Taxation

This discussion is based upon the Code, the regulations promulgated thereunder and any relevant administrative rulings or pronouncements or judicial decisions, all as in effect on the date hereof and as currently interpreted, and does not take into account possible changes in such tax laws or interpretations thereof, which may apply retroactively. This discussion does not include any description of the tax laws of any state or local governments within the U.S. or any foreign government.

The following summary sets forth the material U.S. federal income tax considerations related to the purchase, ownership and disposition of AGL’s shares. Unless otherwise stated, this summary deals only with holders that are U.S. Persons (as defined below) who purchase their shares and who hold their shares as capital assets within the meaning of section 1221 of the Code. The following discussion is only a discussion of the material U.S. federal income tax matters as described herein and does not purport to address all of the U.S. federal income tax consequences that may be relevant to a particular shareholder in light of such shareholder’s specific circumstances. For example, special rules apply to certain shareholders, such as partnerships, insurance companies, regulated investment companies, real estate investment trusts, financial asset securitization investment trusts, dealers or traders in securities,

tax exempt organizations, expatriates, persons that do not hold their securities in the U.S. dollar, persons who are considered with respect to AGL or any of its foreign subsidiaries as "United States shareholders" for purposes of the controlled foreign corporation ("CFC") rules of the Code (generally, a U.S. Person, as defined below, who owns or is deemed to own 10% or more of the total combined voting power of all classes of AGL or the stock of any of AGL's foreign subsidiaries entitled to vote (i.e., 10% U.S. Shareholders)), or persons who hold the common shares as part of a hedging or conversion transaction or as part of a short-sale or straddle. Any such shareholder should consult their tax advisor.

If a partnership holds AGL's shares, the tax treatment of the partners will generally depend on the status of the partner and the activities of the partnership. Partners of a partnership owning AGL's shares should consult their tax advisers.

For purposes of this discussion, the term "U.S. Person" means: (i) a citizen or resident of the U.S., (ii) a partnership or corporation, created or organized in or under the laws of the U.S., or organized under any political subdivision thereof, (iii) an



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estate the income of which is subject to U.S. federal income taxation regardless of its source, (iv) a trust if either (x) a court within the U.S. is able to exercise primary supervision over the administration of such trust and one or more U.S. Persons have the authority to control all substantial decisions of such trust or (y) the trust has a valid election in effect to be treated as a U.S. Person for U.S. federal income tax purposes or (v) any other person or entity that is treated for U.S. federal income tax purposes as if it were one of the foregoing.

**Taxation of Distributions.** Subject to the discussions below relating to the potential application of the CFC, related person insurance income ("RPII") and passive foreign investment company ("PFIC") rules, cash distributions, if any, made with respect to AGL's shares will constitute dividends for U.S. federal income tax purposes to the extent paid out of current or accumulated earnings and profits of AGL (as computed using U.S. tax principles). Dividends paid by AGL to corporate shareholders will not be eligible for the dividends received deduction. To the extent such distributions exceed AGL's earnings and profits, they will be treated first as a return of the shareholder's basis in the common shares to the extent thereof, and then as gain from the sale of a capital asset.

AGL believes dividends paid by AGL on its common shares to non-corporate holders will be eligible for reduced rates of tax at the rates applicable to long-term capital gains as "qualified dividend income," provided that AGL is not a PFIC and certain other requirements, including stock holding period requirements, are satisfied.

**Classification of AGL or its Foreign Subsidiaries as a Controlled Foreign Corporation.** Each 10% U.S. Shareholder (as defined below) of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during a taxable year, and who owns shares in the foreign corporation, directly or indirectly through foreign entities, on the last day of the foreign corporation's taxable year on which it is CFC, must include in its gross income for U.S. federal income tax purposes its pro rata share of the CFC's "subpart F income," even if the subpart F income is not distributed. "Subpart F income" of a foreign insurance corporation typically includes foreign personal holding company income (such as interest, dividends and other types of passive income), as well as insurance and reinsurance income (including underwriting and investment income). A foreign corporation is considered a CFC if 10% U.S. Shareholders own (directly, indirectly through foreign entities or by attribution by application of the constructive ownership rules of section 958(b) of the Code (i.e., "constructively")) more than 50% of the total combined voting power of all classes of voting stock of such foreign corporation, or more than 50% of the total value of all stock of such corporation on any day during the taxable year of such corporation. For purposes of taking into account insurance income, a CFC also includes a foreign insurance company in which more than 25% of the total combined voting power of all classes of stock (or more than 25% of the total value of the stock) is owned by 10% U.S. Shareholders, on any day during the taxable year of such corporation. A "10% U.S. Shareholder" is a U.S. Person who owns (directly, indirectly through foreign entities or constructively) at least 10% of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. AGL believes that because of the dispersion of AGL's share ownership, provisions in AGL's organizational documents that limit voting power (these provisions are described in "Description of Share Capital") and other factors, no U.S. Person who owns shares of AGL directly or indirectly through one or more foreign entities should be treated as owning (directly, indirectly through foreign entities, or constructively), 10% or more of the total voting power of all classes of shares of AGL or any of its foreign subsidiaries. It is possible, however, that the Internal Revenue Service ("IRS") could challenge the effectiveness of these provisions and that a court could sustain such a challenge. In addition, the direct and indirect subsidiaries of AGUS are characterized as CFCs and any subpart F income generated will be included in the gross income of the applicable domestic subsidiaries in the AGL group.

**The RPII CFC Provisions.** The following discussion generally is applicable only if the RPII of AG Re or any other foreign insurance subsidiary that has not made an election under section 953(d) of the Code to be treated as a U.S. corporation for all U.S. federal tax purposes or are CFCs owned directly or indirectly by AGUS (each a "Foreign Insurance Subsidiary" or collectively, with AG Re, the "Foreign Insurance Subsidiaries") determined on a gross basis, is 20% or more of the Foreign Insurance Subsidiary's gross insurance income for the taxable year and the 20%

Ownership Exception (as defined below) is not met. The following discussion generally would not apply for any taxable year in which the Foreign Insurance Subsidiary's gross RPII falls below the 20% threshold or the 20% Ownership Exception is met. Although the Company cannot be certain, it believes that each Foreign Insurance Subsidiary has been, in prior years of operations, and will be, for the foreseeable future, either below the 20% threshold or in compliance with the requirements of 20% Ownership Exception for each tax year.

RPII is any "insurance income" (as defined below) attributable to policies of insurance or reinsurance with respect to which the person (directly or indirectly) insured is a "RPII shareholder" (as defined below) or a "related person" (as defined below) to such RPII shareholder. In general, and subject to certain limitations, "insurance income" is income (including premium and investment income) attributable to the issuing of any insurance or reinsurance contract which would be taxed under the portions of the Code relating to insurance companies if the income were the income of a domestic insurance company. For purposes of inclusion of the RPII of a Foreign Insurance Subsidiary in the income of RPII shareholders, unless an exception applies, the term "RPII shareholder" means any U.S. Person who owns (directly or indirectly through foreign

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entities) any amount of AGL's common shares. Generally, the term "related person" for this purpose means someone who controls or is controlled by the RPII shareholder or someone who is controlled by the same person or persons which control the RPII shareholder. Control is measured by either more than 50% in value or more than 50% in voting power of stock applying certain constructive ownership principles. A Foreign Insurance Subsidiary will be treated as a CFC under the RPII provisions if RPII shareholders are treated as owning (directly, indirectly through foreign entities or constructively) 25% or more of the shares of AGL by vote or value.

**RPII Exceptions.** The special RPII rules do not apply if (i) at all times during the taxable year less than 20% of the voting power and less than 20% of the value of the stock of AGL (the "20% Ownership Exception") is owned (directly or indirectly through entities) by persons who are (directly or indirectly) insured under any policy of insurance or reinsurance issued by a Foreign Insurance Subsidiary or related persons to any such person, (ii) RPII, determined on a gross basis, is less than 20% of a Foreign Insurance Subsidiary's gross insurance income for the taxable year (the "20% Gross Income Exception"), (iii) a Foreign Insurance Subsidiary elects to be taxed on its RPII as if the RPII were effectively connected with the conduct of a U.S. trade or business, and to waive all treaty benefits with respect to RPII and meet certain other requirements or (iv) a Foreign Insurance Subsidiary elects to be treated as a U.S. corporation and waive all treaty benefits and meet certain other requirements. The Foreign Insurance Subsidiaries do not intend to make either of these elections. Where none of these exceptions applies, each U.S. Person owning or treated as owning any shares in AGL (and therefore, indirectly, in a Foreign Insurance Subsidiary) on the last day of AGL's taxable year will be required to include in its gross income for U.S. federal income tax purposes its share of the RPII for the portion of the taxable year during which a Foreign Insurance Subsidiary was a CFC under the RPII provisions, determined as if all such RPII were distributed proportionately only to such U.S. Persons at that date, but limited by each such U.S. Person's share of a Foreign Insurance Subsidiary's current-year earnings and profits as reduced by the U.S. Person's share, if any, of certain prior-year deficits in earnings and profits. The Foreign Insurance Subsidiaries intend to operate in a manner that is intended to ensure that each qualifies for either the 20% Gross Income Exception or 20% Ownership Exception.

**Computation of RPII.** For any year in which a Foreign Insurance Subsidiary does not meet the 20% Ownership Exception or the 20% Gross Income Exception, AGL may also seek information from its shareholders as to whether beneficial owners of shares at the end of the year are U.S. Persons so that the RPII may be determined and apportioned among such persons; to the extent AGL is unable to determine whether a beneficial owner of shares is a U.S. Person, AGL may assume that such owner is not a U.S. Person, thereby increasing the per share RPII amount for all known RPII shareholders. The amount of RPII includable in the income of a RPII shareholder is based upon the net RPII income for the year after deducting related expenses such as losses, loss reserves and operating expenses. If a Foreign Insurance Subsidiary meets the 20% Ownership Exception or the 20% Gross Income Exception, RPII shareholders will not be required to include RPII in their taxable income.

**Apportionment of RPII to U.S. Holders.** Every RPII shareholder who owns shares on the last day of any taxable year of AGL in which a Foreign Insurance Subsidiary does not meet the 20% Ownership Exception or the 20% Gross Income Exception should expect that for such year it will be required to include in gross income its share of a Foreign Insurance Subsidiary's RPII for the portion of the taxable year during which the Foreign Insurance Subsidiary was a CFC under the RPII provisions, whether or not distributed, even though it may not have owned the shares throughout such period. A RPII shareholder who owns shares during such taxable year but not on the last day of the taxable year is not required to include in gross income any part of the Foreign Insurance Subsidiary's RPII.

**Basis Adjustments.** An RPII shareholder's tax basis in its common shares will be increased by the amount of any RPII the shareholder includes in income. The RPII shareholder may exclude from income the amount of any distributions by AGL out of previously taxed RPII income. The RPII shareholder's tax basis in its common shares will be reduced by the amount of such distributions that are excluded from income.

Uncertainty as to Application of RPII. The RPII provisions are complex and have never been interpreted by the courts or the Treasury Department in final regulations; regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any such changes, as well as any interpretation or application of RPII by the IRS, the courts or otherwise, might have retroactive effect. These provisions include the grant of authority to the Treasury Department to prescribe "such regulations as may be necessary to carry out the purpose of this subsection including regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise." Accordingly, the meaning of the RPII provisions and the application thereof to the Foreign Insurance Subsidiaries is uncertain. In addition, the Company cannot be certain that the amount of RPII or the amounts of the RPII inclusions for any particular RPII shareholder, if any, will not be subject to adjustment based upon subsequent IRS examination. Any prospective investor which does business with a Foreign Insurance Subsidiary and is considering an investment in common shares should consult his tax advisor as to the effects of these uncertainties.

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**Information Reporting.** Under certain circumstances, U.S. Persons owning shares (directly, indirectly or constructively) in a foreign corporation are required to file IRS Form 5471 with their U.S. federal income tax returns. Generally, information reporting on IRS Form 5471 is required by (i) a person who is treated as a RPII shareholder, (ii) a 10% U.S. Shareholder of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during any tax year of the foreign corporation and who owned the stock on the last day of that year; and (iii) under certain circumstances, a U.S. Person who acquires stock in a foreign corporation and as a result thereof owns 10% or more of the voting power or value of such foreign corporation, whether or not such foreign corporation is a CFC. For any taxable year in which AGL determines that the 20% Gross Income Exception and the 20% Ownership Exception does not apply, AGL will provide to all U.S. Persons registered as shareholders of its shares a completed IRS Form 5471 or the relevant information necessary to complete the form. Failure to file IRS Form 5471 may result in penalties. In addition, U.S. shareholders should consult their tax advisors with respect to other information reporting requirements that may be applicable to them.

For taxable years beginning after March 18, 2010, the Code requires that any individual owning an interest in "specified foreign financial assets," including an interest in a foreign entity (such as AGL) that is not held in an account maintained by a financial institution, the value of which in the aggregate exceeds certain thresholds, attach IRS Form 8938 to his or her tax return for the year that provides detailed disclosure of such assets. Penalties may be assessed for failure to comply. Future guidance is expected to provide that certain domestic entities would also be subject to this reporting requirement in the future.

**Tax-Exempt Shareholders.** Tax-exempt entities will be required to treat certain subpart F insurance income, including RPII, that is includible in income by the tax-exempt entity as unrelated business taxable income. Prospective investors that are tax exempt entities are urged to consult their tax advisors as to the potential impact of the unrelated business taxable income provisions of the Code. A tax-exempt organization that is treated as a 10% U.S. Shareholder or a RPII Shareholder also must file IRS Form 5471 in certain circumstances.

**Dispositions of AGL's Shares.** Subject to the discussions below relating to the potential application of the Code section 1248 and PFIC rules, holders of shares generally should recognize capital gain or loss for U.S. federal income tax purposes on the sale, exchange or other disposition of shares in the same manner as on the sale, exchange or other disposition of any other shares held as capital assets. If the holding period for these shares exceeds one year, any gain will be subject to tax at a current maximum marginal tax rate of 20% for individuals and 35% for corporations. Moreover, gain, if any, generally will be a U.S. source gain and generally will constitute "passive income" for foreign tax credit limitation purposes.

Code section 1248 provides that if a U.S. Person sells or exchanges stock in a foreign corporation and such person owned, directly, indirectly through foreign entities or constructively, 10% or more of the voting power of the corporation at any time during the five-year period ending on the date of disposition when the corporation was a CFC, any gain from the sale or exchange of the shares will be treated as a dividend to the extent of the CFC's earnings and profits (determined under U.S. federal income tax principles) during the period that the shareholder held the shares and while the corporation was a CFC (with certain adjustments). The Company believes that because of the dispersion of AGL's share ownership, provisions in AGL's organizational documents that limit voting power and other factors that no U.S. shareholder of AGL should be treated as owning (directly, indirectly through foreign entities or constructively) 10% or more of the total voting power of AGL; to the extent this is the case this application of Code Section 1248 under the regular CFC rules should not apply to dispositions of AGL's shares. It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge. A 10% U.S. Shareholder may in certain circumstances be required to report a disposition of shares of a CFC by attaching IRS Form 5471 to the U.S. federal income tax or information return that it would normally file for the taxable year in which the disposition occurs. In the event this is determined necessary, AGL will provide a completed IRS Form 5471

or the relevant information necessary to complete the Form. Code section 1248 in conjunction with the RPII rules also applies to the sale or exchange of shares in a foreign corporation if the foreign corporation would be treated as a CFC for RPII purposes regardless of whether the shareholder is a 10% U.S. Shareholder or whether the 20% Ownership Exception or 20% Gross Income Exception applies. Existing proposed regulations do not address whether Code section 1248 would apply if a foreign corporation is not a CFC but the foreign corporation has a subsidiary that is a CFC and that would be taxed as an insurance company if it were a domestic corporation. The Company believes, however, that this application of Code section 1248 under the RPII rules should not apply to dispositions of AGL's shares because AGL will not be directly engaged in the insurance business. The Company cannot be certain, however, that the IRS will not interpret the proposed regulations in a contrary manner or that the Treasury Department will not amend the proposed regulations to provide that these rules will apply to dispositions of common shares. Prospective investors should consult their tax advisors regarding the effects of these rules on a disposition of common shares.

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U.S. shareholders of AGL will not be subject to any additional U.S. taxes, including withholding tax, as a result of AGL becoming U.K. tax resident.

**Passive Foreign Investment Companies.** In general, a foreign corporation will be a PFIC during a given year if (i) 75% or more of its gross income constitutes "passive income" (the "75% test") or (ii) 50% or more of its assets produce passive income (the "50% test").

If AGL were characterized as a PFIC during a given year, each U.S. Person holding AGL's shares would be subject to a penalty tax at the time of the sale at a gain of, or receipt of an "excess distribution" with respect to, their shares, unless such person (i) is a 10% U.S. Shareholder and AGL is a CFC or (ii) made a "qualified electing fund election" or "mark-to-market" election. It is uncertain that AGL would be able to provide its shareholders with the information necessary for a U.S. Person to make a qualified electing fund election. In addition, if AGL were considered a PFIC, upon the death of any U.S. individual owning common shares, such individual's heirs or estate would not be entitled to a "step-up" in the basis of the common shares that might otherwise be available under U.S. federal income tax laws. In general, a shareholder receives an "excess distribution" if the amount of the distribution is more than 125% of the average distribution with respect to the common shares during the three preceding taxable years (or shorter period during which the taxpayer held common shares). In general, the penalty tax is equivalent to an interest charge on taxes that are deemed due during the period the shareholder owned the common shares, computed by assuming that the excess distribution or gain (in the case of a sale) with respect to the common shares was taken in equal portion at the highest applicable tax rate on ordinary income throughout the shareholder's period of ownership. The interest charge is equal to the applicable rate imposed on underpayments of U.S. federal income tax for such period. In addition, a distribution paid by AGL to U.S. shareholders that is characterized as a dividend and is not characterized as an excess distribution would not be eligible for reduced rates of tax as qualified dividend income.

For the above purposes, passive income generally includes interest, dividends, annuities and other investment income. The PFIC rules provide that income "derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business... is not treated as passive income." The PFIC provisions also contain a look-through rule under which a foreign corporation shall be treated as if it "received directly its proportionate share of the income..." and as if it "held its proportionate share of the assets..." of any other corporation in which it owns at least 25% of the value of the stock.

The insurance income exception is intended to ensure that income derived by a bona fide insurance company is not treated as passive income, except to the extent such income is attributable to financial reserves in excess of the reasonable needs of the insurance business. The Company expects, for purposes of the PFIC rules, that each of AGL's insurance subsidiaries will be predominantly engaged in an insurance business and is unlikely to have financial reserves in excess of the reasonable needs of its insurance business in each year of operations. Accordingly, none of the income or assets of AGL's insurance subsidiaries should be treated as passive. Additionally, the Company expects that in each year of operations the passive income and assets of AGL's non-insurance subsidiaries will not exceed the 75% test or 50% test amounts in each year of operations with respect to the overall income and assets of AGL and its subsidiaries. Under the look-through rule AGL should be deemed to own its proportionate share of the assets and to have received its proportionate share of the income of its direct and indirect subsidiaries for purposes of the 75% test and the 50% test. As a result, the Company believes that AGL was not and should not be treated as a PFIC. The Company cannot be certain, however, as there are currently no regulations regarding the application of the PFIC provisions to an insurance company and new regulations or pronouncements interpreting or clarifying these rules may be forthcoming, that the IRS will not successfully challenge this position. Prospective investors should consult their tax advisor as to the effects of the PFIC rules.

**Foreign tax credit.** If U.S. Persons own a majority of AGL's common shares, only a portion of the current income inclusions, if any, under the CFC, RPII and PFIC rules and of dividends paid by AGL (including any gain from the

sale of common shares that is treated as a dividend under section 1248 of the Code) will be treated as foreign source income for purposes of computing a shareholder's U.S. foreign tax credit limitations. The Company will consider providing shareholders with information regarding the portion of such amounts constituting foreign source income to the extent such information is reasonably available. It is also likely that substantially all of the "subpart F income," RPII and dividends that are foreign source income will constitute either "passive" or "general" income. Thus, it may not be possible for most shareholders to utilize excess foreign tax credits to reduce U.S. tax on such income.

Information Reporting and Backup Withholding on Distributions and Disposition Proceeds. Information returns may be filed with the IRS in connection with distributions on AGL's common shares and the proceeds from a sale or other disposition of AGL's common shares unless the holder of AGL's common shares establishes an exemption from the information reporting rules. A holder of common shares that does not establish such an exemption may be subject to U.S. backup withholding tax on these payments if the holder is not a corporation or non-U.S. Person or fails to provide its taxpayer



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identification number or otherwise comply with the backup withholding rules. The amount of any backup withholding from a payment to a U.S. Person will be allowed as a credit against the U.S. Person's U.S. federal income tax liability and may entitle the U.S. Person to a refund, provided that the required information is furnished to the IRS.

**Changes in U.S. Federal Income Tax Law Could Materially Adversely Affect AGL or AGL's Shareholders.** Legislation has been introduced from time to time in the U.S. Congress intended to eliminate certain perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the U.S. but have certain U.S. connections. For example, legislation has been introduced in Congress to limit the deductibility of reinsurance premiums paid by U.S. companies to foreign affiliates. It is possible that this or similar legislation could be introduced in and enacted by the current Congress or future Congresses that could have an adverse impact on AGL or AGL's shareholders.

Additionally, tax laws and interpretations regarding whether a company is engaged in a U.S. trade or business or whether a company is a CFC or a PFIC or has RPII are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the PFIC rules to an insurance company. Additionally, the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. The Company cannot be certain if, when or in what form such regulations or pronouncements may be provided and whether such guidance will have a retroactive effect.

## United Kingdom

The following discussion is intended to be only a general guide to certain U.K. tax consequences of holding AGL common shares, under current law and the current practice of HMRC, either of which is subject to change at any time, possibly with retrospective effect. Except where otherwise stated, this discussion applies only to shareholders who are not (and have not recently been) resident or (in the case of individuals) domiciled for tax purposes in the U.K., who hold their AGL common shares as an investment and who are the absolute beneficial owners of their common shares. This discussion may not apply to certain shareholders, such as dealers in securities, life insurance companies, collective investment schemes, shareholders who are exempt from tax and shareholders who have (or are deemed to have) acquired their shares by virtue of an office or employment. Such shareholders may be subject to special rules.

The following statements do not purport to be a comprehensive description of all the U.K. considerations that may be relevant to any particular shareholder. Any person who is in any doubt as to their tax position should consult an appropriate professional tax adviser.

**AGL's Tax Residency.** AGL is not incorporated in the U.K., but effective November 6, 2013, the AGL Board of Directors currently intends to manage the affairs of AGL in such a way as to establish and maintain its status as a company that is tax resident in the U.K.

**Dividends.** Under current U.K. tax law, AGL is not required to withhold tax at source from dividends paid to the holders of the AGL common shares.

