

CONSOLIDATED FINANCIAL STATEMENTS

FGIC Corporation and Subsidiaries

March 31, 2008

FGIC Corporation and Subsidiaries

Consolidated Financial Statements

March 31, 2008

Contents

Consolidated Balance Sheets at March 31, 2008 (Unaudited) and December 31, 2007	1
Consolidated Statements of Income for the Three Months Ended March 31, 2008 and 2007 (Unaudited).....	2
Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2008 and 2007 (Unaudited).....	3
Notes to Financial Statements (Unaudited)	4

FGIC Corporation and Subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands, Except Per Share Amounts)

	March 31, 2008	December 31, 2007
	<i>(Unaudited)</i>	
Assets		
Fixed maturity securities, available for sale, at fair value (amortized cost of \$3,873,931 in 2008 and \$3,942,868 in 2007)	\$ 3,901,964	\$ 3,976,178
Variable interest entity fixed maturity securities, held to maturity at amortized cost	750,000	750,000
Short-term investments	58,048	126,688
Total investments	4,710,012	4,852,866
Cash and cash equivalents	576,367	140,590
Accrued investment income	54,696	55,745
Reinsurance recoverable on paid and unpaid losses	40,166	8,693
Prepaid reinsurance premiums	220,209	225,516
Policy acquisition costs deferred, net	103,681	107,854
Property and equipment, net of accumulated depreciation of \$4,565 in 2008 and \$3,891 in 2007	17,150	16,713
Deferred income taxes	836,869	839,265
Derivative assets	18	267
Premiums receivable	14,013	9,607
Income taxes receivable	59,757	116,766
Other assets	54,744	55,485
Total assets	\$ 6,687,682	\$ 6,429,367
Liabilities and stockholders' equity		
Liabilities:		
Unearned premiums	\$ 1,414,580	\$ 1,458,476
Loss and loss adjustment expense reserves	1,538,637	1,267,420
Ceded reinsurance balances payable	2,996	3,696
Accounts payable and accrued expenses	33,851	55,976
Derivative liabilities	1,781,664	1,938,930
Other liabilities	41,498	44,276
Variable interest entity floating rate notes	750,000	750,000
Accrued interest expense – variable interest entity	1,264	1,208
Capital lease obligations	1,587