**Capital gains.** U.K. tax is not normally charged on any capital gains realized by non-U.K. shareholders in AGL unless, in the case of a corporate shareholder, at or before the time the gain accrues, the shareholding is used in or for the purposes of a trade carried on by the non-resident shareholder through a permanent establishment in the U.K. or for the purposes of that permanent establishment. Similarly, an individual shareholder who carries on a trade, profession or vocation in the U.K. through a branch or agency may be liable for U.K. tax on the gain if such shareholder disposes of shares that are, or have been, used, held or acquired for the purposes of such trade, profession or vocation or for the purposes of such branch or agency. This treatment applies regardless of the U.K. tax residence status of AGL.

Stamp Taxes. On the basis that AGL does not currently intend to maintain a share register in the U.K., there should be no U.K. stamp duty reserve tax on a purchase of common shares in AGL. A conveyance or transfer on sale of common shares in AGL will not be subject to U.K. stamp duty provided that the instrument of transfer is not executed in the U.K. and does not relate to any property situate, or any matter or thing done, or to be done, in the U.K.

#### Description of Share Capital

The following summary of AGL's share capital is qualified in its entirety by the provisions of Bermuda law, AGL's memorandum of association and its Bye-Laws, copies of which are incorporated by reference as exhibits to this Annual Report on Form 10-K.

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AGL's authorized share capital of \$5,000,000 is divided into 500,000,000 shares, par value U.S. \$0.01 per share, of which 182,306,886 common shares were issued and outstanding as of February 21, 2014. Except as described below, AGL's common shares have no pre-emptive rights or other rights to subscribe for additional common shares, no rights of redemption, conversion or exchange and no sinking fund rights. In the event of liquidation, dissolution or winding-up, the holders of AGL's common shares are entitled to share equally, in proportion to the number of common shares held by such holder, in AGL's assets, if any remain after the payment of all AGL's debts and liabilities and the liquidation preference of any outstanding preferred shares. Under certain circumstances, AGL has the right to purchase all or a portion of the shares held by a shareholder. See "—Acquisition of Common Shares by AGL" below.

## Voting Rights and Adjustments

In general, and except as provided below, shareholders have one vote for each common share held by them and are entitled to vote with respect to their fully paid shares at all meetings of shareholders. However, if, and so long as, the common shares (and other of AGL's shares) of a shareholder are treated as "controlled shares" (as determined pursuant to section 958 of the Code) of any U.S. Person and such controlled shares constitute 9.5% or more of the votes conferred by AGL's issued and outstanding shares, the voting rights with respect to the controlled shares owned by such U.S. Person shall be limited, in the aggregate, to a voting power of less than 9.5% of the voting power of all issued and outstanding shares, under a formula specified in AGL's Bye-laws. The formula is applied repeatedly until there is no U.S. Person whose controlled shares constitute 9.5% or more of the voting power of all issued and outstanding shares and who generally would be required to recognize income with respect to AGL under the Code if AGL were a controlled foreign corporation as defined in the Code and if the ownership threshold under the Code were 9.5% (as defined in AGL's Bye-Laws as a "9.5% U.S. Shareholder"). In addition, AGL's Board of Directors may determine that shares held carry different voting rights when it deems it appropriate to do so to (i) avoid the existence of any 9.5% U.S. Shareholder; and (ii) avoid adverse tax, legal or regulatory consequences to AGL or any of its subsidiaries or any direct or indirect holder of shares or its affiliates. "Controlled shares" includes, among other things, all shares of AGL that such U.S. Person is deemed to own directly, indirectly or constructively (within the meaning of section 958 of the Code). Further, these provisions do not apply in the event one shareholder owns greater than 75% of the voting power of all issued and outstanding shares.

Under these provisions, certain shareholders may have their voting rights limited to less than one vote per share, while other shareholders may have voting rights in excess of one vote per share. Moreover, these provisions could have the effect of reducing the votes of certain shareholders who would not otherwise be subject to the 9.5% limitation by virtue of their direct share ownership. AGL's Bye-laws provide that it will use its best efforts to notify shareholders of their voting interests prior to any vote to be taken by them.

AGL's Board of Directors is authorized to require any shareholder to provide information for purposes of determining whether any holder's voting rights are to be adjusted, which may be information on beneficial share ownership, the names of persons having beneficial ownership of the shareholder's shares, relationships with other shareholders or any other facts AGL's Board of Directors may deem relevant. If any holder fails to respond to this request or submits incomplete or inaccurate information, AGL's Board of Directors may eliminate the shareholder's voting rights. All information provided by the shareholder will be treated by AGL as confidential information and shall be used by AGL solely for the purpose of establishing whether any 9.5% U.S. Shareholder exists and applying the adjustments to voting power (except as otherwise required by applicable law or regulation).

## Restrictions on Transfer of Common Shares

AGL's Board of Directors may decline to register a transfer of any common shares under certain circumstances, including if they have reason to believe that any adverse tax, regulatory or legal consequences to the Company, any of its subsidiaries or any of its shareholders or indirect holders of shares or its Affiliates may occur as a result of such

transfer (other than such as AGL's Board of Directors considers de minimis). Transfers must be by instrument unless otherwise permitted by the Companies Act.

The restrictions on transfer and voting restrictions described above may have the effect of delaying, deferring or preventing a change in control of Assured Guaranty.

#### Acquisition of Common Shares by AGL

Under AGL's Bye-Laws and subject to Bermuda law, if AGL's Board of Directors determines that any ownership of AGL's shares may result in adverse tax, legal or regulatory consequences to AGL, any of AGL's subsidiaries or any of AGL's shareholders or indirect holders of shares or its Affiliates (other than such as AGL's Board of Directors considers de minimis),

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AGL has the option, but not the obligation, to require such shareholder to sell to AGL or to a third party to whom AGL assigns the repurchase right the minimum number of common shares necessary to avoid or cure any such adverse consequences at a price determined in the discretion of the Board of Directors to represent the shares' fair market value (as defined in AGL's Bye-Laws).

### Other Provisions of AGL's Bye-Laws

#### AGL's Board of Directors and Corporate Action

AGL's Bye-Laws provide that AGL's Board of Directors shall consist of not less than three and not more than 21 directors, the exact number as determined by the Board of Directors. AGL's Board of Directors consists of eleven persons who are elected for annual terms.

Shareholders may only remove a director for cause (as defined in AGL's Bye-Laws) at a general meeting, provided that the notice of any such meeting convened for the purpose of removing a director shall contain a statement of the intention to do so and shall be provided to that director at least two weeks before the meeting. Vacancies on the Board of Directors can be filled by the Board of Directors if the vacancy occurs in those events set out in AGL's Bye-Laws as a result of death, disability, disqualification or resignation of a director, or from an increase in the size of the Board of Directors.

Generally under AGL's Bye-Laws, the affirmative votes of a majority of the votes cast at any meeting at which a quorum is present is required to authorize a resolution put to vote at a meeting of the Board of Directors, including one relating to a merger, acquisition or business combination. Corporate action may also be taken by a unanimous written resolution of the Board of Directors without a meeting. A quorum shall be at least one-half of directors then in office present in person or represented by a duly authorized representative, provided that at least two directors are present in person.

### Shareholder Action

At the commencement of any general meeting, two or more persons present in person and representing, in person or by proxy, more than 50% of the issued and outstanding shares entitled to vote at the meeting shall constitute a quorum for the transaction of business. In general, any questions proposed for the consideration of the shareholders at any general meeting shall be decided by the affirmative votes of a majority of the votes cast in accordance with the Bye-Laws.

The Bye-Laws contain advance notice requirements for shareholder proposals and nominations for directors, including when proposals and nominations must be received and the information to be included.

### Amendment

The Bye-Laws may be amended only by a resolution adopted by the Board of Directors and by resolution of the shareholders.

### Voting of Non-U.S. Subsidiary Shares

If AGL is required or entitled to vote at a general meeting of any of AG Re, AGFOL or any other of its directly held non-U.S. subsidiaries, AGL's Board of Directors shall refer the subject matter of the vote to AGL's shareholders and seek direction from such shareholders as to how they should vote on the resolution proposed by the non-U.S. subsidiary. AGL's Board of Directors in its discretion shall require substantially similar provisions are or will be

contained in the bye-laws (or equivalent governing documents) of any direct or indirect non-U.S. subsidiaries other than U.K. and AGRO.

#### Employees

As of December 31, 2013, the Company had 326 employees. None of the Company's employees are subject to collective bargaining agreements. The Company believes that employee relations are satisfactory.

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Available Information

The Company maintains an Internet web site at [www.assuredguaranty.com](http://www.assuredguaranty.com). The Company makes available, free of charge, on its web site (under [assuredguaranty.com/sec-filings](http://assuredguaranty.com/sec-filings)) the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 (a) or 15 (d) of the Exchange Act as soon as reasonably practicable after the Company files such material with, or furnishes it to, the SEC. The Company also makes available, free of charge, through its web site (under [assuredguaranty.com/governance](http://assuredguaranty.com/governance)) links to the Company's Corporate Governance Guidelines, its Code of Conduct, AGL's Bye-Laws and the charters for its Board committees.

The Company routinely posts important information for investors on its web site (under [assuredguaranty.com/company-statements](http://assuredguaranty.com/company-statements) and, more generally, under the Investor Information and Businesses pages). The Company uses this web site as a means of disclosing material information and for complying with its disclosure obligations under SEC Regulation FD (Fair Disclosure). Accordingly, investors should monitor the Company Statements, Investor Information and Businesses portions of the Company's web site, in addition to following the Company's press releases, SEC filings, public conference calls, presentations and webcasts.

The information contained on, or that may be accessed through, the Company's web site is not incorporated by reference into, and is not a part of, this report.

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ITEM 1A. RISK FACTORS

You should carefully consider the following information, together with the information contained in AGL's other filings with the SEC. The risks and uncertainties discussed below are not the only ones the Company faces. However, these are the risks that the Company's management believes are material. The Company may face additional risks or uncertainties that are not presently known to the Company or that management currently deems immaterial, and such risks or uncertainties also may impair its business or results of operations. The risks discussed below could result in a significant or material adverse effect on the Company's financial condition, results of operations, liquidity or business prospects.

Risks Related to the Company's Expected Losses

Estimates of expected losses are subject to uncertainties and may not be adequate to cover potential paid claims.

The financial guaranties issued by the Company's insurance subsidiaries insure the credit performance of the guaranteed obligations over an extended period of time, in some cases over 30 years, and in most circumstances, the Company has no right to cancel such financial guaranties. As a result, the Company's estimate of ultimate losses on a policy is subject to significant uncertainty over the life of the insured transaction. Credit performance can be adversely affected by economic, fiscal and financial market variability over the long duration of most contracts. If the Company's actual losses exceed its current estimate, this may result in adverse effects on the Company's financial condition, results of operations, liquidity, business prospects, financial strength ratings and ability to raise additional capital.

In addition, if the Company is required to make claim payments, even if it is reimbursed in full over time and does not experience ultimate loss on a particular policy, such claim payments would reduce the Company's invested assets and result in reduced liquidity and net investment income. If the amount of claim payments is significant, the Company's ability to make other claim payments and its financial condition, financial strength ratings and business prospects could be adversely affected.

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. Although the Company may not experience ultimate loss on a particular transaction, the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. As of December 31, 2013, the Company's insured exposure to such transactions was approximately \$3.0 billion. The transactions generally involve long-term infrastructure projects that were financed by bonds that mature prior to the expiration of the project concession. The Company expected the cash flows from these projects to be sufficient to repay all of the debt over the life of the project concession, but also expected the debt to be refinanced in the market at or prior to its maturity. Due to market conditions, the Company may have to pay a claim when the debt matures, 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 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. For the Company's two largest transactions with significant refinancing risk, assuming no refinancing, the Company estimates, based on certain performance assumptions, that total claims could be \$1.8 billion on a gross basis; such claims would be payable from 2017 through 2022.

The determination of expected loss is an inherently subjective process involving numerous estimates, assumptions and judgments by management, using both internal and external data sources with regard to frequency, severity of loss, economic projections and other factors that affect credit performance. The Company does not use traditional actuarial approaches to determine its estimates of expected losses. Actual losses will ultimately depend on future events or



transaction performance. As a result, the Company's current estimates of probable and estimable losses may not reflect the Company's future ultimate claims paid.

Certain sectors within the Company's insured portfolio have experienced losses far in excess of initial expectations. The Company's loss experience, particularly in respect of its insured RMBS transactions, demonstrated the limited value of historical loss data in predicting future losses. The Company's expected loss models take into account current and expected future trends in loss severities, which for RMBS transactions, contemplate the impact of current and probable foreclosure liquidation expectations, default rates, prepayment speeds, the impact of governmental economic and consumer stimulation programs and other factors impacting the transactional cash flows and ultimately losses. These factors, which are integral elements of the Company's reserve estimation methodology, are updated on a quarterly basis based on current U.S. RMBS performance data. The Company's net par outstanding as of December 31, 2013 and December 31, 2012 for U.S. RMBS was \$13.7 billion and \$17.0 billion, respectively, of which \$7.7 billion and \$9.8 billion, respectively, was rated below investment grade under the Company's rating methodology. For a discussion of the Company's review of its RMBS transactions, see

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"Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations—Consolidated Results of Operations—Losses in the Insured Portfolio."

Risks Related to the Company's Financial Strength and Financial Enhancement Ratings

A downgrade of the financial strength or financial enhancement ratings of any of the Company's insurance and reinsurance subsidiaries would adversely affect its business and prospects and, consequently, its results of operations and financial condition.

The financial strength and financial enhancement ratings assigned by S&P, Moody's and Kroll to the Company's insurance and reinsurance subsidiaries represent the rating agencies' opinions of the insurer's financial strength and ability to meet ongoing obligations to policyholders and cedants in accordance with the terms of the financial guaranties it has issued or the reinsurance agreements it has executed. The ratings also reflect qualitative factors, such as the rating agencies' opinion of an insurer's business strategy and franchise value, the anticipated future demand for its product, the composition of its insured portfolio, and its capital adequacy, profitability and financial flexibility. Issuers, investors, underwriters, credit derivative counterparties, ceding companies and others consider the Company's financial strength or financial enhancement ratings an important factor when deciding whether or not to utilize a financial guaranty or purchase reinsurance from the Company's insurance or reinsurance subsidiaries. A downgrade by a rating agency of the financial strength or financial enhancement ratings of one or more of the Company's subsidiaries could impair the Company's financial condition, results of operation, liquidity, business prospects or other aspects of the Company's business.

The ratings assigned by the rating agencies that publish financial strength or financial enhancement ratings on the Company's insurance subsidiaries are subject to frequent review and may be lowered by a rating agency as a result of a number of factors, including, but not limited to, the rating agency's revised stress loss estimates for the Company's insurance portfolio, adverse developments in the Company's or the subsidiaries' financial conditions or results of operations due to underwriting or investment losses or other factors, changes in the rating agency's outlook for the financial guaranty industry or in the markets in which the Company operates, or a revision in the rating agency's capital model or ratings methodology. Their reviews can occur at any time and without notice to the Company and could result in a decision to downgrade, revise or withdraw the financial strength or financial enhancement ratings of AGL's insurance and reinsurance subsidiaries.

Since 2008, each of S&P and Moody's has reviewed and downgraded the financial strength ratings of AGL's insurance and reinsurance subsidiaries, including AGC, AGM and AG Re. In addition, S&P and Moody's have from time to time changed the ratings outlook for certain of the Company's subsidiaries to "negative" from "stable" or have placed such ratings on watch for possible downgrade. For example, in March 2012, Moody's placed the ratings of AGL and its subsidiaries, including the financial strength ratings of AGL's insurance subsidiaries, on review for possible downgrade. Moody's did not complete its review until January 2013, when Moody's downgraded the financial strength ratings of AGM and AGC from Aa3 to A2 and A3, respectively, and that of AG Re from A1 to Baa1. In February 2014, Moody's affirmed the financial strength ratings and outlooks of AGM and AGC, and affirmed AG Re's financial strength rating but changed AG Re's outlook to negative, citing its vulnerability to adverse developments within its insured portfolio.

The Company believes that S&P and Moody's actions and proposals have reduced the Company's new business opportunities and have also affected the value of the Company's product to issuers and investors. The insurance subsidiaries' financial strength ratings are an important competitive factor in the financial guaranty insurance and reinsurance markets. If the financial strength or financial enhancement ratings of one or more of the Company's insurance subsidiaries were reduced below current levels, the Company expects that would reduce the number of

transactions that would benefit from the Company's insurance; consequently, a downgrade could harm the Company's new business production, results of operations and financial condition.

In addition, a downgrade may have a negative impact on the Company in respect of transactions that it has insured or reinsurance that it has assumed. For example, a downgrade of one of the Company's insurance subsidiaries may result in increased claims under financial guaranties such subsidiary has issued. Under variable rate demand obligations insured by AGM, further downgrades past rating levels specified in the transaction documents could result in the municipal obligor paying a higher rate of interest and in such obligations amortizing on a more accelerated basis than expected when the obligations originally were issued; if the municipal obligor is unable to make such interest or principal payments, AGM may receive a claim under its financial guaranty. Under interest rate swaps insured by AGM, further downgrades past specified rating levels could entitle the municipal obligor's swap counterparty to terminate the swap; if the municipal obligor owed a termination payment as a result and were unable to make such payment, AGM may receive a claim if its financial guaranty guaranteed such termination payment. For more information about increased claim payments the Company may potentially make, see Note 7,

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Financial Guaranty Insurance Losses, of the Financial Statements and Supplementary Data, Ratings Impact on Financial Guaranty Business. In certain other transactions, beneficiaries of financial guaranties issued by the Company's insurance subsidiaries may have the right to cancel the credit protection offered by the Company, which would result in the loss of future premium earnings and the reversal of any fair value gains recorded by the Company. In addition, a downgrade of AG Re or AGC could result in certain ceding companies recapturing business that they had ceded to these reinsurers. See "The downgrade of the financial strength ratings of AG Re or of AGC gives certain reinsurance counterparties the right to recapture ceded business, which would lead to a reduction in the Company's unearned premium reserve and related earnings on such reserve" below.

If AGC's financial strength or financial enhancement ratings were downgraded, the Company could be required to post additional collateral under certain of its credit derivative contracts or certain of the Company's counterparties could have a right to terminate such credit derivative contract. See "If AGC's financial strength or financial enhancement ratings were downgraded, the Company could be required to make termination payments or post collateral under certain of its credit derivative contracts, which could impair its liquidity, results of operations and financial condition" below.

If AGM's financial strength or financial enhancement ratings were downgraded, AGM-insured GICs issued by the former AGMH subsidiaries that conducted AGMH's Financial Products Business (the "Financial Products Companies") may come due or may come due absent the provision of collateral by the GIC issuers. The Company relies on agreements pursuant to which Dexia has agreed to guarantee or lend certain amounts, or to post liquid collateral, in regards to AGMH's former financial products business. See "Risks Related to the AGMH Acquisition—The Company has exposure to credit and liquidity risks from Dexia."

Furthermore, if the financial strength ratings of AGE or AGUK were downgraded, AGM or AGC may be required to contribute additional capital to their respective subsidiary pursuant to the terms of the support arrangements for such subsidiaries, including those described under "Material Contracts" in the "Regulation—United Kingdom" section of "Item 1. Business."

If AGC's financial strength or financial enhancement ratings were downgraded, the Company could be required to make termination payments or post collateral under certain of its credit derivative contracts, which could impair its liquidity, results of operations and financial condition.

Within the Company's insured CDS portfolio, the transaction documentation for approximately \$1.7 billion in CDS gross par insured as of December 31, 2013 provides that a downgrade of AGC's financial strength rating below BBB- or Baa3 would constitute a termination event that would allow the relevant CDS counterparty to terminate the affected transactions. As of December 31, 2012, such amount was \$2.0 billion. If the CDS counterparty elected to terminate the affected transactions, AGC could be required to make a termination payment (or may be entitled to receive a termination payment from the CDS counterparty). The Company does not believe that it can accurately estimate the termination payments AGC could be required to make if, as a result of any such downgrade, a CDS counterparty terminated the affected transactions. These payments could have a material adverse effect on the Company's liquidity and financial condition.

The transaction documentation for approximately \$10.3 billion in CDS gross par insured as of December 31, 2013 requires certain of the Company's insurance subsidiaries to post eligible collateral to secure its obligations to make payments under such contracts. Eligible collateral is generally cash or U.S. government or agency securities; eligible collateral other than cash is valued at a discount to the face amount. For approximately \$9.9 billion of such contracts, AGC has negotiated caps such that the posting requirement cannot exceed a certain fixed amount, regardless of the mark-to-market valuation of the exposure or the financial strength ratings of AGC. For such contracts, AGC need not post on a cash basis more than \$665 million, although the value of the collateral posted may exceed such fixed amount

depending on the advance rate agreed with the counterparty for the particular type of collateral posted. For the remaining approximately \$347 million of such contracts, the Company could be required from time to time to post additional collateral without such cap based on movements in the mark-to-market valuation of the underlying exposure. As of December 31, 2013, the Company was posting approximately \$677 million to secure obligations under its CDS exposure, of which approximately \$62 million related to such \$347 million of notional. As of December 31, 2012, the Company was posting approximately \$728 million, of which approximately \$68 million related to \$400 million of notional where AGC or AGRO could be required to post additional collateral based on movements in the mark-to-market valuation of the underlying exposure.

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The downgrade of the financial strength ratings of AG Re or of AGC gives certain reinsurance counterparties the right to recapture ceded business, which would lead to a reduction in the Company's unearned premium reserve and related earnings on such reserve.

The downgrade of the financial strength ratings of AG Re or of AGC gives certain reinsurance counterparties the right to recapture ceded business, which would lead to a reduction in the Company's unearned premium reserve and related earnings on such reserve. With respect to a significant portion of the Company's in-force financial guaranty assumed business, based on AG Re's and AGC's current ratings and subject to the terms of each reinsurance agreement, the third party ceding company may have the right to recapture assumed business ceded to AG Re and/or AGC, and in connection therewith, to receive payment from the assuming reinsurer of an amount equal to the reinsurer's statutory unearned premium (net of ceding commissions) and statutory loss reserves (if any) associated with that business, plus, in certain cases, an additional ceding commission. As of December 31, 2013, if each third party company ceding business to AG Re and/or AGC had a right to recapture such business, and chose to exercise such right, the aggregate amounts that AG Re and AGC could be required to pay to all such companies would be approximately \$293 million and \$61 million, respectively.

Actions taken by the rating agencies with respect to capital models and rating methodology of the Company's business or changes in capital charges or downgrades of transactions within its insured portfolio may adversely affect its ratings, business prospects, results of operations and financial condition.

The rating agencies from time to time have evaluated the Company's capital adequacy under a variety of scenarios and assumptions. The rating agencies do not always supply clear guidance on their approach to assessing the Company's capital adequacy and the Company may disagree with the rating agencies' approach and assumptions. For example, S&P and Moody's assess each individual credit (including potential new credits) insured by the Company based on a variety of factors, including the nature of the credit, the nature of the support or credit enhancement for the credit, its tenor, and its expected and actual performance. This assessment determines the amount of capital the Company is required to maintain against that credit to maintain its financial strength ratings under the relevant rating agency's capital adequacy model. Factors influencing the rating agencies are beyond management's control and not always known to the Company. In the event of an actual or perceived deterioration in creditworthiness, or a change in a rating agency's capital model or rating methodology, that rating agency may require the Company to increase the amount of capital allocated to support the affected credits, regardless of whether losses actually occur, or against potential new business. Significant reductions in the rating agencies' assessments of credits in the Company's insured portfolio can produce significant increases in the amount of capital required for the Company to maintain its financial strength ratings under the rating agencies' capital adequacy models, which may require the Company to seek additional capital. The amount of such capital required may be substantial, and may not be available to the Company on favorable terms and conditions or at all. Accordingly, the Company cannot ensure that it will seek to, or be able to, raise additional capital. The failure to raise additional required capital could result in a downgrade of the Company's ratings and thus have an adverse impact on its business, results of operations and financial condition. See "Risks Related to the Company's Capital and Liquidity Requirements—The Company may require additional capital from time to time, including from soft capital and liquidity credit facilities, which may not be available or may be available only on unfavorable terms."

Since 2009, Moody's and S&P have downgraded a number of structured finance securities and public finance bonds, including obligations that the Company insures. Additional obligations in the Company's insured portfolio may be reviewed and downgraded in the future. Downgrades of the Company's insured credits will result in higher capital requirements for the Company under the relevant rating agency capital adequacy model. If the additional amount of capital required to support such exposures is significant, the Company may need to undertake certain actions in order to maintain its ratings, including, but not limited to, raising additional capital (which, if available, may not be available on terms and conditions that are favorable to the Company); curtailing new business; or paying to transfer a

portion of its in-force business to generate rating agency capital. If the Company is unable to complete any of these capital initiatives, it could suffer ratings downgrades. These capital actions or ratings downgrades could adversely affect the Company's results of operations, financial condition, ability to write new business or competitive positioning.

#### Risks Related to the Financial, Credit and Financial Guaranty Markets

Improvement in the recent difficult conditions in the U.S. and world-wide financial markets has been gradual, and the Company's business, liquidity, financial condition and stock price may continue to be adversely affected.

The Company's loss reserves, profitability, financial position, insured portfolio, investment portfolio, cash flow, statutory capital and stock price could be materially affected by the U.S. and global markets. Upheavals in the financial markets affect economic activity and employment and therefore can affect the Company's business. The global economic outlook remains uncertain, including the overall growth rate of the U.S. economy, the fragile economic recovery in Europe and the

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impact of the gradual tightening of global monetary conditions on emerging markets. These and other risks could materially and negatively affect the Company's ability to access the capital markets, the cost of the Company's debt, the demand for its products, the amount of losses incurred on transactions it guarantees, the value of its investment portfolio, its financial ratings and the price of its common shares.

Some of the state and local governments and entities that issue obligations the Company insures are experiencing unprecedented budget deficits and revenue shortfalls that could result in increased credit losses or impairments and capital charges on those obligations.

State and local governments that issue some of the obligations the Company insures have experienced significant budget deficits and revenue collection shortfalls that required 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 and although overall state revenues have increased in recent years, significant budgetary pressures remain, especially at the local government level. Certain local governments, including ones that have issued obligations insured by the Company, have sought protection from creditors under Chapter 9 of the U.S. Bankruptcy Code as a means of restructuring their outstanding debt. 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 could materially and adversely affect its business, financial condition and results of operations.

The Company'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 reduce the municipality's ability to service its debt. Downgrades could also affect the interest rate that the municipality must pay on its variable rate debt or for new debt issuance. Municipal credit downgrades, as with other downgrades, result in an increase in the capital charges the rating agencies assess when evaluating the Company's capital adequacy in their rating models. Significant municipal downgrades could result in higher capital requirements for the Company in order to maintain its financial strength ratings.

One governmental entity with significant economic challenges that the Company is closely following is the Commonwealth of Puerto Rico. Although recent announcements and actions by the current Governor and his administration indicate officials of the Commonwealth are focused on measures that are intended to help Puerto Rico operate within its financial resources and maintain its access to the capital markets, Puerto Rico faces high debt levels, a declining population and an economy that has been in recession since 2006. Puerto Rico has been operating with a structural budget deficit in recent years, and its two largest pension funds are significantly underfunded. In February 2014, S&P, Moody's and Fitch Ratings downgraded much of the debt of Puerto Rico and its related authorities and public corporations to below investment grade, citing various factors including limited liquidity and market access risk. Although Puerto Rico has not defaulted on any of its debt payments and is presently current on debt service payments for the \$5.4 billion net par insured by the Company, if the Company were required to make claim payments on such insured exposure, such payments could have a negative effect on the Company's liquidity and results of operations. Neither Puerto Rico nor its related authorities and public corporations are eligible debtors under Chapter 9 of the U.S. Bankruptcy Code.

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 stabilized and growth is slow. These obligations, which may not necessarily benefit from financial support from other tax revenues or governmental authorities, may also experience increased losses if the revenue streams are insufficient to pay scheduled interest and principal payments.



Changes in interest rate levels and credit spreads could adversely affect demand for financial guaranty insurance as well as the Company's financial condition.

Demand for financial guaranty insurance generally fluctuates with changes in market credit spreads. Credit spreads, which are based on the difference between interest rates on high-quality or "risk free" securities versus those on lower-rated or uninsured securities, fluctuate due to a number of factors and are sensitive to the absolute level of interest rates, current credit experience and investors' risk appetite. Within the last five years, interest rates in the U.S. had been at historically low levels. Although interest rates did rise somewhat in 2013, they are expected to remain low for the near future. When interest rates are low, or when the market is relatively less risk averse, the credit spread between high-quality or insured obligations versus lower-rated or uninsured obligations typically narrows. As a result, financial guaranty insurance typically provides lower interest cost savings to issuers than it would during periods of relatively wider credit spreads. When issuers are less likely to

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use financial guaranties on their new issues when credit spreads are narrow, this results in decreased demand or premiums obtainable for financial guaranty insurance, and a resulting reduction in the Company's results of operations.

Conversely, in a deteriorating credit environment, credit spreads increase and become "wide", which increases the interest cost savings that financial guaranty insurance may provide and can result in increased demand for financial guaranties by issuers. However, if the weakening credit environment is associated with economic deterioration, the Company's insured portfolio could generate claims and loss payments in excess of normal or historical expectations. In addition, increases in market interest rate levels could reduce new capital markets issuances and, correspondingly, a decreased volume of insured transactions.

Competition in the Company's industry may adversely affect its revenues.

As described in greater detail under "Competition" in "Item 1. Business," the Company can face competition, either in the form of current or new providers of credit enhancement or in terms of alternative structures, including uninsured offerings, or pricing competition. Increased competition could have an adverse effect on the Company's insurance business.

The Company's financial position, results of operations and cash flows may be adversely affected by fluctuations in foreign exchange rates.

The Company's reporting currency is the U.S. dollar. The principal functional currencies of AGL's insurance and reinsurance subsidiaries include the U.S. dollar and U.K. sterling. Exchange rate fluctuations relative to the functional currencies may materially impact the Company's financial position, results of operations and cash flows. The Company's non-U.S. subsidiaries maintain both assets and liabilities in currencies different than their functional currency, which exposes the Company to changes in currency exchange rates. In addition, locally-required capital levels are invested in local currencies in order to satisfy regulatory requirements and to support local insurance operations regardless of currency fluctuations.

The principal currencies creating foreign exchange risk are the British pound sterling and the European Union euro. The Company cannot accurately predict the nature or extent of future exchange rate variability between these currencies or relative to the U.S. dollar. Foreign exchange rates are sensitive to factors beyond the Company's control. The Company does not engage in active management, or hedging, of its foreign exchange rate risk. Therefore, fluctuation in exchange rates between these currencies and the U.S. dollar could adversely impact the Company's financial position, results of operations and cash flows.

The Company's international operations expose it to less predictable credit and legal risks.

The Company pursues new business opportunities in international markets and currently operates in various countries in Europe and the Asia Pacific region. The underwriting of obligations of an issuer in a foreign country involves the same process as that for a domestic issuer, but additional risks must be addressed, such as the evaluation of foreign currency exchange rates, foreign business and legal issues, and the economic and political environment of the foreign country or countries in which an issuer does business. Changes in such factors could impede the Company's ability to insure, or increase the risk of loss from insuring, obligations in the countries in which it currently does business and limit its ability to pursue business opportunities in other countries.

The Company's investment portfolio may be adversely affected by credit, interest rate and other market changes.

The Company's operating results are affected, in part, by the performance of its investment portfolio which consists primarily of fixed-income securities and short-term investments. As of December 31, 2013, the fixed-maturity securities and short-term investments had a fair value of approximately \$10.6 billion. Credit losses and changes in interest rates could have an adverse effect on its shareholders' equity and net income. Credit losses result in realized losses on the Company's investment portfolio, which reduce net income and shareholders' equity. Changes in interest rates can affect both shareholders' equity and investment income. For example, if interest rates decline, funds reinvested will earn less than expected, reducing the Company's future investment income compared to the amount it would earn if interest rates had not declined. However, the value of the Company's fixed-rate investments would generally increase if interest rates decreased, resulting in an unrealized gain on investments included in shareholders' equity. Conversely, if interest rates increase, the value of the investment portfolio will be reduced, resulting in unrealized losses that the Company is required to include in shareholders' equity as a change in accumulated other comprehensive income. Accordingly, interest rate increases could reduce the Company's shareholders' equity.

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Interest rates are highly sensitive to many factors, including monetary policies, domestic and international economic and political conditions and other factors beyond the Company's control. The Company does not engage in active management, or hedging, of interest rate risk, and may not be able to mitigate interest rate sensitivity effectively.

The market value of the investment portfolio also may be adversely affected by general developments in the capital markets, including decreased market liquidity for investment assets, market perception of increased credit risk with respect to the types of securities held in the portfolio, downgrades of credit ratings of issuers of investment assets and/or foreign exchange movements which impact investment assets. In addition, the Company invests in securities insured by other financial guarantors, the market value of which may be affected by the rating instability of the relevant financial guarantor.

### Risks Related to the Company's Capital and Liquidity Requirements

The Company may require additional capital from time to time, including from soft capital and liquidity credit facilities, which may not be available or may be available only on unfavorable terms.

The Company's capital requirements depend on many factors, primarily related to its in-force book of business and rating agency capital requirements. The Company needs liquid assets to make claim payments on its insured portfolio and to write new business. For example, as discussed in the Risk Factor captioned "Estimates of expected losses are subject to uncertainties and may not be adequate to cover potential paid claims" under Risks Related to the Company's Expected Losses, the Company has substantial exposure to infrastructure transactions with refinancing risk as to which the Company may need to make large claim payments that it did not anticipate paying when the policies were issued. Failure to raise additional capital as needed may result in the Company being unable to write new business and may result in the ratings of the Company and its subsidiaries being downgraded by one or more ratings agency. The Company's access to external sources of financing, as well as the cost of such financing, is dependent on various factors, including the market supply of such financing, the Company's long-term debt ratings and insurance financial strength ratings and the perceptions of its financial strength and the financial strength of its insurance subsidiaries. The Company's debt ratings are in turn influenced by numerous factors, such as financial leverage, balance sheet strength, capital structure and earnings trends. If the Company's need for capital arises because of significant losses, the occurrence of these losses may make it more difficult for the Company to raise the necessary capital.

Future capital raises for equity or equity-linked securities could also result in dilution to the Company's shareholders. In addition, some securities that the Company could issue, such as preferred stock or securities issued by the Company's operating subsidiaries, may have rights, preferences and privileges that are senior to those of its common shares.

Financial guaranty insurers and reinsurers typically rely on providers of lines of credit, credit swap facilities and similar capital support mechanisms (often referred to as "soft capital") to supplement their existing capital base, or "hard capital." The ratings of soft capital providers directly affect the level of capital credit which the rating agencies give the Company when evaluating its financial strength. The Company currently maintains soft capital facilities with providers having ratings adequate to provide the Company's desired capital credit. For example, effective January 1, 2014, AGC, AGM and MAC entered into a \$450 million aggregate excess of loss reinsurance facility that covers certain U.S. public finance credits insured or reinsured by those companies. However, no assurance can be given that the Company will be able to renew any existing soft capital facilities or that one or more of the rating agencies will not downgrade or withdraw the applicable ratings of such providers in the future. In addition, the Company may not be able to replace a downgraded soft capital provider with an acceptable replacement provider for a variety of reasons, including if an acceptable replacement provider is willing to provide the Company with soft capital commitments or if any adequately-rated institutions are actively providing soft capital facilities. Furthermore, the rating agencies may in the future change their methodology and no longer give credit for soft capital, which may necessitate the Company

having to raise additional capital in order to maintain its ratings.

An increase in the Company's subsidiaries' leverage ratio may prevent them from writing new insurance.

Insurance regulatory authorities impose capital requirements on the Company's insurance subsidiaries. These capital requirements, which include leverage ratios and surplus requirements, may limit the amount of insurance that the Company's subsidiaries may write. The Company's insurance subsidiaries have several alternatives available to control their leverage ratios, including obtaining capital contributions from the Company, purchasing reinsurance or entering into other loss mitigation agreements, or reducing the amount of new business written. However, a material reduction in the statutory capital and surplus of a subsidiary, 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 a subsidiary's leverage ratio. This in turn could require that subsidiary to obtain reinsurance for existing business (which may not be available, or may be available on terms that the Company considers unfavorable), or add to its capital base to maintain its financial strength ratings. Failure to maintain regulatory capital levels could limit that subsidiary's ability to write new business.

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The Company's holding companies' ability to meet its obligations may be constrained.

Each of AGL, AGUS and AGMH is a holding company and, as such, has no direct operations of its own. None of the holding companies expects to have any significant operations or assets other than its ownership of the shares of its subsidiaries.

The insurance company subsidiaries' ability to pay dividends and make other payments depends, among other things, upon their 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 their states of domicile. Restrictions applicable to AGC and AGM, and to AG Re and AGRO, are described under the "Regulation—United States—State Dividend Limitations" and "Regulation—Bermuda—Restrictions on Dividends and Distributions" sections of "Item 1. Business." Such dividends and permitted payments are expected to be the primary source of funds for the holding companies to meet ongoing cash requirements, including operating expenses, any future debt service payments and other expenses, and to pay dividends to their respective shareholders. Accordingly, if the insurance subsidiaries cannot pay sufficient dividends or make other permitted payments at the times or in the amounts that are required, that would have an adverse effect on the ability of AGL, AGUS and AGMH to satisfy their ongoing cash requirements and on their ability to pay dividends to shareholders.

If AGL does not pay dividends, the only return on an investment in AGL's shares, if at all, would come from any appreciation in the price of the common shares. Previously, dividends paid to AGL from a U.S. subsidiary would have been subject to a 30% withholding tax. After AGL became tax resident in the United Kingdom, as described under "Tax Matters" in "Item 1. Business," it became subject to the tax rules applicable to companies resident in the U.K., including the benefits afforded by the U.K.'s tax treaties. The income tax treaty between the U.K. and the U.S. reduces or eliminates the U.S. withholding tax on certain U.S. sourced investment income (to 5% or 0%), including dividends from U.S. subsidiaries to U.K. resident persons entitled to the benefits of the treaty.

If AGRO were to pay dividends to its U.S. holding company parent and that U.S. holding company were to pay dividends to its Bermudian parent AG Re, such dividends would be subject to U.S. withholding tax at a rate of 30%.

The ability of AGL and its subsidiaries to meet their liquidity needs may be limited.

Each of AGL, AGUS and AGMH requires liquidity, either in the form of cash or in the ability to easily sell investment assets for cash, in order to meet its payment obligations, including, without limitation, its operating expenses, interest on debt and dividends on common shares, and to make capital investments in operating subsidiaries. The Company's operating subsidiaries require substantial liquidity in order to meet their respective payment and/or collateral posting obligations, including under financial guaranty insurance policies, CDS contracts or reinsurance agreements. They also require liquidity to pay operating expenses, reinsurance premiums, dividends to AGUS or AGMH for debt service and dividends to the Company, as well as, where appropriate, to make capital investments in their own subsidiaries. The Company cannot give any assurance that the liquidity of AGL and its subsidiaries will not be adversely affected by adverse market conditions, changes in insurance regulatory law or changes in general economic conditions.

AGL anticipates that its liquidity needs will be met by the ability of its operating subsidiaries to pay dividends or to make other payments; external financings; investment income from its invested assets; and current cash and short-term investments. The Company expects that its subsidiaries' need for liquidity will be met by the operating cash flows of such subsidiaries; external financings; investment income from their invested assets; and proceeds derived from the sale of its investment portfolio, a significant portion of which is in the form of cash or short-term investments. All of these sources of liquidity are subject to market, regulatory or other factors that may impact the

Company's liquidity position at any time. As discussed above, AGL's insurance subsidiaries are subject to regulatory and rating agency restrictions limiting their ability to declare and to pay dividends and make other payments to AGL. As further noted above, external financing may or may not be available to AGL or its subsidiaries in the future on satisfactory terms.

In addition, investment income at AGL and its subsidiaries may fluctuate based on interest rates, defaults by the issuers of the securities AGL or its subsidiaries hold in their respective investment portfolios, or other factors that the Company does not control. Finally, the value of the Company's investments may be adversely affected by changes in interest rates, credit risk and capital market conditions and therefore may adversely affect the Company's potential ability to sell investments quickly and the price which the Company might receive for those investments.

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### Risks Related to the AGMH Acquisition

The Company has exposure to credit and liquidity risks from Dexia.

Dexia and the Company have entered into a number of agreements intended to protect the Company from having to pay claims on AGMH's former Financial Products Business, which the Company did not acquire. Dexia has agreed to guarantee certain amounts, lend certain amounts or post liquid collateral for or in respect of AGMH's former Financial Products Business. Dexia SA and Dexia Crédit Local S.A. ("DCL"), jointly and severally, have also agreed to indemnify the Company for losses associated with AGMH's former Financial Products Business, including the ongoing Department of Justice investigations of such business. Furthermore, DCL, acting through its New York Branch, is providing a liquidity facility in order to make loans to AGM to finance the payment of claims under certain financial guaranty insurance policies issued by AGM or its affiliate that relate to the equity portion of leveraged lease transactions insured by AGM. The equity portion of the leveraged lease transactions is part of AGMH's financial guaranty business, which the Company did acquire. However, in connection with the AGMH Acquisition, DCL agreed to provide AGM with a liquidity facility so that AGM could fund its payment of claims made under financial guaranty policies issued in respect of this portion of the business, because the amount of such claims could be large and are generally payable within a short time after AGM receives them. On February 7, 2014, AGM reduced the size of the liquidity facility by \$460 million to approximately \$500 million, after taking into account its experience with its exposure to leveraged lease transactions to date. For a description of the agreements entered into with Dexia and a further discussion of the risks that these agreements are intended to protect against, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Liquidity Arrangements with respect to AGMH's former Financial Products Business."

Despite the execution of such documentation, the Company remains subject to the risk that Dexia may not make payments or securities available (a) on a timely basis, which is referred to as "liquidity risk," or (b) at all, which is referred to as "credit risk," because of the risk of default. Even if Dexia has sufficient assets to pay, lend or post as collateral all amounts when due, concerns regarding Dexia's financial condition or willingness to comply with its obligations could cause one or more rating agencies to view negatively the ability or willingness of Dexia to perform under its various agreements and could negatively affect the Company's ratings.

AGMH and its subsidiaries could be subject to non-monetary consequences arising out of litigation associated with AGMH's former financial products business, which the Company did not acquire.

As noted under "Item 3. Legal Proceedings—Proceedings Related to AGMH's Former Financial Products Business," in November 2006, AGMH received a subpoena from the Antitrust Division of the Department of Justice issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives. Although the subpoena relates to AGMH's former Financial Products Business, which the Company did not acquire, it was issued to AGMH, which the Company did acquire. Furthermore, while Dexia SA and DCL, jointly and severally, have agreed to indemnify the Company against liability arising out of these proceedings, such indemnification might not be sufficient to fully hold the Company harmless against any injunctive relief or civil or criminal sanction that is imposed against AGMH or its subsidiaries.

### Risks Related to the Company's Business

The Company's financial guaranty products may subject it to significant risks from individual or correlated credits.

The Company is exposed to the risk that issuers of debt that it insures or other counterparties may default in their financial obligations, whether as a result of insolvency, lack of liquidity, operational failure or other reasons. Similarly, the Company could be exposed to corporate credit risk if a corporation's securities are contained in a



portfolio of collateralized debt obligations ("CDOs") it insures, or if the corporation or financial institution is the originator or servicer of loans, mortgages or other assets backing structured securities that the Company has insured.

In addition, because the Company insures or reinsures municipal bonds, it can have significant exposures to single municipal risks (i.e, the Commonwealth of Puerto Rico). While the Company's risk of a complete loss, where it would have to pay the entire principal amount of an issue of bonds and interest thereon with no recovery, is generally lower than for corporate credits as most municipal bonds are backed by tax or other revenues, there can be no assurance that a single default by a municipality would not have a material adverse effect on its results of operations or financial condition.

The Company's ultimate exposure to a single name may exceed its underwriting guidelines, and an event with respect to a single name may cause a significant loss. The Company seeks to reduce this risk by managing exposure to large single

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risks, as well as concentrations of correlated risks, through tracking its aggregate exposure to single names in its various lines of business, establishing underwriting criteria to manage risk aggregations. It has also in the past obtained third party reinsurance for such exposure. The Company may insure and has insured individual public finance and asset-backed risks well in excess of \$1 billion. Should the Company's risk assessments prove inaccurate and should the applicable limits prove inadequate, the Company could be exposed to larger than anticipated losses, and could be required by the rating agencies to hold additional capital against insured exposures whether or not downgraded by the rating agencies.

The Company is exposed to correlation risk across the various assets the Company insures. During periods of strong macroeconomic performance, stress in an individual transaction generally occurs in a single asset class or for idiosyncratic reasons. During a broad economic downturn, a wider range of the Company's insured portfolio could be exposed to stress at the same time. This stress may manifest itself in ratings downgrades, which may require more capital, or in actual losses. In addition, while the Company has experienced catastrophic events in the past without material loss, unexpected catastrophic events may have a material adverse effect upon the Company's insured portfolio and/or its investment portfolios.

Some of the Company's direct financial guaranty products may be riskier than traditional financial guaranty insurance.

As of December 31, 2013 and 2012, 13% and 15%, respectively, of the Company's financial guaranty direct exposures were executed as credit derivatives. Traditional financial guaranty insurance provides an unconditional and irrevocable guaranty that protects the holder of a municipal finance or structured finance obligation against non-payment of principal and interest, while credit derivatives provide protection from the occurrence of specified credit events, including non-payment of principal and interest. In general, the Company structures credit derivative transactions such that circumstances giving rise to its obligation to make payments are similar to that for financial guaranty policies and generally occur when issuers fail to make payments on the underlying reference obligations. The tenor of credit derivatives exposures, like exposure under financial guaranty insurance policies, is also generally for as long as the reference obligation remains outstanding.

Nonetheless, credit derivative transactions are governed by International Swaps and Derivatives Association, Inc. ("ISDA") documentation and operate differently from financial guaranty insurance policies. For example, the Company's control rights with respect to a reference obligation under a credit derivative may be more limited than when it issues a financial guaranty insurance policy on a direct primary basis. In addition, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events, unlike financial guaranty insurance policies. In some of the Company's credit derivative transactions with one counterparty, one such specified event is the failure of AGC to maintain specified financial strength ratings. If the counterparty were to terminate the credit derivative transactions, the Company could be required to make a termination payment as determined under the ISDA documentation. In addition, under a limited number of credit derivative contracts, the Company may be required to post eligible securities as collateral, generally cash or U.S. government or agency securities, under specified circumstances. The need to post collateral under many of these transactions is subject to caps that the Company has negotiated with its counterparties, but there are some transactions as to which the Company could be required to post collateral without such a cap based on movements in the mark-to-market valuation of the underlying exposure in excess of contractual thresholds. See "Risks Related to the Company's Financial Strength and Financial Enhancement Ratings—If AGC's financial strength or financial enhancement ratings were downgraded, the Company could be required to make termination payments or post collateral under certain of its credit derivative contracts, which could impair its liquidity, results of operations and financial condition."

Further downgrades of one or more of the Company's reinsurers could reduce the Company's capital adequacy and return on equity. The impairment of other financial institutions also could adversely affect the Company.

At December 31, 2013, the Company had ceded approximately 6% of its principal amount of insurance outstanding to third party reinsurers. In evaluating the credits insured by the Company, securities rating agencies allow capital charge "credit" for reinsurance based on the reinsurers' ratings. In recent years, a number of the Company's reinsurers were downgraded by one or more rating agencies, resulting in decreases in the credit allowed for reinsurance and in the financial benefits of using reinsurance under existing rating agency capital adequacy models. Many of the Company's reinsurers have already been downgraded to single-A or below by one or more rating agencies. The Company could be required to raise additional capital to replace the lost reinsurance credit in order to satisfy rating agency and regulatory capital adequacy and single risk requirements. The rating agencies' reduction in credit for reinsurance could also ultimately reduce the Company's return on equity to the extent that ceding commissions paid to the Company by the reinsurers were not adequately increased to compensate for the effect of any additional capital required. In addition, downgraded reinsurers may default on amounts due to the Company and such reinsurer obligations may not be adequately collateralized, resulting in additional losses to the Company and a reduction in its shareholders' equity and net income.

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The Company also has exposure to counterparties in various industries, including banks, hedge funds and other investment vehicles in its insured transactions. Many of these transactions expose the Company to credit risk in the event its counterparty fails to perform its obligations.

The Company is dependent on key executives and the loss of any of these executives, or its inability to retain other key personnel, could adversely affect its business.

The Company's success substantially depends upon its ability to attract and retain qualified employees and upon the ability of its senior management and other key employees to implement its business strategy. The Company believes there are only a limited number of available qualified executives in the business lines in which the Company competes. Although the Company is not aware of any planned departures, the Company relies substantially upon the services of Dominic J. Frederico, President and Chief Executive Officer, and other executives. Although the Company has designed its executive compensation with the goal of retaining and incentivizing its executive officers, the Company may not be successful in retaining their services. The loss of the services of any of these individuals or other key members of the Company's management team could adversely affect the implementation of its business strategy.

### Risks Related to GAAP and Applicable Law

Changes in the fair value of the Company's insured credit derivatives portfolio may subject net income to volatility.

The Company is required to mark-to-market certain derivatives that it insures, including CDS that are considered derivatives under GAAP. Although there is no cash flow effect from this "marking-to-market," net changes in the fair value of the derivative are reported in the Company's consolidated statements of operations and therefore affect its reported earnings. As a result of such treatment, and given the large principal balance of the Company's CDS portfolio, small changes in the market pricing for insurance of CDS will generally result in the Company recognizing material gains or losses, with material market price increases generally resulting in large reported losses under GAAP. Accordingly, the Company's GAAP earnings will be more volatile than would be suggested by the actual performance of its business operations and insured portfolio.

The fair value of a credit derivative will be affected by any event causing changes in the credit spread (i.e., the difference in interest rates between comparable securities having different credit risk) on an underlying security referenced in the credit derivative. Common events that may cause credit spreads on an underlying municipal or corporate security referenced in a credit derivative to fluctuate include changes in the state of national or regional economic conditions, industry cyclicality, changes to a company's competitive position within an industry, management changes, changes in the ratings of the underlying security, movements in interest rates, default or failure to pay interest, or any other factor leading investors to revise expectations about the issuer's ability to pay principal and interest on its debt obligations. Similarly, common events that may cause credit spreads on an underlying structured security referenced in a credit derivative to fluctuate may include the occurrence and severity of collateral defaults, changes in demographic trends and their impact on the levels of credit enhancement, rating changes, changes in interest rates or prepayment speeds, or any other factor leading investors to revise expectations about the risk of the collateral or the ability of the servicer to collect payments on the underlying assets sufficient to pay principal and interest. 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 AGC and AGM. For discussion of the Company's fair value methodology for credit derivatives, see Note 8, Fair Value Measurement, of the Financial Statements and Supplementary Data.

If a credit derivative is held to maturity and no credit loss is incurred, any unrealized gains or losses previously reported would be offset as the transactions reach maturity. Due to the complexity of fair value accounting and the application of GAAP requirements, future amendments or interpretations of relevant accounting standards may cause the Company to modify its accounting methodology in a manner which may have an adverse impact on its financial

results.

Change in industry and other accounting practices could impair the Company's reported financial results and impede its ability to do business.

Changes in or the issuance of new accounting standards, as well as any changes in the interpretation of current accounting guidance, may have an adverse effect on the Company's reported financial results, including future revenues, and may influence the types and/or volume of business that management may choose to pursue.

Changes in or inability to comply with applicable law could adversely affect the Company's ability to do business.

The Company's businesses are subject to direct and indirect regulation under state insurance laws, federal securities, commodities and tax laws affecting public finance and asset backed obligations, and federal regulation of derivatives, as well as

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applicable laws in the other countries in which the Company operates. Future legislative, regulatory, judicial or other legal changes in the jurisdictions in which the Company does business may adversely affect its ability to pursue its current mix of business, thereby materially impacting its financial results by, among other things, limiting the types of risks it may insure, lowering applicable single or aggregate risk limits, increasing required reserves or capital, increasing the level of supervision or regulation to which the Company's operations may be subject, imposing restrictions that make the Company's products less attractive to potential buyers, lowering the profitability of the Company's business activities, requiring the Company to change certain of its business practices and exposing it to additional costs (including increased compliance costs).

In particular, regulations under the Dodd-Frank Act impose requirements on activities that AGL's subsidiaries may engage in that involve "swaps," as defined under that Act. Although final product rules published by the CFTC and SEC in August 2012 established an insurance safe-harbor that provides that AGM's and AGC's financial guaranty insurance policies are not generally deemed swaps under the Dodd-Frank Act and are therefore not subject to regulation under the Act as swaps, regulations under the Act could require certain of AGL's subsidiaries to register with the CFTC or the SEC as a "major swap participant" ("MSP") or "major security-based swap participant" ("MSBSP"), respectively, as a result of either the legacy financial guaranty insurance policies and derivatives portfolios or new activities. MSPs or MSBSPs would need to satisfy the regulatory capital requirements of the applicable agency and would be subject to additional compliance requirements. The Company has analyzed the exposures created by its legacy financial guaranty insurance policies and derivatives portfolio and determined its subsidiaries do not need to register as an MSP with the CFTC at this time, based on the historical sizes of those exposures. However, in the event such swap exposure exceeds the triggers, then one or more of AGL's subsidiaries may be required to register as an MSP with the CFTC. The SEC has not adopted final rules for MSBSP registration yet, but when such rules are issued, one or more of AGL's subsidiaries may be required to register as an MSBSP with the SEC. In addition, certain of AGL's subsidiaries may need to post margin with respect to either future or legacy derivative transactions when rules relating to margin take effect. While the CFTC and SEC have indicated that they do not intend to require margin for legacy derivative transactions, when the CFTC and SEC adopt margin requirements, it is possible the CFTC and SEC will take the position that amendments to existing swaps will cause the amended swaps to be treated as new swaps for purposes of these margin rules and certain other new regulatory requirements. Such an expansion of the margin and other regulatory requirements to amendments of existing swaps may impede the Company's ability to amend insured derivative transactions in connection with loss mitigation efforts or municipal refunding transactions. The magnitude of capital and/or margin requirements could be substantial and, as discussed in "Risks Related to the Company's Capital and Liquidity Requirements —The Company may require additional capital from time to time, including from soft capital and liquidity credit facilities, which may not be available or may be available only on unfavorable terms," there can be no assurance that the Company will be able to obtain, or obtain on favorable terms, such additional capital as may be required by the Dodd-Frank Act.

Furthermore, pursuant to the Dodd-Frank Act, the FSOC has been charged with identifying certain non-bank financial companies to be subject to supervision by the Board of Governors of the Federal Reserve System. In a parallel international process, the IAIS, which has been identifying GSII, published a proposed assessment methodology that deemed financial guaranty insurance to be an activity that poses increased systemic risk relative to more traditional insurance activities. The Company does not at this time expect to be designated as a SIFI by the FSOC or a GSII by the IAIS, but the Company's status could change pursuant to new criteria from the FSOC or the IAIS.

In addition, a Federal Insurance Office ("FIO") has been established to develop federal policy relating to insurance matters. The FIO is conducting a study for submission to the U.S. Congress on how to modernize and improve insurance regulation in the U.S. Moreover, various federal regulatory agencies have proposed and adopted additional regulations in furtherance of the Dodd-Frank Act provisions. To the extent these or other requirements ultimately apply to the Company, they could require the Company to change how it conducts and manages its business, including subjecting it to higher capital requirements, and could adversely affect it.

The foregoing requirements, as well as others that could be applied to the Company as a result of the legislation, could limit the Company's ability to conduct certain lines of business and/or subject the Company to enhanced business conduct standards and/or otherwise adversely affect its future results of operations. Because many provisions of the Dodd-Frank Act are being implemented through agency rulemaking processes, a number of which have not been completed, the Company's assessment of the legislation's impact on its business remains uncertain and is subject to change.

In addition, the decline in the financial strength of many financial guaranty insurers has caused government officials to examine the suitability of some of the complex securities guaranteed by financial guaranty insurers. For example, the New York Department of Financial Services ("NY DFS") had announced that it would develop new rules and regulations for the financial guaranty industry. On September 22, 2008, the NY DFS issued Circular Letter No. 19 (2008) (the "Circular Letter"), which established best practices guidelines for financial guaranty insurers effective January 1, 2009. Although the Company is not

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aware of any current efforts by the NY DFS to propose legislation to formalize these guidelines, any such legislation may limit the amount of new structured finance business that AGC may write.

Furthermore, if the Company fails to comply with applicable insurance laws and regulations it could be exposed to fines, the loss of insurance licenses, limitations on the 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. If an insurance company's surplus declines below minimum required levels, the insurance regulator could impose additional restrictions on the insurer or initiate insolvency proceedings. AGC and AGM may increase surplus by various means, including obtaining capital contributions from the Company, purchasing reinsurance or entering into other loss mitigation arrangements, reducing the amount of new business written or obtaining regulatory approval to release contingency reserves. From time to time, AGM and AGC have obtained approval from their regulators to release contingency reserves based on losses and, in the case of AGM, also based on the expiration of its insured exposure.

From time to time, legislators have called for changes to the Internal Revenue Code in order to limit or eliminate the Federal income tax exclusion for municipal bond interest. Such a change is expected to increase the cost of borrowing for state and local governments, and as a result, to cause a decrease in infrastructure spending by states and municipalities. Municipalities may issue a lower volume of bonds, and in particular may be less likely to refund existing debt, in which case, the amount of bonds that can benefit from insurance might also be reduced.

AGL's ability to pay dividends may be constrained by certain insurance regulatory requirements and restrictions.

AGL is subject to Bermuda regulatory requirements that affect its ability to pay dividends on common shares and to make other payments. Under the Bermuda Companies Act 1981, as amended, AGL may declare or pay a dividend only if it has reasonable grounds for believing that it is, and after the payment would be, able to pay its liabilities as they become due, and if the realizable value of its assets would not be less than its liabilities. While AGL currently intends to pay dividends on its common shares, investors who require dividend income should carefully consider these risks before investing in AGL. In addition, if, pursuant to the insurance laws and related regulations of Bermuda, Maryland and New York, AGL's insurance subsidiaries cannot pay sufficient dividends to AGL at the times or in the amounts that it requires, it would have an adverse effect on AGL's ability to pay dividends to shareholders. See "Risks Related to the Company's Capital and Liquidity Requirements—The ability of AGL and its subsidiaries to meet their liquidity needs may be limited."

Applicable insurance laws may make it difficult to effect a change of control of AGL.

Before a person can acquire control of a U.S. or U.K. insurance company, prior written approval must be obtained from the insurance commissioner of the state or country where the insurer is domiciled. Because a person acquiring 10% or more of AGL's common shares would indirectly control the same percentage of the stock of its U.S. insurance company subsidiaries, the insurance change of control laws of Maryland, New York and the U.K. would likely apply to such a transaction. These laws may discourage potential acquisition proposals and may delay, deter or prevent a change of control of AGL, including through transactions, and in particular unsolicited transactions, that some or all of its shareholders might consider to be desirable. While AGL's Bye-Laws limit the voting power of any shareholder to less than 10%, we cannot assure you that the applicable regulatory body would agree that a shareholder who owned 10% or more of its common shares did not control the applicable insurance company subsidiary, notwithstanding the limitation on the voting power of such shares.

## Risks Related to Taxation

Changes in U.S. tax laws could reduce the demand or profitability of financial guaranty insurance, or negatively impact the Company's investment portfolio.



Any material change in the U.S. tax treatment of municipal securities, the imposition of a national sales tax or a flat tax in lieu of the current federal income tax structure in the U.S., or changes in the treatment of dividends, could adversely affect the market for municipal obligations and, consequently, reduce the demand for financial guaranty insurance and reinsurance of such obligations.

Changes in U.S. federal, state or local laws that materially adversely affect the tax treatment of municipal securities or the market for those securities, or other changes negatively affecting the municipal securities market, also may adversely impact the Company's investment portfolio, a significant portion of which is invested in tax-exempt instruments. These adverse changes may adversely affect the value of the Company's tax-exempt portfolio, or its liquidity.

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Certain of the Company's foreign subsidiaries may be subject to U.S. tax.

The Company manages its business so that AGL and its foreign subsidiaries (other than AGRO and AGE) operate in such a manner that none of them should be subject to U.S. federal tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks, and U.S. withholding tax on certain U.S. source investment income). However, because there is considerable uncertainty as to the activities which constitute being engaged in a trade or business within the U.S., the Company cannot be certain that the IRS will not contend successfully that AGL or any of its foreign subsidiaries (other than AGRO and AGE) is/are engaged in a trade or business in the U.S. If AGL and its foreign subsidiaries (other than AGRO and AGE) were considered to be engaged in a trade or business in the U.S., each such company could be subject to U.S. corporate income and branch profits taxes on the portion of its earnings effectively connected to such U.S. business.

AGL, AG Re and AGRO may become subject to taxes in Bermuda after March 2035, which may have a material adverse effect on the Company's results of operations and on an investment in the Company.

The Bermuda Minister of Finance, under Bermuda's Exempted Undertakings Tax Protection Act 1966, as amended, has given AGL, AG Re and AGRO an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then subject to certain limitations the imposition of any such tax will not be applicable to AGL, AG Re or AGRO, or any of AGL's or its subsidiaries' operations, shares, debentures or other obligations until March 31, 2035. Given the limited duration of the Minister of Finance's assurance, the Company cannot be certain that it will not be subject to Bermuda tax after March 31, 2035.

U.S. Persons who hold 10% or more of AGL's shares directly or through foreign entities may be subject to taxation under the U.S. controlled foreign corporation rules.

Each 10% U.S. shareholder of a foreign corporation that is a controlled foreign corporation ("CFC") for an uninterrupted period of 30 days or more during a taxable year, and who owns shares in the foreign corporation directly or indirectly through foreign entities on the last day of the foreign corporation's taxable year on which it is a CFC, must include in its gross income for U.S. federal income tax purposes its pro rata share of the CFC's "subpart F income," even if the subpart F income is not distributed. In addition, upon a sale of shares of a CFC, 10% U.S. shareholders may be subject to U.S. federal income tax on a portion of their gain at ordinary income rates.

The Company believes that because of the dispersion of the share ownership in AGL, provisions in AGL's Bye-Laws that limit voting power, contractual limits on voting power and other factors, no U.S. Person who owns AGL's shares directly or indirectly through foreign entities should be treated as a 10% U.S. shareholder of AGL or of any of its foreign subsidiaries. It is possible, however, that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge, in which case such U.S. Person may be subject to taxation under U.S. tax rules.

U.S. Persons who hold shares may be subject to U.S. income taxation at ordinary income rates on their proportionate share of the Company's related person insurance income.

If:

• the Company is 25% or more owned directly, indirectly through foreign entities or by attribution by U.S. Persons;

• the gross RPII of AG Re or any other AGL foreign subsidiary engaged in the insurance business that has not made an election under section 953(d) of the Code to be treated as a U.S. corporation for all U.S. tax purposes or are CFCs owned directly or indirectly by AGUS (each, with AG Re, a "Foreign Insurance Subsidiary") were to equal or exceed

20% of such Foreign Insurance Subsidiary's gross insurance income in any taxable year; and

direct or indirect insureds (and persons related to such insureds) own (or are treated as owning directly or indirectly through entities) 20% or more of the voting power or value of the Company's shares,

then a U.S. Person who owns AGL's shares (directly or indirectly through foreign entities) on the last day of the taxable year would be required to include in its income for U.S. federal income tax purposes such person's pro rata share of such Foreign Insurance Subsidiary's RPII for the entire taxable year, determined as if such RPII were distributed proportionately only to U.S. Persons at that date, regardless of whether such income is distributed. In addition, any RPII that is includible in the income of a U.S. tax-exempt organization may be treated as unrelated business taxable income.

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The amount of RPII earned by a Foreign Insurance Subsidiary (generally, premium and related investment income from the direct or indirect insurance or reinsurance of any direct or indirect U.S. holder of shares or any person related to such holder) will depend on a number of factors, including the geographic distribution of a Foreign Insurance Subsidiary's business and the identity of persons directly or indirectly insured or reinsured by a Foreign Insurance Subsidiary. The Company believes that each of its Foreign Insurance Subsidiaries either should not in the foreseeable future have RPII income which equals or exceeds 20% of its gross insurance income or have direct or indirect insureds, as provided for by RPII rules, that directly or indirectly own 20% or more of either the voting power or value of AGL's shares. However, the Company cannot be certain that this will be the case because some of the factors which determine the extent of RPII may be beyond its control.

U.S. Persons who dispose of AGL's shares may be subject to U.S. income taxation at dividend tax rates on a portion of their gain, if any.

The meaning of the RPII provisions and the application thereof to AGL and its Foreign Insurance Subsidiaries is uncertain. The RPII rules in conjunction with section 1248 of the Code provide that if a U.S. Person disposes of shares in a foreign insurance corporation in which U.S. Persons own (directly, indirectly, through foreign entities or by attribution) 25% or more of the shares (even if the amount of gross RPII is less than 20% of the corporation's gross insurance income and the ownership of its shares by direct or indirect insureds and related persons is less than the 20% threshold), any gain from the disposition will generally be treated as dividend income to the extent of the holder's share of the corporation's undistributed earnings and profits that were accumulated during the period that the holder owned the shares. This provision applies whether or not such earnings and profits are attributable to RPII. In addition, such a holder will be required to comply with certain reporting requirements, regardless of the amount of shares owned by the holder.

In the case of AGL's shares, these RPII rules should not apply to dispositions of shares because AGL is not itself directly engaged in the insurance business. However, the RPII provisions have never been interpreted by the courts or the U.S. Treasury Department in final regulations, and regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form, what changes or clarifications might ultimately be made thereto, or whether any such changes, as well as any interpretation or application of the RPII rules by the IRS, the courts, or otherwise, might have retroactive effect. The U.S. Treasury Department has authority to impose, among other things, additional reporting requirements with respect to RPII.

U.S. Persons who hold common shares will be subject to adverse tax consequences if AGL is considered to be a "passive foreign investment company" for U.S. federal income tax purposes.

If AGL is considered a passive foreign investment company ("PFIC") for U.S. federal income tax purposes, a U.S. Person who owns any shares of AGL will be subject to adverse tax consequences that could materially adversely affect its investment, including subjecting the investor to both a greater tax liability than might otherwise apply and an interest charge. The Company believes that AGL is not, and currently does not expect AGL to become, a PFIC for U.S. federal income tax purposes; however, there can be no assurance that AGL will not be deemed a PFIC by the IRS.

There are currently no regulations regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be forthcoming. The Company cannot predict what impact, if any, such guidance would have on an investor that is subject to U.S. federal income taxation.

Changes in U.S. federal income tax law could materially adversely affect an investment in AGL's common shares.

Legislation has been introduced in the U.S. Congress intended to eliminate certain perceived tax advantages of companies (including insurance companies) that have legal domiciles outside the U.S. but have certain U.S. connections. For example, legislation has been introduced in Congress to limit the deductibility of reinsurance premiums paid by U.S. insurance companies to foreign affiliates and impose additional limits on deductibility of interest of foreign owned U.S. corporations. Another legislative proposal would treat a foreign corporation that is primarily managed and controlled in the U.S. as a U.S. corporation for U.S. federal income tax purposes. Further, legislation has previously been introduced to override the reduction or elimination of the U.S. withholding tax on certain U.S. source investment income under a tax treaty in the case of a deductible related party payment made by a U.S. member of a foreign controlled group to a foreign member of the group organized in a tax treaty country to the extent that the ultimate foreign parent corporation would not enjoy the treaty benefits with respect to such payments. It is possible that this or similar legislation could be introduced in and enacted by the current Congress or future Congresses that could have an adverse impact on the Company or the Company's shareholders.

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U.S. federal income tax laws and interpretations regarding whether a company is engaged in a trade or business within the U.S. is a PFIC, or whether U.S. Persons would be required to include in their gross income the "subpart F income" of a CFC or RPII are subject to change, possibly on a retroactive basis. There currently are no regulations regarding the application of the PFIC rules to insurance companies, and the regulations regarding RPII are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. The Company cannot be certain if, when, or in what form such regulations or pronouncements may be implemented or made, or whether such guidance will have a retroactive effect.

Recharacterization by the Internal Revenue Service of the Company's U.S. federal tax treatment of losses on the Company's CDS portfolio can adversely affect the Company's financial position.

As part of the Company's financial guaranty business, the Company has sold credit protection by insuring CDS entered into with various financial institutions. Assured Guaranty's CDS portfolio has experienced significant cumulative fair value losses which are only deductible for U.S. federal income tax purposes upon realization and, consequently, generate a significant deferred tax asset based on the Company's intended treatment of such losses as ordinary insurance losses upon realization. The U.S. federal income tax treatment of CDS is an unsettled area of the tax law. As such, it is possible that the Internal Revenue Service may decide that the losses generated by the Company's CDS business should be characterized as capital rather than ordinary insurance losses, which could materially adversely affect the Company's financial condition.

An ownership change under Section 382 of the Code could have adverse U.S. federal tax consequences.

If AGL were to issue equity securities in the future, including in connection with any strategic transaction, or if previously issued securities of AGL were to be sold by the current holders, AGL may experience an "ownership change" within the meaning of Section 382 of the Code. In general terms, an ownership change would result from transactions increasing the aggregate ownership of certain stockholders in AGL's stock by more than 50 percentage points over a testing period (generally three years). If an ownership change occurred, the Company's ability to use certain tax attributes, including certain built-in losses, credits, deductions or tax basis and/or the Company's ability to continue to reflect the associated tax benefits as assets on AGL's balance sheet, may be limited. The Company cannot give any assurance that AGL will not undergo an ownership change at a time when these limitations could materially adversely affect the Company's financial condition.

AGMH likely experienced an ownership change under Section 382 of the Code.

In connection with the AGMH Acquisition, AGMH likely experienced an "ownership change" within the meaning of Section 382 of the Code. The Company has concluded that the Section 382 limitations as discussed in "An ownership change under Section 382 of the Code could have adverse U.S. federal tax consequences" are unlikely to have any material tax or accounting consequences. However, this conclusion is based on a variety of assumptions, including the Company's estimates regarding the amount and timing of certain deductions and future earnings, any of which could be incorrect. Accordingly, there can be no assurance that these limitations would not have an adverse effect on the Company's financial condition or that such adverse effects would not be material.

A change in AGL's U.K. tax residency status or its ability to otherwise qualify for the benefits of income tax treaties to which the U.K. is a party could adversely affect an investment in AGL's common shares.

AGL is not incorporated in the U.K. and, accordingly, can only be resident in the U.K. for U.K. tax purposes if it is "centrally managed and controlled" in the U.K. Central management and control constitutes the highest level of control of a company's affairs. AGL believes that it will be entitled to take advantage of the benefits of income tax treaties to which the U.K. is a party on the basis that it has established central management and control in the U.K. AGL has obtained confirmation that there is a low risk of challenge to its residency status from HMRC under the facts as they

stand today. The board of directors intends to manage the affairs of AGL in such a way as to maintain its status as a company that is tax-resident in the U.K. for U.K. tax purposes and to qualify for the benefits of income tax treaties to which the U.K. is a party. However, the concept of central management and control is a case-law concept that is not comprehensively defined in U.K. statute. In addition, it is a question of fact. Moreover, tax treaties may be revised in a way that causes AGL to fail to qualify for benefits thereunder. Accordingly, a change in relevant U.K. tax law or in tax treaties to which the U.K. is a party, or in AGL's central management and control as a factual matter, or other events, could adversely affect the ability of Assured Guaranty to manage its capital in the efficient manner that it contemplated in establishing U.K. tax residence.

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Changes in U.K. tax law or in AGL's ability to satisfy all the conditions for exemption from U.K. taxation on dividend income or capital gains in respect of its direct subsidiaries could affect an investment in AGL's common shares.

As a U.K. tax resident, AGL is subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to applicable exemptions. The main rate of corporation tax is 23% currently.

• With respect to income, the dividends that AGL receives from its subsidiaries should be exempt from U.K. corporation tax under the exemption contained in section 931D of the Corporation Tax Act 2009.

With respect to capital gains, if AGL were to dispose of shares in its direct subsidiaries or if it were deemed to have done so, it may realize a chargeable gain for U.K. tax purposes. Any tax charge would be based on AGL's original acquisition cost. It is anticipated that any such future gain should qualify for exemption under the substantial shareholding exemption in Schedule 7AC to the Taxation of Chargeable Gains Act 1992. However, the availability of such exemption would depend on facts at the time of disposal, in particular the "trading" nature of the activities of the Assured Guaranty group and of the relevant subsidiary. There is no statutory definition of what constitutes "trading" activities for this purpose and in practice reliance is placed on the published guidance of HMRC.

A change in U.K. tax law or its interpretation by HMRC, or any failure to meet all the qualifying conditions for relevant exemptions from U.K. corporation tax, could affect Assured Guaranty's financial results of operations or its ability to provide returns to shareholders.

The financial results of our operations may be affected by measures taken in response to the OECD BEPS project. On July 19, 2013, the Organisation for Economic Co-operation and Development published its Action Plan on Base Erosion and Profit Shifting (the "BEPS Action Plan"), in an attempt to coordinate multilateral action on international tax rules. The recommended actions include an examination of the definition of a "permanent establishment" and the rules for attributing profit to a permanent establishment. Other recommended actions relate to the goal of ensuring that transfer pricing outcomes are in line with value creation, noting that the current rules may facilitate the transfer of risks or capital away from countries where the economic activity takes place. Any changes in U.S. or U.K. tax law in response to the BEPS Action Plan could adversely affect Assured Guaranty's liability to tax.

An adverse adjustment under U.K. legislation governing the taxation of U.K. tax resident holding companies on the profits of their foreign subsidiaries could adversely impact Assured Guaranty's tax liability.

Under the U.K. "controlled foreign company" regime, the income profits of non-U.K. resident companies may, in certain circumstances, be attributed to controlling U.K. resident shareholders for U.K. corporation tax purposes. A new CFC regime was introduced with effect for CFC accounting periods beginning on or after January 1, 2013. The non-U.K. resident members of the Assured Guaranty group intend to operate and manage their levels of capital in such a manner that their profits would not be taxed on AGL under the U.K. CFC regime. Assured Guaranty has obtained clearance from HMRC that none of the profits of the non-U.K. resident members of the Assured Guaranty group should be subject to U.K. tax as a result of attribution under the CFC regime on the facts as they currently stand. However, a change in the way in which Assured Guaranty operates or any further change in the CFC regime, resulting in an attribution to AGL of any of the income profits of any of AGL's non-U.K. resident subsidiaries for U.K. corporation tax purposes, could adversely affect Assured Guaranty's financial results of operations.

Becoming resident in the U.K. for tax purposes may subject Assured Guaranty to additional regulatory requirements with which it may have difficulty complying or which may constrain or limit its ability to take certain actions.

In connection with AGL's establishment of tax residence in the U.K., AGL has been discussing the regulation of AGL and its subsidiaries as a group with the Prudential Regulation Authority in the U.K. and with the NY DFS. The NY DFS has indicated that it will assume responsibility for regulation of the Assured Guaranty group. Group supervision by the NY DFS would result in additional regulatory oversight over Assured Guaranty, and may subject Assured Guaranty to new regulatory requirements and constraints. If the PRA determines that, notwithstanding the NY DFS becoming Assured Guaranty's group regulator, AGL's head office is in the U.K. based upon it having a tax residence there, then AGL may be subject to additional capital and compliance requirements that it must satisfy. If Assured Guaranty is unable to satisfy these additional regulatory requirements, it may not be able to effectuate the efficient management of capital that it contemplated in establishing U.K. tax residence.





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Risks Related to AGL's Common Shares

The market price of AGL's common shares may be volatile, which could cause the value of an investment in the Company to decline.

The market price of AGL's common shares has experienced, and may continue to experience, significant volatility. Numerous factors, including many over which the Company has no control, may have a significant impact on the market price of its common shares. These risks include those described or referred to in this "Risk Factors" section as well as, among other things:

- investor perceptions of the Company, its prospects and that of the financial guaranty industry and the markets in which the Company operates;
- the Company's operating and financial performance;
- the Company's access to financial and capital markets to raise additional capital, refinance its debt or replace existing senior secured credit and receivables-backed facilities;
- the Company's ability to repay debt;
- the Company's dividend policy;
- future sales of equity or equity-related securities;
- changes in earnings estimates or buy/sell recommendations by analysts; and
- general financial, economic and other market conditions.

In addition, the stock market in recent years has experienced extreme price and trading volume fluctuations that often have been unrelated or disproportionate to the operating performance of individual companies. These broad market fluctuations may adversely affect the price of AGL's common shares, regardless of its operating performance.

AGL's common shares are equity securities and are junior to existing and future indebtedness.

As equity interests, AGL's common shares rank junior to indebtedness and to other non-equity claims on AGL and its assets available to satisfy claims on AGL, including claims in a bankruptcy or similar proceeding. For example, upon liquidation, holders of AGL debt securities and shares of preferred stock and creditors would receive distributions of AGL's available assets prior to the holders of AGL common shares. Similarly, creditors, including holders of debt securities, of AGL's subsidiaries, have priority on the assets of those subsidiaries. Future indebtedness may restrict payment of dividends on the common shares.

Additionally, unlike indebtedness, where principal and interest customarily are payable on specified due dates, in the case of common shares, dividends are payable only when and if declared by AGL's board of directors or a duly authorized committee of the board. Further, the common shares place no restrictions on its business or operations or on its ability to incur indebtedness or engage in any transactions, subject only to the voting rights available to stockholders generally.

There may be future sales or other dilution of AGL's equity, which may adversely affect the market price of its common shares.

Future sales or other issuances of AGL's equity may adversely affect the market price of its common shares. In addition, based on a Schedule 13D/A filed by WL Ross Group, L.P. on June 4, 2013 reporting the amount of securities beneficially owned as of May 31, 2013, the Company calculates that WL Ross Group, L.P. and its affiliates owned 8.2% of AGL's common shares as of February 21, 2014. WL Ross Group, L.P. and its affiliates have registration rights with respect to AGL common shares. A sale of a significant portion of such holdings could adversely affect the market price of AGL's common shares.

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Provisions in the Code and AGL's Bye-Laws may reduce or increase the voting rights of its common shares.

Under the Code, AGL's Bye-Laws and contractual arrangements, certain shareholders have their voting rights limited to less than one vote per share, resulting in other shareholders having voting rights in excess of one vote per share. Moreover, the relevant provisions of the Code may have the effect of reducing the votes of certain shareholders who would not otherwise be subject to the limitation by virtue of their direct share ownership.

More specifically, pursuant to the relevant provisions of the Code, if, and so long as, the common shares of a shareholder are treated as "controlled shares" (as determined under section 958 of the Code) of any U.S. Person (as defined below) and such controlled shares constitute 9.5% or more of the votes conferred by AGL's issued shares, the voting rights with respect to the controlled shares of such U.S. Person (a "9.5% U.S. Shareholder") are limited, in the aggregate, to a voting power of less than 9.5%, under a formula specified in AGL's Bye-Laws. The formula is applied repeatedly until the voting power of all 9.5% U.S. Shareholders has been reduced to less than 9.5%. For these purposes, "controlled shares" include, among other things, all shares of AGL that such U.S. Person is deemed to own directly, indirectly or constructively (within the meaning of section 958 of the Code).

In addition, the Board of Directors may limit a shareholder's voting rights where it deems appropriate to do so to (1) avoid the existence of any 9.5% U.S. Shareholders, and (2) avoid certain material adverse tax, legal or regulatory consequences to the Company or any of the Company's subsidiaries or any shareholder or its affiliates. AGL's Bye-Laws provide that shareholders will be notified of their voting interests prior to any vote taken by them.

As a result of any such reallocation of votes, the voting rights of a holder of AGL common shares might increase above 5% of the aggregate voting power of the outstanding common shares, thereby possibly resulting in such holder becoming a reporting person subject to Schedule 13D or 13G filing requirements under the Securities Exchange Act of 1934. In addition, the reallocation of votes could result in such holder becoming subject to the short swing profit recovery and filing requirements under Section 16 of the Exchange Act.

AGL also has the authority under its Bye-Laws to request information from any shareholder for the purpose of determining whether a shareholder's voting rights are to be reallocated under the Bye-Laws. If a shareholder fails to respond to a request for information or submits incomplete or inaccurate information in response to a request, the Company may, in its sole discretion, eliminate such shareholder's voting rights.

Provisions in AGL's Bye-Laws may restrict the ability to transfer common shares, and may require shareholders to sell their common shares.

AGL's Board of Directors may decline to approve or register a transfer of any common shares (1) if it appears to the Board of Directors, after taking into account the limitations on voting rights contained in AGL's Bye-Laws, that any adverse tax, regulatory or legal consequences to AGL, any of its subsidiaries or any of its shareholders may occur as a result of such transfer (other than such as the Board of Directors considers to be de minimis), or (2) subject to any applicable requirements of or commitments to the New York Stock Exchange ("NYSE"), if a written opinion from counsel supporting the legality of the transaction under U.S. securities laws has not been provided or if any required governmental approvals have not been obtained.

AGL's Bye-Laws also provide that if the Board of Directors determines that share ownership by a person may result in adverse tax, legal or regulatory consequences to the Company, any of the subsidiaries or any of the shareholders (other than such as the Board of Directors considers to be de minimis), then AGL has the option, but not the obligation, to require that shareholder to sell to AGL or to third parties to whom AGL assigns the repurchase right for fair market value the minimum number of common shares held by such person which is necessary to eliminate such adverse tax, legal or regulatory consequences.

Existing reinsurance agreement terms may make it difficult to effect a change of control of AGL.

Some of the Company's reinsurance agreements have change of control provisions that are triggered if a third party acquires a designated percentage of AGL's shares. If a change of control provision is triggered, the ceding company may recapture some or all of the reinsurance business ceded to the Company in the past. Any such recapture could adversely affect the Company's shareholders' equity, future income or financial strength or debt ratings. These provisions may discourage potential acquisition proposals and may delay, deter or prevent a change of control of AGL, including through transactions that some or all of the shareholders might consider to be desirable.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The principal executive offices of AGL and AG Re consist of approximately 8,250 square feet of office space located in Hamilton, Bermuda; the lease for this space expires in April 2015 and is renewable at the option of the Company. In addition, the Company occupies approximately 110,000 square feet of office space in New York City; the lease for this office space expires in April 2026. The Company also occupies another approximately 21,000 square feet of office space in London and Sydney, and two offices in San Francisco and Irvine, California. Management believes that the office space is adequate for its current and anticipated needs.

ITEM 3. LEGAL PROCEEDINGS

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

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 their respective businesses, certain of the Company's subsidiaries assert claims in legal proceedings against third parties to recover losses paid in prior periods. For example, as described in the "Recovery Litigation," section of Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data, as of the date of this filing, AGC and AGM have filed complaints against certain sponsors and underwriters of RMBS securities that AGC or AGM had insured, alleging, among other claims, that such persons had breached representations and warranties ("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

The Company receives subpoenas duces tecum and interrogatories from regulators from time to time.

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. On September 9, 2013,

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plaintiffs filed an appeal of the anti-SLAPP ruling on the California antitrust statute. On September 30, 2013, AGC, AGM and the other bond insurer defendants filed a notice of cross-appeal. 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 28, 2011, Lehman Brothers International (Europe) (in administration) ("LBIE") sued AG Financial Products Inc. ("AGFP"), an affiliate of AGC which in the past had provided credit protection to counterparties under credit default swaps. AGC acts as the credit support provider of AGFP under these credit default swaps. LBIE's complaint, which was filed in the Supreme Court of the State of New York, alleged that AGFP improperly terminated nine credit derivative transactions between LBIE and AGFP and improperly calculated the termination payment in connection with the termination of 28 other credit derivative transactions between LBIE and AGFP. With respect to the 28 credit derivative transactions, AGFP calculated that LBIE owes AGFP approximately \$25 million, whereas LBIE asserted in the complaint that AGFP owes LBIE a termination payment of approximately \$1.4 billion. LBIE is seeking unspecified damages. On February 3, 2012, AGFP filed a motion to dismiss certain of the counts in the complaint, and on March 15, 2013, the court granted AGFP's motion to dismiss the count relating to improper termination of the nine credit derivative transactions and denied AGFP's motion to dismiss the count relating to the remaining transactions. The Company cannot reasonably estimate the possible loss, if any, that may arise from this lawsuit.

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.

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. The Company estimates that an adverse outcome to the interpleader proceeding could increase losses on the transaction by approximately \$10 - \$20 million, net of expected settlement payments and reinsurance in force.



Previously, AGM, together with other financial institutions and other parties, including bond insurers, had been 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 in the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00. The action was brought in August 2008 on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleged conspiracy and fraud in connection with the issuance of the County's debt. The complaint sought equitable relief, unspecified monetary damages, interest, attorneys' fees and other costs. In January 2011, the circuit court issued an order denying a motion by the bond insurers and other defendants to dismiss the action. The defendants, including the bond insurers, 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. While awaiting a ruling from the Alabama Supreme Court, Jefferson County filed for bankruptcy and the Alabama Supreme Court entered a stay pending the resolution of the bankruptcy. In November 2013, the United States Bankruptcy Court approved a bankruptcy plan that included dismissal of the pending claims in state court. On January 13, 2014, the circuit court entered an order dismissing the claims against AGM and the other defendants and on January 17, 2014, the Supreme Court of Alabama entered an order dismissing the petition for writ of mandamus.

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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 the Company 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 the Company did acquire. While Dexia SA and DCL, jointly and severally, have agreed to indemnify the Company 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 the Company 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; and

AGM received a subpoena from the SEC in November 2006 related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives.

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 addition, AGMH had 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 indicated that the SEC staff was 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. On January 8, 2014, the SEC issued a letter stating that it had concluded the investigation as to AGMH and, based on the information it had as of such date, it did not intend to recommend an enforcement action by the SEC against AGMH.

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. After appeal, their convictions were reversed by a three-judge panel of the U.S. Court of Appeals for the Second Circuit in November 2013. In January 2014, the Department of Justice petitioned the U.S. Court of Appeals for the Second Circuit for a panel rehearing and a rehearing en banc of the appeal.

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 an amended complaint. The Corrected Third Consolidated Amended Class Action Complaint, filed on October 9, 2013, lists neither AGM nor AGMH as a named defendant or a co-conspirator. The complaints in these lawsuits

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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.

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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. AGM and AGUS answered West Virginia's Second Amended Complaint on November 11, 2013. 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.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## Executive Officers of the Company

The table below sets forth the names, ages, positions and business experience of the executive officers of Assured Guaranty Ltd.

Name	Age	Position(s)
Dominic J. Frederico	61	President and Chief Executive Officer; Deputy Chairman
James M. Michener	61	General Counsel and Secretary
Robert B. Mills	64	Chief Operating Officer
Russell B. Brewer II	56	Chief Surveillance Officer
Robert A. Bailenson	47	Chief Financial Officer
Bruce E. Stern	59	Executive Officer
Howard W. Albert	54	Chief Risk Officer

Dominic J. Frederico has been President and Chief Executive Officer of AGL since December 2003. Mr. Frederico served as Vice Chairman of ACE Limited from June 2003 until April 2004 and served as President and Chief Operating Officer of ACE Limited and Chairman of ACE INA Holdings, Inc. from November 1999 to June 2003. Mr. Frederico was a director of ACE Limited from 2001 until his retirement from that board in May 2005.

Mr. Frederico has also served as Chairman, President and Chief Executive Officer of ACE INA Holdings, Inc. from May 1999 through November 1999. Mr. Frederico previously served as President of ACE Bermuda Insurance Ltd. from July 1997 to May 1999, Executive Vice President, Underwriting from December 1996 to July 1997, and as Executive Vice President, Financial Lines from January 1995 to December 1996. Prior to joining ACE Limited, Mr. Frederico spent 13 years working for various subsidiaries of American International Group ("AIG").

Mr. Frederico completed his employment at AIG after serving as Senior Vice President and Chief Financial Officer of AIG Risk Management. Before that, Mr. Frederico was Executive Vice President and Chief Financial Officer of UNAT, a wholly owned subsidiary of AIG headquartered in Paris, France.

James M. Michener has been General Counsel and Secretary of AGL since February 2004. Prior to joining Assured Guaranty, Mr. Michener was General Counsel and Secretary of Travelers Property Casualty Corp. from January 2002 to February 2004. From April 2001 to January 2002, Mr. Michener served as general counsel of Citigroup's Emerging Markets business. Prior to joining Citigroup's Emerging Markets business, Mr. Michener was General Counsel of Travelers Insurance from April 2000 to April 2001 and General Counsel of Travelers Property Casualty Corp. from May 1996 to April 2000.

Robert B. Mills has been Chief Operating Officer of AGL since June 2011. Mr. Mills was Chief Financial Officer of AGL from January 2004 until June 2011. Prior to joining Assured Guaranty, Mr. Mills was Managing Director and Chief Financial Officer—Americas of UBS AG and UBS Investment Bank from April 1994 to January 2004, where he was also a member of the Investment Bank Board of Directors. Previously, Mr. Mills was with KPMG from 1971 to 1994, where his responsibilities included being partner-in-charge of the Investment Banking and Capital Markets practice.

Russell B. Brewer II has been Chief Surveillance Officer of AGL since November 2009 and Chief Surveillance Officer of AGC and AGM since July 2009. Mr. Brewer has been with AGM since 1986. Mr. Brewer was Chief Risk Management Officer of AGM from September 2003 until July 2009 and Chief Underwriting Officer of AGM from September 1990 until September 2003. Mr. Brewer was also a member of the Executive Management Committee of AGM. He was a Managing Director of AGMH from May 1999 until July 2009. From March 1989 to August 1990, Mr. Brewer was Managing

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Director, Asset Finance Group, of AGM. Prior to joining AGM, Mr. Brewer was an Associate Director of Moody's Investors Service, Inc.

Robert A. Bailenson has been Chief Financial Officer of AGL since June 2011. Mr. Bailenson has been with Assured Guaranty and its predecessor companies since 1990. Mr. Bailenson became Chief Accounting Officer of AGM in July 2009 and has been Chief Accounting Officer of AGL since May 2005 and Chief Accounting Officer of AGC since 2003. He was Chief Financial Officer and Treasurer of AG Re from 1999 until 2003 and was previously the Assistant Controller of Capital Re Corp., the Company's predecessor.

Bruce E. Stern has been Executive Officer of AGC and AGM since July 2009. Mr. Stern was General Counsel, Managing Director, Secretary and Executive Management Committee member of AGM from 1987 until July 2009. Prior to joining AGM, Mr. Stern was an associate at the New York office of Cravath, Swaine & Moore. Mr. Stern has served as Chairman of the Association of Financial Guaranty Insurers since April 2010.

Howard W. Albert has been Chief Risk Officer of AGL since May 2011. Prior to that, he was Chief Credit Officer of AGL from 2004 to April 2011. Mr. Albert joined Assured Guaranty in September 1999 as Chief Underwriting Officer of Capital Re Company, the predecessor to AGC. Before joining Assured Guaranty, he was a Senior Vice President with Rothschild Inc. from February 1997 to August 1999. Prior to that, he spent eight years at Financial Guaranty Insurance Company from May 1989 to February 1997, where he was responsible for underwriting guaranties of asset-backed securities and international infrastructure transactions. Prior to that, he was employed by Prudential Capital, an investment arm of The Prudential Insurance Company of America, from September 1984 to April 1989, where he underwrote investments in asset-backed securities, corporate loans and project financings.



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## PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND  
5. ISSUER PURCHASES OF EQUITY SECURITIES

AGL's common shares are listed on the New York Stock Exchange under symbol "AGO." The table below sets forth, for the calendar quarters indicated, the reported high and low sales prices and amount of any cash dividends declared.

## Common Stock Prices and Dividends

	2013			2012		
	Sales Price		Cash	Sales Price		Cash
	High	Low	Dividends	High	Low	Dividends
First Quarter	\$21.30	\$13.95	\$0.10	\$19.04	\$13.20	\$0.09
Second Quarter	24.73	18.92	0.10	16.58	11.17	0.09
Third Quarter	23.64	18.42	0.10	15.83	11.29	0.09
Fourth Quarter	24.81	17.80	0.10	14.80	12.48	0.09

On February 21, 2013, the closing price for AGL's common shares on the NYSE was \$23.08, and the approximate number of shareholders of record at the close of business on that date was 111.

AGL is a holding company whose principal source of income is dividends from its operating subsidiaries. The ability of the operating subsidiaries to pay dividends to AGL and AGL's ability to pay dividends to its shareholders are each subject to legal and regulatory restrictions. The declaration and payment of future dividends will be at the discretion of AGL's Board of Directors and will be dependent upon the Company's profits and financial requirements and other factors, including legal restrictions on the payment of dividends and such other factors as the Board of Directors deems relevant. For more information concerning AGL's dividends, please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations under the caption "Liquidity and Capital Resources" and Note 12, Insurance Company Regulatory Requirements, of the Financial Statements and Supplementary Data.

## Recent Purchases

During 2013, under the Company's prior \$315 million share repurchase authorization, the Company had repurchased a total of 12.5 million common shares for approximately \$264 million at an average price of \$21.12 per share. This included 5.0 million common shares purchased on June 5, 2013 from funds associated with WL Ross & Co. LLC and its affiliates (collectively, the "WLR Funds") and Wilbur L. Ross, Jr., a director of the Company, for \$109.7 million. This share purchase reduced the WLR Funds' and Mr. Ross's ownership of AGL's common shares to approximately 14.9 million common shares, or to approximately 8.2% of its total common shares outstanding, from approximately 10.5% of such outstanding common shares.

On November 11, 2013, the Company's prior share repurchase authorization was replaced by a new share repurchase authorization of \$400 million. The Company expects the repurchases to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program are at the discretion of management and will depend on a variety of factors, including availability of funds at the holding companies, market conditions, the Company's capital position, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time. It does not have an expiration date.

During the three months ended December 31, 2013, the Company did not repurchase any shares under its share repurchase program or in connection with the payment of employee withholding taxes due in connection with the vesting of restricted stock awards.

## Performance Graph

Set forth below are a line graph and a table comparing the dollar change in the cumulative total shareholder return on AGL's common shares from December 31, 2008 through December 31, 2013 as compared to the cumulative total return of the Standard & Poor's 500 Stock Index and the cumulative total return of the Standard & Poor's 500 Financials Index. The chart and table depict the value on December 31, 2008, December 31, 2009, December 31, 2010, December 31, 2011, December 31, 2012 and December 31, 2013 of a \$100 investment made on December 31, 2008, with all dividends reinvested:



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	Assured Guaranty	S&P 500 Index	S&P 500 Financial Index
12/31/2008	\$ 100.00	\$ 100.00	\$ 100.00
12/31/2009	193.65	126.45	117.15
12/31/2010	159.12	145.49	131.36
12/31/2011	119.69	148.56	108.95
12/31/2012	133.06	172.32	140.26
12/31/2013	224.66	228.12	190.18

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Source: Bloomberg

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## ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read together with the other information contained in this Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes included elsewhere in this Form 10-K. Results of operations of AGMH are included for periods beginning July 1, 2009, which we refer to as the Acquisition Date. Certain prior year balances have been reclassified to conform to the current year's presentation.

	Year Ended December 31,				
	2013	2012	2011	2010	2009
	(dollars in millions, except per share amounts)				
Statement of operations data:					
Revenues:					
Net earned premiums <sup>(1)</sup>	\$752	\$853	\$920	\$1,187	\$930
Net investment income <sup>(1)</sup>	393	404	396	361	262
Net realized investment gains (losses) <sup>(1)</sup>	52	1	(18	) (2	) (33
Realized gains and other settlements on credit derivatives	(42	) (108	) 6	153	164
Net unrealized gains (losses) on credit derivatives	107	(477	) 554	(155	) (338
Fair value gains (losses) on committed capital securities	10	(18	) 35	9	(123
Fair value gains (losses) on financial guaranty variable interest entities <sup>(1)</sup>	346	191	(146	) (274	) (1
Other income (loss)	(10	) 108	58	34	56
Total revenues	1,608	954	1,805	1,313	917
Expenses:					
Loss and loss adjustment expenses <sup>(1)</sup>	154	504	448	412	394
Amortization of deferred acquisition costs <sup>(2)</sup>	12	14	17	22	44
Assured Guaranty Municipal Holdings Inc. acquisition-related expenses	—	—	—	7	92
Interest expense	82	92	99	100	63
Goodwill and settlement of pre-existing relationship	—	—	—	—	23
Other operating expenses <sup>(2)</sup>	218	212	212	238	192
Total expenses	466	822	776	779	808
Income (loss) before (benefit) provision for income taxes	1,142	132	1,029	534	109
Provision (benefit) for income taxes	334	22	256	50	29
Net income (loss)	808	110	773	484	80
Less: Noncontrolling interest of variable interest entities	—	—	—	—	(2
Net income (loss) attributable to Assured Guaranty Ltd.	\$808	\$110	\$773	\$484	\$82
Earnings (loss) per share:					
Basic	\$4.32	\$0.58	\$4.21	\$2.63	\$0.64
Diluted	\$4.30	\$0.57	\$4.16	\$2.56	\$0.63
Dividends per share	\$0.40	\$0.36	\$0.18	\$0.18	\$0.18

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	As of December 31,				
	2013	2012	2011	2010	2009
	(dollars in millions, except per share amounts)				
Balance sheet data (end of period):					
Assets:					
Investments and cash	\$ 10,969	\$ 11,223	\$ 11,314	\$ 10,849	\$ 11,013
Premiums receivable, net of commissions payable	876	1,005	1,003	1,168	1,418
Ceded unearned premium reserve	452	561	709	822	1,078
Salvage and subrogation recoverable	174	456	368	1,032	395
Credit derivative assets	94	141	153	185	217
Total assets	16,287	17,242	17,709	19,370	16,449
Liabilities and shareholders' equity:					
Unearned premium reserve	4,595	5,207	5,963	6,973	8,381
Loss and loss adjustment expense reserve	592	601	679	574	300
Reinsurance balances payable, net	148	219	171	274	212
Long-term debt	816	836	1,038	1,053	1,066
Credit derivative liabilities	1,787	1,934	1,457	2,055	1,759
Total liabilities	11,172	12,248	13,057	15,700	12,995
Accumulated other comprehensive income	160	515	368	112	142
Shareholders' equity attributable to Assured Guaranty Ltd.	5,115	4,994	4,652	3,670	3,455
Shareholders' equity	5,115	4,994	4,652	3,670	3,454
Book value per share	28.07	25.74	25.52	19.97	18.76
Consolidated statutory financial information <sup>(3)</sup> :					
Contingency reserve	\$ 2,934	\$ 2,364	\$ 2,571	\$ 2,288	\$ 1,879
Policyholders' surplus	3,202	3,579	3,116	2,627	2,962
Claims paying resources <sup>(4)</sup>	12,147	12,328	12,839	12,630	13,051
Outstanding Exposure:					
Net debt service outstanding	\$ 690,535	\$ 780,356	\$ 844,447	\$ 926,698	\$ 958,037
Net par outstanding	459,107	518,772	556,830	616,686	640,194

(1) Accounting guidance for variable interest entities ("VIEs") changed effective January 1, 2010. As a result, amounts are not comparable.

(2) Accounting guidance restricting the types and amounts of financial guaranty insurance contract acquisition costs that may be deferred was adopted and retrospectively applied effective January 1, 2012.

(3) Prepared in accordance with accounting practices prescribed or permitted by U.S. insurance regulatory authorities, for all insurance subsidiaries.

(4) Claims paying resources is calculated as the sum of statutory policyholders' surplus, statutory contingency reserve, statutory unearned premium reserves, statutory loss and LAE reserves, present value of installment premium on financial guaranty and credit derivatives, discounted at 6%, and standby lines of credit/stop loss. Total claims paying resources is used by the Company to evaluate the adequacy of capital resources.

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ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF  
7. OPERATIONS

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's consolidated financial statements and accompanying notes which appear elsewhere in this Form 10-K. It contains forward looking statements that involve risks and uncertainties. Please see "Forward Looking Statements" for more information. The Company's actual results could differ materially from those anticipated in these forward looking statements as a result of various factors, including those discussed below and elsewhere in this Form 10-K, particularly under the headings "Risk Factors" and "Forward Looking Statements."

Introduction

The Company provides credit protection products to the 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 financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment ("Debt Service"), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. Obligations insured by the Company include bonds issued by U.S. state or municipal governmental authorities; notes issued to finance international infrastructure projects; and asset-backed securities issued by special purpose entities. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the U.K. The Company also guarantees obligations issued in other countries and regions, including Australia and Western Europe.

Executive Summary

This executive summary of management's discussion and analysis highlights selected information and may not contain all of the information that is important to readers of this Annual Report. For a more detailed description of events, trends and uncertainties, as well as the capital, liquidity, credit, operational and market risks and the critical accounting policies and estimates affecting the Company, this Annual Report should be read in its entirety.

Economic Environment

Business conditions have been difficult for the entire financial guaranty insurance industry since mid-2007, and the industry continues to face challenges in maintaining its market penetration. After a number of years in which Assured Guaranty was essentially the only active financial guarantor, a second monoline guarantor insured a number of small and medium-size issuances in 2013. The Company believes that the presence of a new financial guaranty insurer led to marginally higher overall insurance penetration of the U.S. municipal bond market while also displacing the Company in certain insured transactions.

The overall economic environment in the U.S. has consistently, albeit slowly, recovered over the last few years in a volatile market environment. Indicators such as lower mortgage delinquency rates and increasing housing prices reflected gradual improvement in the housing market. Notably, the stock market rose to record levels during 2013. Still, unemployment rates remained relatively high, leading the Federal Reserve to maintain its program of quantitative easing to keep interest rates low and stimulate economic activity. Although the Federal Reserve began to taper its quantitative easing program in December 2013, management expects the Federal Reserve to do so at a measured pace and to employ conventional methods to maintain a low interest environment until it considers the unemployment problem addressed. A persistently low interest rate environment would continue to present challenges

for the financial guaranty industry but could help stabilize municipal issuance volume following a 15% decline in new issuances in 2013.

Although few municipalities have fully rebuilt reserves to pre-recession levels, most have been taking steps to address the ongoing fiscal challenges they have experienced since the global credit crisis of 2008 and the ensuing recession. This includes, in many cases, significant unfunded pension and retiree healthcare liabilities. Revenues at the state level have been rebounding in general, and while the strength of the housing recovery varies from region to region, property tax and other revenues have stabilized for most local governments. Although municipal defaults remain rare, a small number of municipal credits have sought, though not always obtained, bankruptcy protection.

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Municipal bankruptcy is an area of law that is relatively undeveloped due to the relatively low frequency of such cases. The Company has been active in efforts to resolve municipal bankruptcy cases involving Jefferson County, Alabama and the cities of Stockton, California, and Detroit, Michigan. It has also been closely monitoring legal proceedings in other municipal bankruptcy cases in various states. In the cases of Jefferson County and Stockton, as well as the receivership of Harrisburg, Pennsylvania, final or preliminary settlements have been reached. The publicity surrounding high-profile defaults and bankruptcy filings, especially those few where bond insurers are paying claims, provides evidence of the value of bond insurance; the Company believes this may stimulate demand for its product, especially at the retail level.

The Company is also closely following developments in the Commonwealth of Puerto Rico, which has significant economic challenges. Although recent announcements and actions by the current Governor and his administration indicate officials of the Commonwealth are focused on measures that are intended to help Puerto Rico operate within its financial resources and maintain its access to capital markets, Puerto Rico faces high debt levels, a declining population and an economy that has been in recession since 2006. For additional information on the Company's exposure to Puerto Rico, please refer to "Insured Portfolio— Exposure to Puerto Rico" below.

Although annual new-money issuance volume in the U.S. public finance market changed little from 2012 to 2013, total new issue volume decreased in 2013 because refunding volume decreased approximately 30%. Additionally, the political appetite for incurring new debt was constrained as municipal budgets are still in a recovery mode from the financial recession. Low interest rates tend to suppress demand for bond insurance as the potential savings for issuers are less compelling and some investors prefer to forgo insurance in favor of greater yield.

In the international arena, troubled Eurozone countries continue to be a source of stress in global equity and debt markets. Following the 2011 restructuring of the sovereign debt of Greece, debt costs in Portugal, Spain and Italy remain elevated, although they have declined substantially since the European Central Bank's August 2, 2012 announcement that it would undertake outright monetary transactions in support of Eurozone sovereign bonds. Fiscal austerity programs initiated to address the problems in those and other European Union ("EU") countries have constrained economic growth, although a number of countries are in the process of emerging from recession. The rating agencies have downgraded many European sovereign credits. The Company's exposure to troubled Eurozone countries is described in "—Results of Operations—Consolidated Results of Operations—Losses in the Insured Portfolio" and "—Insured Portfolio—Selected European Exposures."

The economic environment since 2008 has had a significant negative impact on the demand by investors for financial guaranty policies, and it is uncertain when or if demand for financial guaranties will return to their pre-economic crisis level. In particular, there was limited new issue activity and also limited demand for financial guaranties in 2013 and 2012 in both the global structured finance and international infrastructure finance markets. In the latter, however, the Company's three U.K. public-private partnership transactions in the second half of 2013 may signal that demand for capital market infrastructure financings, which have typically required financial guarantees, may be returning. In general, the Company expects that global structured finance and international infrastructure opportunities will increase in the future as the global economy recovers, interest rates rise, more issuers return to the capital markets for financings and institutional investors again utilize financial guaranties.

In 2013 and 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 AGM and AGC to AA- (Stable Outlook) under its revised criteria. In January 2013, after a ten-month review, Moody's assigned the following lower financial strength ratings: A2 (Stable) for AGM, A3 (Stable) for AGC, and Baa1 (Stable) for AG Re. In February 2014, Moody's affirmed the A2 (Stable) for AGM and the A3 (Stable) for AGC, but changed the outlook on the Baa1 for AG Re from stable to negative. The Company believes that Moody's review for possible downgrade of the financial strength ratings of



Assured Guaranty that lasted throughout most of 2012 contributed to a reduction in the demand for the Company's insurance product during that year. In a sign that the impact of the Moody's downgrade has been limited, AGC's and AGM's credit spreads were narrower at June 30, 2013 than at January 1, 2013 by 49% and 32%, respectively. In the second half of 2013, other market factors affected AGC's and AGM's credit spreads, which were 32% and 2% tighter at December 31, 2013 than at January 1, 2013. The higher the Company's credit spread, the lower the perceived benefit of the Company's guaranty is to certain investors. If investors view the Company as being only marginally less risky, or perhaps even as risky, as the uninsured security, they may require almost as much, or as much, yield on a security insured by the Company as on a comparable security offered without insurance by the same issuer. Accordingly, issuers may be unwilling to pay a premium for the Company to insure their securities if the insurance does not lower the costs of borrowing. Although high compared with their pre-2007 levels, both AGC's and AGM's credit spreads were 9% and 16%, respectively, of their March 2009 peaks as of December 31, 2013.

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## Financial Performance of Assured Guaranty

## Financial Results

	Year Ended December 31,		
	2013	2012	Change
	(in millions, except per share amounts)		
Selected income statement data			
Net earned premiums	\$752	\$853	\$(101 )
Net investment income	393	404	(11 )
Realized gains (losses) and other settlements on credit derivatives	(42 )	(108 )	66
Net unrealized gains (losses) on credit derivatives	107	(477)	584
Fair value gains (losses) on financial guaranty variable interest entities	346	191	155
Loss and loss adjustment expenses	(154 )	(504 )	350
Other operating expenses	(218 )	(212 )	(6 )
Net income (loss)	808	110	698
Diluted earnings per share	\$4.30	\$0.57	\$3.73
Selected non-GAAP measures(1)			
Operating income	\$609	\$535	\$74
Operating income per share	\$3.25	\$2.81	\$0.44
Present value of new business production ("PVP")	\$141	\$210	\$(69 )

Please refer to "—Non-GAAP Financial Measures" for a definition of the financial measures that were not (1) promulgated in accordance with GAAP and a reconciliation of the non-GAAP financial measure and the most directly comparable GAAP financial measure, if available.

## Net Income (Loss)

There are several primary drivers of volatility in reported net income or loss that are not necessarily indicative of credit impairment or improvement, or ultimate economic gains or losses: changes in credit spreads of insured credit derivative obligations and financial guaranty variable interest entities' ("FG VIEs") assets and liabilities, changes in the Company's own credit spreads, and changes in risk-free rates used to discount expected losses. Changes in credit spreads have the most significant effect on changes in fair value of credit derivatives and FG VIE assets and liabilities. In addition to these factors, changes in expected losses, the timing of refundings and terminations, realized gains and losses on the investment portfolio (including other-than-temporary impairments), the effects of large settlements or transactions, and the effects of the Company's various loss mitigation strategies, among other factors, may also have a significant effect on reported net income or loss in a given reporting period.

Net income for 2013 increased to \$808 million from \$110 million in 2012 due primarily to unrealized gains on credit derivatives, compared to unrealized losses in 2012, lower loss and loss adjustment expenses and higher FG VIE gains. The unrealized gains on credit derivatives for 2013 were due to the termination of two large policies, the run-off of par outstanding and underlying asset price appreciation, while in 2012, the unrealized losses were due to the decline in the credit spreads on AGC and AGM. In 2013, the FG VIE gains were the result of R&W benefits on several VIE assets as a result of settlements with various counterparties during the year. The decline in loss and loss adjustment expenses is due to lower U.S. RMBS losses and lower non-U.S. public finance losses (2012 included losses on European exposures), partially offset by U.S. public finance losses. Net earned premiums in 2013 declined compared to 2012 due to the scheduled amortization of the insured portfolio.

## Operating Income and Adjusted Book Value

In 2013, operating income, a non-GAAP financial measure, was \$609 million, compared with \$535 million in 2012. The increase in operating income was primarily due to lower loss expense. As of December 31, 2013, adjusted book value and adjusted book value per share, both of which are non-GAAP financial measures, were \$9.0 billion and \$49.58, respectively, compared to \$9.2 billion and \$47.17 as of December 31, 2012. Share repurchases in 2013 reduced adjusted book value, but increased adjusted book value per share by \$1.84. See Note 19, Shareholders' Equity, of the Financial Statements and

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Supplementary Data for additional detail about the common shares that the Company has repurchased in 2013 and see "-Non-GAAP Financial Measures" below for a description of these non-GAAP financial measures.

### Key Business Strategies

In 2013, the Company's key business strategies were comprised of: loss mitigation; new business development; and the development of a strategy to manage capital more efficiently within the Assured Guaranty group.

### Loss Mitigation

The Company continued its risk remediation strategies in 2013, which lowered losses and improved its rating agency capital position. The Company believes that it is often in a better position to manage the risks in its insured portfolio and to mitigate losses from troubled credits than a bondholder or security holder would be, due to its knowledge about the terms of the insured transactions, its surveillance and workout resources and, in some instances, the remedies available to it as an insurer.

In an effort to recover losses the Company experienced in its insured U.S. RMBS portfolio, the Company pursues R&W providers by enforcing R&W provisions in contracts, negotiating agreements with R&W providers relating to those provisions and, where appropriate, initiating litigation against R&W providers. See Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data, for a discussion of the R&W settlements the Company has entered into and the litigation proceedings the Company has initiated against R&W providers and other parties. In 2013, the Company entered into several RMBS settlements that contributed \$289 million to the R&W development. The Company's loss mitigation efforts in respect of its U.S. RMBS exposure over the past several years have resulted in R&W providers paying or agreeing to pay, pursuant to settlement agreements and/or following favorable court decisions, an aggregate of \$3.6 billion (gross of reinsurance) in respect of R&W. The Company believes these results are significant and will enable it to pursue more effectively R&W providers for U.S. RMBS transactions it has insured.

In addition, the Company has been focused on the quality of servicing of the mortgage loans underlying its insured RMBS transactions. Servicing 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 of December 31, 2013, the Company's net insured par of the transactions subject to a servicing transfer was \$2.3 billion and the net insured par of the transactions subject to a special servicing arrangement was \$843 million.

In the public finance and infrastructure finance arena, the Company has been able to negotiate consensual restructurings with various obligors. During 2013, the Company reached agreements with respect to its exposures to Mashantucket Pequot Tribe; Jefferson County, Alabama; Stockton, California and Harrisburg, Pennsylvania. The agreement with respect to Stockton, California is still subject to Bankruptcy Court approval. In connection with the Jefferson County and Harrisburg settlements, the Company insured new revenue bonds for both municipalities, and the premium it was paid was included as part of the 2013 PVP below. See "Selected U.S. Public Finance Transactions" in Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data, for a discussion of the respective arrangements reached.

The Company is also continuing to purchase attractively priced BIG obligations that it has insured. These purchases resulted in a reduction of net expected loss to be paid of \$573 million as of December 31, 2013. As of December 31, 2013, the fair value of assets purchased for loss mitigation purposes (excluding the value of the Company's insurance)

was \$537 million, with a par of \$1,652 million (including bonds related to FG VIEs of \$98 million in fair value and \$695 million in par).

#### New Business Development

In July 2013, the Company completed a series of transactions that enabled it to begin offering financial guaranty insurance through MAC, an insurer that will only underwrite U.S. public finance risk, focusing on investment grade obligations in select sectors of the municipal market. The Company increased the capitalization of MAC, which it had acquired in May 2012, and ceded to it a portfolio of geographically diversified U.S. public finance exposure from AGM and AGC. The Company believes MAC enhances its overall competitive position because it was able to begin operations with capital consisting of \$400 million in surplus, \$300 million in surplus notes issued to its parent Municipal Assurance Holdings Inc. ("MAC Holdings") and \$100 million in surplus notes issued to AGM, and with a seasoned book of U.S. public finance business totaling \$111 billion in assumed par; it has a future stream of investment income and premiums earnings; and it has no structured finance exposure. MAC has obtained financial strength ratings of AA+ (stable outlook) from Kroll and AA- (stable

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outlook) from S&P. It has also obtained licenses to provide financial guaranty insurance and reinsurance in 47 U.S. jurisdictions, including the District of Columbia. MAC issued its first financial guaranty insurance policy in August 2013. Additional information about the transactions the Company effected to establish MAC is set out in Note 12, Insurance Company Regulatory Requirements, of the Financial Statements and Supplementary Data.

In 2013, the Company continued to focus on new business production. During the year, it issued financial guaranty insurance policies and financial guarantees in all of its markets: U.S. public finance, structured finance, and international infrastructure. The average internal rating of the gross par written by the Company in 2013 was A-.

## New Business Production

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
PVP(1):			
Public Finance—U.S.			
Assumed from Radian Asset Assurance Inc.	\$—	\$22	\$—
Direct	116	144	173
Public Finance—non-U.S.	18	1	3
Structured Finance—U.S.	7	43	60
Structured Finance—non-U.S.	—	—	7
Total PVP	\$141	\$210	243
Gross Par Written:			
Public Finance—U.S.			
Assumed from Radian Asset Assurance Inc.	\$—	\$1,797	\$—
Direct	8,671	14,364	15,092
Public Finance—non-U.S.	392	35	127
Structured Finance—U.S.	287	620	1,673
Structured Finance—non-U.S.	—	—	—
Total gross par written	\$9,350	\$16,816	16,892

PVP represents the present value of estimated future earnings primarily on new financial guaranty contracts written (1) in the period, before consideration of cessions to reinsurers. See “--Non-GAAP Financial Measures--PVP or Present Value of New Business Production” for a definition of this non-GAAP financial measure.

In the Company’s U.S. public finance business, PVP and gross par written have declined over the past three years due to the low interest rate environment in the U.S., which results in lower demand for financial guaranty insurance from issuers; the low volume of new issuance in the U.S. public finance market, which results in fewer insurable bonds; increased competition from a new financial guaranty insurer; and uncertainty over the financial strength ratings of AGM and AGC. However, the Company believes there will be continued demand for its insurance in this market because for those exposures that the Company guarantees, it undertakes the tasks of credit selection, analysis, negotiation of terms, surveillance and, if necessary, loss mitigation. The Company believes that its insurance encourages retail investors, who typically have fewer resources than the Company for analyzing municipal bonds, to purchase such bonds; enables institutional investors to operate more efficiently; and allows smaller, less well-known issuers to gain market access on a more cost-effective basis.

The following tables present summarized information about the U.S. municipal market's new debt issuance volume and the Company's share of that market over the past three years.



Table of ContentsU.S. Municipal Market Data  
Based on Sale Date

	Year Ended December 31, 2013		2012		2011	
	Par	Number of issues	Par	Number of issues	Par	Number of issues
	(dollars in billions, except number of issues)					
New municipal bonds issued	\$311.9	10,558	\$366.7	12,544	\$285.2	10,176
Total insured	12.1	1,025	13.2	1,159	15.2	1,228
Insured by AGC, AGM and MAC	7.5	488	13.2	1,157	15.2	1,228

Industry Penetration Rates  
U.S. Municipal Market

	Year Ended December 31,		
	2013	2012	2011
Market penetration par	3.9%	3.6%	5.3%
Market penetration based on number of issues	9.7	9.2	12.1
% of single A par sold	11.0	11.9	15.8
% of single A transactions sold	30.6	29.5	37.8
% of under \$25 million par sold	10.9	11.7	14.7
% of under \$25 million transactions sold	10.7	10.3	13.2

U.S. public finance PVP, which increased in 2013, included written business related to the Jefferson County, Alabama and Harrisburg, Pennsylvania debt restructurings. Structured finance PVP decreased in 2013; in that market, AGC guaranteed transactions related to equipment leases and state insurance premium tax credits. International infrastructure PVP increased to \$18 million due to the guarantee of three U.K. infrastructure transactions, the first wrapped U.K. infrastructure bonds since 2008.

The Company has entered into several commutation agreements over the past three years to reassume previously ceded books of business resulting in an increase to net unearned premiums of \$100 million and an increase in net par of \$18.5 billion.

## Capital Management

The Company reviewed strategies for improving the efficiency of its management of capital within the Assured Guaranty group and decided that AGL would become tax resident in the United Kingdom, while remaining a Bermuda-based company and continuing to carry on its administrative and head office functions in Bermuda. As a U.K. tax resident company, AGL will be subject to the tax rules applicable to companies resident in the U.K. For more information about AGL becoming a U.K. tax resident, see the "Tax Matters" section of "Item 1. Business."

The Company has utilized its capital to repurchase its common shares. As of December 31, 2013, the Company's share repurchase authorization was \$400 million. In 2013, the Company had repurchased a total of 12.5 million common shares for approximately \$264 million at an average price of \$21.12 per share. The Company expects future share repurchases, if any, to be made from time to time in the open market or in privately negotiated transactions. The timing, form and amount of the share repurchases under the program are at the discretion of management and will depend on a variety of factors, including availability of funds at the holding companies, market conditions, the



Company's capital position, legal requirements and other factors. The repurchase program may be modified, extended or terminated by the Board of Directors at any time. It does not have an expiration date. See Note 19, Shareholders' Equity, of the Financial Statements and Supplementary Data, for additional information about the Company's repurchases of its common shares.

In order to reduce leverage, and possibly rating agency capital charges, the Company has mutually agreed with beneficiaries to terminate selected financial guaranty insurance and credit derivative contracts. In particular, the Company has targeted investment grade securities for which claims are not expected but which carry a disproportionately large rating agency

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capital charge. The Company terminated \$7.1 billion in net par in 2013, \$4.1 billion in net par in 2012 and \$12.8 billion in net par in 2011.

Results of Operations

Estimates and Assumptions

The Company's consolidated financial statements include amounts that are determined using estimates and assumptions. The actual amounts realized could ultimately be materially different from the amounts currently provided for in the Company's consolidated financial statements. Management believes the most significant items requiring inherently subjective and complex estimates are expected losses, including assumptions for breaches of R&W, fair value estimates, other-than-temporary impairment, deferred income taxes, and premium revenue recognition. The following discussion of the results of operations includes information regarding the estimates and assumptions used for these items and should be read in conjunction with the notes to the Company's consolidated financial statements.

An understanding of the Company's accounting policies is of critical importance to understanding its consolidated financial statements. See Part II, Item 8. "Financial Statements and Supplementary Data" for significant accounting policies, fair value methodologies and significant assumptions.

The Company carries a portion of its assets and liabilities at fair value, the majority of which are measured at fair value on a recurring basis. Level 3 assets, consisting primarily of financial guaranty variable interest entities' assets, credit derivative assets and investments, represented approximately 25% of total assets measured at fair value on a recurring basis as of December 31, 2013 and 2012. All of the Company's liabilities measured at fair value on a recurring basis as of December 31, 2013 and 2012 are Level 3. See Note 8, Fair Value Measurement, of the Financial Statements and Supplementary Data for additional information about assets and liabilities classified as Level 3.

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## Consolidated Results of Operations

## Consolidated Results of Operations

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Revenues:			
Net earned premiums	\$752	\$853	\$920
Net investment income	393	404	396
Net realized investment gains (losses)	52	1	(18 )
Net change in fair value of credit derivatives:			
Realized gains (losses) and other settlements	(42 )	(108 )	6 )
Net unrealized gains (losses)	107	(477)	554 )
Net change in fair value of credit derivatives	65	(585)	560 )
Fair value gains (losses) on committed capital securities ("CCS")	10	(18)	35 )
Fair value gains (losses) on FG VIEs	346	191	(146 )
Other income (loss)	(10 )	108 )	58
Total revenues	1,608	954	1,805
Expenses:			
Loss and LAE	154	504	448
Amortization of deferred acquisition costs	12	14	17
Interest expense	82	92	99
Other operating expenses	218	212	212
Total expenses	466	822	776
Income (loss) before provision for income taxes	1,142	132	1,029
Provision (benefit) for income taxes	334	22	256
Net income (loss)	\$808	\$110	\$773

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## Net Earned Premiums

Net earned premiums are recognized over the contractual lives, or in the case of homogeneous pools of insured obligations, the remaining expected lives, of financial guaranty insurance contracts. The Company estimates remaining expected lives of its insured obligations and makes prospective adjustments for such changes in expected lives.

## Net Earned Premiums

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Financial guaranty:			
Public finance			
Scheduled net earned premiums and accretion	\$292	\$339	\$360
Accelerations(1)	207	250	125
Total public finance	499	589	485
Structured finance			
Scheduled net earned premiums and accretion	195	263	433
Accelerations(1)	56	—	—
Total structured finance(2)	251	263	433
Other	2	1	2
Total net earned premiums	\$752	\$853	\$920

(1) Reflects the unscheduled refunding of an insured obligation or the termination of the insurance on an insured obligation.

(2) Excludes \$60 million, \$153 million and \$75 million for 2013, 2012 and 2011, respectively, related to consolidated FG VIEs.

2013 compared with 2012: Net earned premiums decreased compared with 2012 due primarily to the scheduled amortization of the insured portfolio offset in part by higher premium accelerations due to refundings and terminations. At December 31, 2013, \$4.2 billion of net deferred premium revenue remained to be earned over the life of the insurance contracts. Scheduled net earned premiums are expected to decrease each year unless replaced by a higher amount of new business or reassumptions of previously ceded business. See Note 4, Financial Guaranty Insurance Premiums, of the Financial Statements and Supplementary Data, for the expected timing of future premium earnings.

2012 compared with 2011: Net earned premiums decreased compared with 2011 due primarily to the scheduled amortization of the structured finance insured portfolio, offset in part by an increase in premium accelerations due to refundings and terminations. Refundings were higher due to the low interest rate environment, which encourages refinancings of relatively more expensive debt obligations with lower cost debt obligations. At December 31, 2012, \$4.8 billion of net deferred premium revenue remained to be earned over the life of the insurance contracts. Before considering the elimination of premiums related to consolidated FG VIEs, net earned premiums increased primarily due to the acceleration of \$82 million in net earned premiums on two transactions that are accounted for as FG VIEs, for which the Company's financial guaranty insurance obligation was terminated.

## Net Investment Income

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.

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## Net Investment Income (1)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Income from fixed-maturity securities managed by third parties	\$322	\$346	\$359
Income from internally managed securities:			
Fixed maturities	74	60	39
Other invested assets	5	6	6
Other	0	1	1
Gross investment income	401	413	405
Investment expenses	(8	) (9	) (9
Net investment income	\$393	\$404	\$396

(1) Net investment income excludes \$13 million for 2013 and 2012 and \$8 million for 2011 related to consolidated FG VIEs.

2013 compared with 2012: Net investment income decreased primarily due to lower reinvestment rates, partially offset by higher income earned on loss mitigation bonds, which the Company generally purchased at a discount resulting in higher yields. The overall pre-tax book yield was 3.79% at December 31, 2013 and 3.85% at December 31, 2012, respectively.

2012 compared with 2011: Net investment income increased primarily due to higher income earned on loss mitigation bonds, which the Company generally purchased at a discount and which carry high investment yields. Income earned on the externally managed portfolio declined due to a lower fixed maturity balance and lower reinvestment rates. The overall pre-tax book yield was 3.85% at December 31, 2012 and 4.00% at December 31, 2011, respectively.

## Net Realized Investment Gains (Losses)

The table below presents the components of net realized investment gains (losses). See Note 11, Investments and Cash, of the Financial Statements and Supplementary Data.

## Net Realized Investment Gains (Losses)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Gross realized gains on investment portfolio	\$113	\$43	\$37
Gross realized losses on investment portfolio	(19	) (25	) (10
Other-than-temporary impairment (1)	(42	) (17	) (45
Net realized investment gains (losses)	\$52	\$1	\$(18

(1) Net realized investment gains (losses) reported in accordance with GAAP exclude other-than-temporary impairment related to consolidated FG VIEs of \$2 million for 2013, \$4 million for 2012 and \$12 million for 2011.

The increase in gross realized gains on investment portfolio in 2013 when compared to 2012 was due to sales of assets acquired as part of negotiated settlements, bonds purchased for loss mitigation purposes and other invested assets. Other-than-temporary impairment for all three years was primarily attributable to securities that were acquired for loss mitigation purposes.

Other Income

Other income is comprised of recurring items such as foreign exchange remeasurement gains and losses, ancillary fees on financial guaranty policies such as commitment, consent and processing fees, and other revenue items on financial guaranty insurance and reinsurance contracts such as commutation gains on re-assumptions of previously ceded business.

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## Other Income (Loss)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Foreign exchange gain (loss) on remeasurement of premium receivable and loss reserves	\$(1 )	\$22	\$(5 )
Commutation gains (losses)	2	82	32
Other	(11 )	4	31
Total other income (loss)	\$(10 )	\$108	\$58

Over the past several years, the Company has entered into several commutations in order to reassume previously ceded books of business from its reinsurers, as discussed in Note 14, Reinsurance and Other Monoline Exposures, of the Financial Statements and Supplementary Data.

Other income includes the R&W settlement benefit for transactions where the Company had recovered more than its expected lifetime losses due to a negotiated agreement with an R&W provider. Such excess may not be recorded as an offset to loss and LAE under GAAP.

## Other Operating Expenses and Amortization of Deferred Acquisition Costs

2013 compared with 2012: Other operating expenses increased primarily due to higher employee compensation and benefits. In 2012, the employee compensation and benefits were impacted by the reduction of the bonus and Performance Retention Plan ("PRP") accruals.

2012 compared with 2011: Other operating expenses in 2012 were relatively consistent with 2011. Deferral rates were 6.4% in 2012 compared to 7.3% in 2011.

## Losses in the Insured Portfolio

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. Please refer to Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data, for a discussion of the accounting policies, assumptions and methodologies used in calculating the expected loss to be paid for all contracts. For a discussion of the measurement and recognition accounting policies under GAAP for each type of contract, see the following in Item 8, Financial Statements and Supplementary Data:

- Notes 4, 5 and 7 for financial guaranty insurance,
- Note 9 for credit derivatives,
- Note 10 for consolidated FG VIE, and
- Note 8 for fair value methodologies for credit derivatives and FG VIE assets and liabilities.

The discussion of losses that follows encompasses losses on all contracts in the insured portfolio regardless of accounting model, unless otherwise specified. In order to effectively evaluate and manage the economics of the entire insured portfolio, management compiles and analyzes expected loss information for all policies on a consistent basis. That is, management monitors and assigns ratings and calculates expected losses in the same manner for all its exposures. Management also considers contract specific characteristics that affect the estimates of expected loss.



The surveillance process for identifying transactions with expected losses is described in the notes to the consolidated financial statements. In the third quarter of 2013, the Company refined the definitions of its BIG surveillance categories to be consistent with its new approach to assigning internal credit ratings. See "Refinement of Approach to Internal Credit Ratings and Surveillance Categories" in Note 3, Outstanding Exposure, of the Financial Statements and Supplementary Data. 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 future losses possible, but for which none are currently expected.

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BIG Category 2: Below-investment-grade transactions for which future 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 future losses are expected and on which claims (other than liquidity claims) have been paid.

BIG Net Par Outstanding  
and Number of Risks

Description	Net Par Outstanding as of December 31, 2013                      2012 (dollars in millions)		Number of Risks (1) as of December 31, 2013                      2012	
	BIG:			
Category 1	\$14,751	\$10,820	210	196
Category 2	3,949	4,617	101	103
Category 3	3,838	6,860	146	160
Total BIG	\$22,538	\$22,297	457	459

(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 increase in BIG net par outstanding was due primarily to the downgrade of most of the Company's insured Puerto Rico credits from investment grade to the BIG 1 category, offset in part by the run off of BIG U.S. RMBS exposures.

Net Expected Loss

Net expected loss to be paid consists primarily of the present value of future: expected claim payments, expected recoveries of excess spread in the transaction structures, cessions to reinsurers, and expected recoveries for breaches of R&W and the effects of other loss mitigation strategies. Current risk free rates are used to discount expected losses at the end of each reporting period and therefore changes in such rates from period to period affect the expected loss estimates reported. The effect of changes in discount rates are included in net economic loss development, however, economic loss development attributable to changes in discount rates is not indicative of credit impairment or improvement. Assumptions used in the determination of the net expected loss to be paid 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. The primary drivers of changes in expected loss to be paid are discussed below.

The primary difference between net economic loss development and loss expense included in operating income relates to the consideration of deferred premium revenue in the calculation of loss reserves and loss expense. For financial guaranty insurance contracts, a loss is generally recorded only when expected losses exceed deferred premium revenue. Therefore, the timing of loss recognition does not necessarily coincide with the timing of the actual credit impairment or improvement reported in net economic loss development. AGM's U.S. RMBS transactions generally have the largest deferred premium revenue balances because of the purchase accounting adjustments that were made in 2009 in connection with Assured Guaranty's purchase of AGM, and therefore the largest differences between net economic loss development and loss expense relate to AGM policies. See "-Losses Incurred" below.



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## Economic Loss Development (1)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
U.S. RMBS before benefit for recoveries for breaches of R&W	\$140	\$367	\$1,039
Net benefit for recoveries for breaches of R&W	(296	) (179	) (1,038
U.S. RMBS after benefit for recoveries for breaches of R&W	(156	) 188	1
Other structured finance	(34	) (28	) 80
Public finance	256	295	43
Other	(10	) (17	) —
Total	\$56	\$438	\$124

(1) Economic loss development 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.

## Claims (Paid) Recovered (1)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
U.S. RMBS before benefit for recoveries for breaches of R&W	\$(587	) \$(996	) \$(1,051
Net benefit for recoveries for breaches of R&W	954	459	1,059
U.S. RMBS after benefit for recoveries for breaches of R&W	367	(537	) 8
Other structured finance	(134	) (39	) (26
Public finance (2)	6	(303	) (65
Other	10	12	—
Total	\$249	\$(867	) \$(83

(1) Includes cash paid and recovered, as well as non-cash settlement of claims such as those negotiated in restructurings where the Company receives securities instead of cash.

(2) The largest component of claims paid in 2012 was related to exposure to Greek sovereign debt which has been fully settled.

## Net Expected Loss to be Paid

	As of	As of
	December 31,	December 31,
	2013	2012
	(in millions)	
U.S. RMBS before benefit for recoveries for breaches of R&W	\$1,205	\$1,652
Net benefit for recoveries for breaches of R&W	(712	) (1,370
U.S. RMBS after benefit for recoveries for breaches of R&W	493	282
Other structured finance	171	339
Public finance	321	59
Other	(3	) (3
Total	\$982	\$677

## 2013 Net Economic Loss Development

Total economic loss development was \$56 million in 2013, primarily due to U.S. public finance losses related to Detroit, Puerto Rico and Harrisburg, partially offset by favorable development in U.S. RMBS due to the various settlements

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during the year. Excluding the settlements, U.S. RMBS loss development was primarily due to the change in assumptions for first liens. The risk-free rates used to discount expected losses ranged from 0.0% to 4.44% as of December 31, 2013 compared with 0.0% to 3.28% as of December 31, 2012.

**U.S. Public Finance Economic Loss Development:** The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$5.4 billion net par. The Company rates \$5.2 billion net par of that amount BIG. Although recent announcements and actions by the current Governor and his administration indicate officials of the Commonwealth are focused on measures that are intended to help Puerto Rico operate within its financial resources and maintain its access to the capital markets, Puerto Rico faces significant challenges, including high debt levels, a declining population and an economy that has been in recession since 2006. Puerto Rico has been operating with a structural budget deficit in recent years, and its two largest pension funds are significantly underfunded. In February 2014, S&P, Moody's and Fitch Ratings downgraded much of the debt of Puerto Rico and its related authorities and public corporations to below investment grade, citing various factors including limited liquidity and market access risk. The Commonwealth has not defaulted on any of its debt. Neither Puerto Rico nor its related authorities and public corporations are eligible debtors under Chapter 9 of the U.S. Bankruptcy Code. Information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer to "Insured Portfolio—Exposure to Puerto Rico" below.

Many U.S. municipalities and related entities continue to be under increased pressure, 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. In 2013, the Company reached agreements with Jefferson County, Harrisburg and Stockton. See "Selected U.S. Public Finance Transactions" in Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data, for a discussion of respective arrangements reached.

The net par outstanding for these and all other BIG rated U.S. public finance obligations was \$9.1 billion as of December 31, 2013 and \$4.6 billion as of December 31, 2012. The Company projects that its total future expected net loss across its troubled U.S. public finance credits as of December 31, 2013 will be \$264 million, up from \$7 million as of December 31, 2012.

**U.S. RMBS Economic Loss Development:** 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 or 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 Company's RMBS loss projection methodology assumes that the housing and mortgage markets will continue improving. 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. Based on such observations the Company chose to use the same general approach (with the refinements described below) to project RMBS losses as of December 31, 2013 as it used as of December 31, 2012. The Company's use of the same general methodology to project RMBS losses as of December 31, 2013 as it used as of December 31, 2012 was consistent with its view at December 31, 2013 that the housing and mortgage market recovery was occurring at a slower pace than it anticipated at December 31, 2012.

The Company refined its first lien RMBS loss projection methodology as of December 31, 2013 to model explicitly the behavior of borrowers with loans that had been modified. The Company has observed that mortgage loan servicers were modifying more mortgage loans (reducing or forbearing from collecting interest or principal or both due on mortgage loans) to reduce the borrowers' monthly payments and so improve their payment performance than was the case before the mortgage crisis. Borrowers who are current based on their new, reduced monthly payments are generally reported as current, but are more

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likely to default than borrowers who are current and whose loans have not been modified. The Company believes modified loans are most likely to default again during the first year after modification. The Company set its liquidation rate assumptions as of December 31, 2012 based on observed roll rates and with modification activity in mind. As of December 31, 2013 the Company made a number of refinements to its first lien RMBS loss projection assumptions to treat loan modifications explicitly. Specifically, in the base case approach, it:

- established a liquidation rate assumption for loans reported as current but that had been reported as modified in the previous 12 months,

- assumed that currently delinquent loans that did not roll to liquidation would behave like modified loans, and so applied the modified loan liquidation rate to them,

- increased from two to three years the period over which it calculates the initial conditional default rate ("CDR") based on assumed liquidations of non-performing loans and modified loans, to account for the longer period modified loans will take to default,

- increased the period it assumes the transactions will experience the initial loss severity assumption before it improves and the period during which the transaction will experience low voluntary prepayment rates,

- established an assumption for servicers not to advance loan payments on all delinquent loans

The methodology and revised assumptions the Company uses to project first lien RMBS losses and the scenarios it employs are described in more detail Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data. The refinement in assumptions described above resulted in a reduction of the initial CDRs but the application of the initial CDRs for a longer period, which generally resulted in a higher amount of loans being liquidated at the initial CDR under the refined assumptions than under the initial CDR under the previous assumptions. The Company estimated the impact of all of the refinements to its assumptions described above to be an increase of expected losses of approximately \$8 million (before adjustments for settlements or loss mitigation purchases) by running on the first lien RMBS portfolio as of December 31, 2013 base case assumptions similar to what it used as of December 31, 2012 and comparing those results to the results from the refined assumptions.

During 2013 the Company observed improvements in the performance of its second lien RMBS transactions that, when viewed in the context of their performance prior to 2013, suggested those transactions were beginning to respond to the improvements in the residential property market and economy being widely reported by market observers. Based on such observations, in projecting losses for 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 December 31, 2012. Also during 2013 the Company observed material improvements in the delinquency measures of certain second lien RMBS for which the servicing had been transferred, and made certain adjustments on just those transactions to reflect its view that much of this improvement was due to loan modifications and reinstatements made by the new servicer and that such recently modified and reinstated loans may have a higher likelihood of defaulting again. The methodology and assumptions the Company uses to project second lien RMBS losses and the scenarios it employs are described in more detail in Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data.

The Company observed some improvement in delinquency trends in most of its RMBS transactions during 2013, with some of that improvement in second liens driven by servicing transfers it effectuated. Such improvement is naturally transmitted to its projections for each individual RMBS transaction, since the projections are based on the delinquency performance of the loans in that individual transaction.



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—RMBS Transactions," section of Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data. 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

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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 December 31, 2013 the Company has caused entities providing R&Ws to pay or agree to pay approximately \$3.6 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided insurance.

	(in millions)
Agreement amounts already received	\$2,608
Agreement amounts projected to be received in the future	425
Repurchase amounts paid into the relevant RMBS prior to settlement (1)	578
Total R&W payments, gross of reinsurance	\$3,611

(1) These amounts were paid into the relevant RMBS transactions (rather than to the Company as in most settlements) 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 December 31, 2013 an estimated net benefit related to breaches of R&W of \$712 million, which includes \$413 million from agreements with R&W providers and \$299 million in transactions where the Company does not yet have such an agreement, all net of reinsurance.

Developments in the Company's R&W recovery efforts are included in economic loss development. 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.

## Components of R&amp;W Development

	Year Ended December 31, 2013 (in millions)
Inclusion (removal) of deals with breaches of R&W during period	\$6
Change in recovery assumptions as the result of additional file review and recovery success	(6 )
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	(8 )
Results of settlements	289
Accretion of discount on balance	15
Total	\$296

Infrastructure: The Company has insured exposure of approximately \$3.0 billion 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. For more information about this risk, see the Risk Factor captioned "Estimates of expected losses are subject to uncertainties and may not be adequate to cover potential paid claims" under Risks Related to the Company's Expected Losses in "Item 1A. Risk Factors."

## 2012 Net Economic Loss Development

Total economic loss development in 2012 was \$438 million, which was primarily driven by losses on its troubled European exposures, particularly a \$189 million loss in relation to the Company's Greek sovereign bond exposures and loss development on Spanish sub-sovereign exposures, higher U.S. RMBS and U.S. public finance losses, offset in part by positive developments in the TruPS portfolio. Changes in discount rates did not have a significant effect on economic loss development in 2012 as the risk-free rates used to discount expected losses ranged from 0.0% to 3.28% as of December 31, 2012 compared with 0.0% to 3.27% as of December 31, 2011.

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Based on the Company's observation during 2012 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, 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 and December 31, 2011 was consistent with its view at December 31, 2012 that the housing and mortgage market recovery was 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 the Company used to project RMBS losses and the scenarios it employs are described in more detail in Note 6, Expected Loss to be Paid, of the Financial Statements and Supplementary Data.

Developments in the Company's R&W recovery efforts are also included in economic loss development. 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.

## Components of R&amp;W Development

	Year Ended December 31, 2012 (in millions)	
Inclusion (removal) of deals with breaches of R&W during period	\$(3	)
Change in recovery assumptions as the result of additional file review and recovery success	(10	)
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	63	
Results of settlements and judgments	120	
Accretion of discount on balance	9	
Total	\$179	

The net par outstanding for BIG rated U.S. public finance obligations, including Jefferson County, Alabama and Stockton, California, was \$4.6 billion as of December 31, 2012 and \$4.5 billion as of December 31, 2011. The Company projected that its total future expected net loss across its troubled U.S. public finance credits (after projected recoveries of claims already paid) was \$7 million as of December 31, 2012, down from \$16 million as of December 31, 2011.

## 2011 Net Economic Loss Development

Net economic loss development in 2011 was \$124 million, which was driven primarily by non-U.S. RMBS structured finance and non U.S public finance obligations. In the non U.S. RMBS structured finance portfolio, economic loss

development was primarily driven by the decline in risk free rates used to discount expected losses. Loss development in life insurance and film securitizations also contributed to the net loss development, offset in part by positive development in the TruPS portfolio. Economic loss development in the non- U.S. public finance portfolio was comprised mainly of the probability weighted loss estimate on exposures to Greek sovereign debt based on information available at that time. In the U.S. RMBS portfolio, loss development was offset by positive developments in actual and expected recoveries for breaches of R&W. Changes in discount rates had a significant effect on the economic loss development in 2011 as the rates ranged from 0.0% to 3.27% as of December 31, 2011 compared with 0.0% to 5.34% as of December 31, 2010.

During each quarter of 2011 also the Company made a judgment as to whether to change the assumptions it used 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

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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 methodology and scenarios to project RMBS losses as of December 31, 2011 and 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.

Developments in the Company's R&W recovery efforts are also included in economic loss development. 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.

## Components of R&amp;W Development

	Year Ended December 31, 2011 (in millions)
Inclusion (removal) of deals with breaches of R&W during period	\$115
Change in recovery assumptions as the result of additional file review and recovery success	218
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	17
Results of settlements	668
Accretion of discount on balance	20
Total	\$1,038

## Losses Incurred

For transactions accounted for as financial guaranty insurance under GAAP, each transaction's expected loss to be expensed, net of estimated R&W recoveries, is compared with the deferred premium revenue of that transaction. Generally, when the expected loss to be expensed exceeds the deferred premium revenue, a loss is recognized in the income statement for the amount of such excess.

When the Company measures operating income, a non-GAAP financial measure, it calculates the credit derivative and FG VIE losses incurred in a similar manner. Changes in fair value in excess of expected loss that are not indicative of economic deterioration or improvement are not included in operating income.

Expected loss to be paid, as discussed above under "Losses in the Insured Portfolio", is an important liquidity measure in that it provides 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 on financial guaranty insurance policies. Expected loss to be paid

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for FG VIEs pursuant to AGC's and AGM's financial guaranty policies is calculated in a manner consistent with financial guaranty insurance contracts, but eliminated in consolidation under GAAP.

The following tables present the loss and LAE recorded in the consolidated statements of operations by sector for non-derivative contracts and the loss expense recorded under non-GAAP operating income respectively. Amounts presented are net of reinsurance.

Loss and LAE Reported  
on the Consolidated Statements of Operations

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
U.S. RMBS	\$ (4 )	\$ 308	\$ 389
Other structured finance	(35 )	(7 )	118 )
Public finance	214	285	48
Other	—	(17 )	—
Total insurance contracts before FG VIE consolidation	175	569	555
Effect of consolidating FG VIEs	(21 )	(65 )	(107 )
Total loss and LAE	\$ 154	\$ 504	\$ 448

Loss Expense Non-GAAP Operating

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
U.S. RMBS	\$ 8	\$ 369	\$ 365
Other structured finance	(36 )	(40 )	99 )
Public finance	212	284	29
Other	(10 )	(17 )	—
Total	\$ 174	\$ 596	\$ 493

Reconciliation of Loss and LAE to Non-GAAP Loss Expense

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Loss and LAE	\$ 154	\$ 504	\$ 448
Credit derivative loss expense	(1 )	28	(62 )
FG VIE loss expense	21	64	107
Loss expense included in operating income	\$ 174	\$ 596	\$ 493

In 2013, losses incurred were due primarily to U.S. public finance, including Detroit, Puerto Rico and Harrisburg partially offset by positive developments in structured finance, primarily "XXX" life insurance transactions and U.S. RMBS. The positive developments in U.S. RMBS were primarily due to the settlement of several R&W claims. Changes in risk-free rates used to discount losses also affected loss expense for long-dated transactions, however this component of loss expense does not reflect actual credit impairment or improvement in the period.





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In 2012 and 2011, U.S. RMBS insured transactions generated the majority of the losses, partially offset by R&W recoveries and negotiated loss sharing agreements. The incurred loss in public finance in 2012 was primarily due to the Company's Greek sovereign exposures.

For financial guaranty contracts accounted for as insurance, the amounts reported in the GAAP financial statements may only reflect a portion of the current period's economic development and may also include a portion of prior-period economic development. The difference between economic loss development on financial guaranty insurance contracts and loss and LAE recognized in GAAP income is essentially loss development and accretion for financial guaranty insurance contracts that is, or was previously, absorbed in unearned premium reserve. Such amounts have not yet been recognized in income.

The table below presents the expected timing of loss recognition for insurance contracts on both a reported GAAP and non-GAAP operating income basis.

Financial Guaranty Insurance  
Net Expected Loss to be Expensed  
As of December 31, 2013

	In GAAP Reported Income (in millions)	In Non-GAAP Operating Income
2014	\$42	\$53
2015	41	52
2016	33	42
2017	30	39
2018	27	35
2014-2018	173	221
2019-2023	99	120
2024-2028	56	68
2029-2033	36	44
After 2033	27	36
Net expected loss to be expensed (1)	391	489
Discount	406	457
Total future value	\$797	\$946

(1) Net expected loss to be expensed for GAAP reported income is different than non-GAAP operating income by the amount related to consolidated FG VIEs.

#### Net Change in Fair Value of Credit Derivatives

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 and credit spreads, and other market factors. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Except for net estimated credit impairments (i.e., net expected payments), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. Changes in the fair value of

the Company's credit derivatives that do not reflect actual or expected claims or credit losses have no impact on the Company's statutory claims paying resources, rating agency capital or regulatory capital positions. Expected losses to be paid in respect of contracts accounted for as credit derivatives are included in the discussion above "—Losses in the Insured Portfolio."

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 AGC and AGM. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance

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sheet date. Generally, a widening of the CDS prices traded on AGC and 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 AGC and AGM has an effect of offsetting unrealized gains that result from narrowing general market credit spreads.

There are typically no quoted prices for the Company's instruments or similar instruments as financial guaranty contracts do not typically trade in active markets. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to those in the credit derivatives issued by the Company. Therefore, the valuation of the Company's credit derivative contracts requires the use of models that contain significant, unobservable inputs, and are classified as Level 3 in the fair value hierarchy. See Note 8, Fair Value Measurement, of the Financial Statements and Supplemental Data.

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, interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows.

The models used to determine fair value are primarily developed internally based on market conventions for similar transactions that the Company observed in the past. There has been very limited new issuance activity in this market over the past three years and as of December 31, 2013, market prices for the Company's credit derivative contracts were generally not available. Inputs to the estimate of fair value include various market indices, credit spreads, the Company's own credit spread, and estimated contractual payments.

Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. These terms differ from more standardized credit derivatives sold by companies outside of the financial guaranty industry. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions. In addition, the Company employs relatively high attachment points. Because of these terms and conditions, the fair value of the Company's credit derivatives may not reflect the same prices observed in an actively traded market of CDS that do not contain terms and conditions similar to those observed in the financial guaranty market. The Company considers R&W claim recoveries in determining the fair value of its CDS contracts.

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.

## Net Change in Fair Value of Credit Derivatives

Gain (Loss)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Net credit derivative premiums received and receivable	\$119	\$127	\$185
Net ceding commissions (paid and payable) received and receivable	2	1	3
Realized gains on credit derivatives	121	128	188
Terminations	0	(1	) (23

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Net credit derivative losses (paid and payable) recovered and recoverable	(163	)	(235	)	(159	)
Total realized gains (losses) and other settlements on credit derivatives	(42	)	(108	)	6	
Net change in unrealized gains (losses) on credit derivatives	107		(477	)	554	
Net change in fair value of credit derivatives	\$65		\$(585	)	\$560	

Net credit derivative premiums have declined in 2013 and 2012 due primarily to the decline in the net par outstanding to \$54.5 billion at December 31, 2013 from \$70.8 billion at December 31, 2012 and \$85.0 billion at December 31, 2011.

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The table below sets out the net par amount of credit derivative contracts that the Company and its counterparties agreed to terminate on a consensual basis.

Net Par and Accelerations of Credit Derivative Revenues  
from Terminations of CDS Contracts

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Net par of terminated CDS contracts	\$4,054	\$2,264	\$11,543
Accelerations of credit derivative revenues	21	3	25

In 2013, in addition to the agreements to terminate CDS transactions discussed above, in connection with loss mitigation efforts, the Company terminated a CDS transaction that referenced a film securitization after paying the counterparty \$120 million which was recorded in realized gains (losses) and other settlements on credit derivatives, with a corresponding release of the unrealized loss recorded in unrealized gains (losses) on credit derivatives of \$127 million for a net change in fair value of credit derivatives of \$7 million.

Net Change in Unrealized Gains (Losses)  
on Credit Derivatives  
By Sector

Asset Type	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Pooled corporate obligations	\$(32	) \$59	\$39
U.S. RMBS	(69	) (551	) 381
CMBS	0	2	11
Other (1)	208	13	123
Total	\$107	\$(477	) \$554

(1) "Other" includes all other U.S. and international asset classes, such as commercial receivables, international infrastructure, international RMBS securities, and pooled infrastructure securities.

During 2013, unrealized fair value gains were generated in the "other" sector primarily as a result of the termination of a film securitization transaction and a U.K. infrastructure transaction, as well as price improvement on a XXX life securitization transaction. These unrealized gains were partially offset by unrealized fair value losses in the prime first lien, Alt-A, Option ARM and subprime RMBS sectors due to wider implied net spreads. The wider implied net spreads were primarily a result of the decreased cost to buy protection in AGC's name as the market cost of AGC's credit protection decreased. These 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 AGC, which management refers to as the CDS spread on AGC, decreased, the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased slightly during 2013, but did not lead to significant fair value losses, as the majority of AGM policies continue to price at floor levels.

During 2012, U.S. RMBS unrealized fair value losses were generated primarily in the prime first lien, Alt-A, Option ARM and subprime RMBS sectors primarily as a result of the decreased cost to buy protection in AGC's name as the

market cost of AGC's credit protection decreased. These transactions were pricing above their floor levels therefore when the cost of purchasing CDS protection on AGC decreased, the implied spreads that the Company would expect to receive on these transactions increased. The cost of AGM's credit protection also decreased during 2012, but did not lead to significant fair value losses, as the majority of AGM policies continue to price at floor levels. In addition, 2012 included an \$85 million unrealized gain relating to R&W benefits from the agreement with Deutsche Bank.

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In 2011, U.S. RMBS unrealized fair value gains were generated primarily in the Option ARM, Alt-A, prime first lien and subprime sectors primarily as a result of the increased cost to buy protection in AGC's name as the market cost of AGC's credit protection increased. These transactions were pricing above their floor levels; therefore when the cost of purchasing CDS protection on AGC increased, the implied spreads that the Company would expect to receive on these transactions decreased. The unrealized fair value gain in "other" primarily resulted from tighter implied net spreads on a XXX life securitization transaction and a film securitization, which also resulted from the increased cost to buy protection in AGC's name, referenced above. The cost of AGM's credit protection also increased during the year, but did not lead to significant fair value gains, as the majority of AGM policies continue to price at floor levels.

Increases in AGC's credit spreads generally resulted in unrealized gains due to tighter implied net spreads, and decreases in AGC's credit spreads generally resulted in unrealized losses due to wider implied net spreads. See the tables below for the 5 Year and 1 Year CDS spreads on AGC and AGM.

Five-Year CDS Spread  
on AGC and AGM

Quoted price of CDS contract (in basis points)

	As of December 31, 2013	As of December 31, 2012	As of December 31, 2011
AGC	460	678	1,140
AGM	525	536	778

One-Year CDS Spread  
on AGC and AGM

Quoted price of CDS contract (in basis points)

	As of December 31, 2013	As of December 31, 2012	As of December 31, 2011
AGC	185	270	965
AGM	220	257	538

Effect of Changes in the Company's Credit Spread on  
Unrealized Gains (Losses) on Credit Derivatives

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Change in unrealized gains (losses) of credit derivatives:			
Before considering implication of the Company's credit spreads	\$1,374	\$798	\$(68)
Resulting from change in the Company's credit spreads	(1,267)	(1,275)	) 622
After considering implication of the Company's credit spreads	\$107	\$(477)	) \$554

Management believes that the trading level of AGC's and AGM's credit spreads is due to the correlation between AGC's and AGM's risk profile, the current risk profile of the broader financial markets, and to increased demand for credit protection against AGC and AGM, relative to pre-financial crisis levels, 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 AGC's and AGM's credit spread were higher credit spreads in the fixed income security markets relative to pre-financial crisis



levels. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high-yield CDO, trust preferred securities CDO ("TruPS CDOs"), and collateralized loan obligation ("CLO") markets as well as continuing market concerns over the 2005-2008 vintages of RMBS.

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## Interest Expense

For the years ended December 31, 2013 and December 31, 2012, interest expense decreased due to the retirement of the AGUS 8.5% Senior Notes on June 1, 2012 (see Note 17, Long-Term Debt and Credit Facilities, of the Financial Statements and Supplementary Data). The following table presents the components of interest expense.

## Interest Expense

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Debt issued by AGUS	\$23	\$31	\$39
Debt issued by AGMH	54	54	54
Notes payable by AGM	5	7	6
Total	\$82	\$92	\$99

## Provision for Income Tax

Deferred income tax assets and liabilities are established for the 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. Such temporary differences relate principally to unrealized gains and losses on investments and credit derivatives, FG VIE fair value adjustments, loss and LAE reserve, unearned premium reserve and tax attributes for net operating losses, alternative minimum tax ("AMT") credits and foreign tax credits. As of December 31, 2013 and December 31, 2012, the Company had a net deferred income tax asset of \$688 million and \$721 million, respectively. As of December 31, 2013, the Company has foreign tax credits carried forward of \$37 million which expire in 2018 through 2021 and AMT credits of \$90 million which do not expire. Foreign tax credits of \$22 million are from its acquisition of AGMH on July 1, 2009 ("AGMH Acquisition"); the Internal Revenue Code limits the amount of credits the Company may utilize each year.

## Provision for Income Taxes and Effective Tax Rates

	Year Ended December 31,			
	2013	2012	2011	
	(in millions)			
Total provision (benefit) for income taxes	\$334	\$22	\$256	
Effective tax rate	29.2	% 16.5	% 24.9	%

The Company's effective tax rates reflect the proportion of income recognized by each of the Company's operating subsidiaries, with U.S. subsidiaries taxed at the U.S. marginal corporate income tax rate of 35%, U.K. subsidiaries taxed at the U.K. blended marginal corporate tax rate of 23.25% unless subject to U.S. tax by election or as a U.S. controlled foreign corporation, and no taxes for the Company's Bermuda subsidiaries unless subject to U.S. tax by election or as a U.S. controlled foreign corporation. The Company's overall corporate effective tax rate fluctuates based on the distribution of taxable income across these jurisdictions. 2013 and 2012 had disproportionate losses and income across jurisdictions, offset by tax-exempt interest, and are the primary reasons for the 29.2% and 16.5% effective tax rates, respectively.

## Financial Guaranty Variable Interest Entities

As of December 31, 2013 and 2012, the Company consolidated, 40 and 33 VIEs, respectively. The table below presents the effects on reported GAAP income resulting from consolidating these FG VIEs and eliminating their related insurance and investment accounting entries and, in total, represents a difference between GAAP reported net income and non-GAAP operating income attributable to FG VIEs. The consolidation of FG VIEs has a significant effect on net income and shareholders' equity due to (1) changes in fair value gains (losses) on FG VIE assets and liabilities, (2) the eliminations of premiums and losses related to the AGC and AGM FG VIE liabilities with recourse and (3) the elimination of investment balances related to the Company's purchase of AGC and 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

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eliminated. See “—Non-GAAP Financial Measures—Operating Income” below and Note 10, Consolidation of Variable Interest Entities, of the Financial Statements and Supplementary Data for more details.

## Effect of Consolidating FG VIEs on Net Income (Loss)

	Year Ended December 31,		
	2013	2012	2011
	(in millions)		
Net earned premiums	\$(60 )	\$(153 )	\$(75 )
Net investment income	(13 )	(13 )	(8 )
Net realized investment gains (losses)	2	4	12
Fair value gains (losses) on FG VIEs	346	191	(146 )
Loss and LAE	21	65	107
Total pretax effect on net income	296	94	(110 )
Less: tax provision (benefit)	103	32	(38 )
Total effect on net income (loss)	\$193	\$62	\$(72 )

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs' assets and liabilities. In 2013, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of \$346 million. The gain was primarily driven by R&W benefits received on several VIE assets as a result of settlements with various counterparties throughout the year. These R&W settlements resulted in a gain of approximately \$265 million. The remainder of the gain was driven by price appreciation on the Company's FG VIE assets during the year resulting from improvements in the underlying collateral, as well as large principal paydowns made on the Company's FG VIEs.

In 2012, the Company recorded a pre-tax fair value gain on FG VIEs of \$191 million. The majority of this gain, approximately \$166 million, is a result of a R&W benefit received on several VIE assets as a result of a settlement with Deutsche Bank that closed in 2012. While prices continued to appreciate during the period on the Company's FG VIE assets and liabilities, gains in the second half of the year were primarily driven by large principal paydowns made on the Company's FG VIEs.

The 2011 pre-tax fair value losses on consolidated FG VIEs of \$146 million were driven by the unrealized loss on consolidation of eight 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.

Expected losses to be paid (recovered) in respect of consolidated FG VIEs were \$60 million of expected losses to be paid as December 31, 2013, \$96 million of expected losses to be recovered as of December 31, 2012, and \$107 million of expected losses to be recovered as of December 31, 2011, are included in the discussion of “—Losses in the Insured Portfolio.”

## Non-GAAP Financial Measures

To reflect the key financial measures management analyzes in evaluating the Company's operations and progress towards long-term goals, the Company discusses both measures promulgated in accordance with GAAP and measures not promulgated in accordance with GAAP (“non-GAAP financial measures”). Although the financial measures identified as non-GAAP should not be considered substitutes for GAAP measures, management considers them key performance indicators and employs them as well as other factors in determining compensation. Non-GAAP financial measures, therefore, provide investors with important information about the key financial measures management utilizes in measuring its business. The primary limitation of non-GAAP financial measures is the potential lack of

comparability to those of other companies, which may define non-GAAP measures differently because there is limited literature with respect to such measures. Three of the primary non-GAAP financial measures analyzed by the Company's senior management are: operating income, adjusted book value and PVP.

Management and the board of directors utilize non-GAAP financial measures in evaluating the Company's financial performance and as a basis for determining senior management incentive compensation. By providing these non-GAAP financial measures, investors, analysts and financial news reporters have access to the same information that management reviews internally. In addition, Assured Guaranty's presentation of non-GAAP financial measures is consistent with how

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analysts calculate their estimates of Assured Guaranty's financial results in their research reports on Assured Guaranty and with how investors, analysts and the financial news media evaluate Assured Guaranty's financial results.

The following paragraphs define each non-GAAP financial measure and describe why it is useful. A reconciliation of the non-GAAP financial measure and the most directly comparable GAAP financial measure, if available, is also presented below.

Operating Income

Reconciliation of Net Income (Loss)  
to Operating Income

Year Ended December 31,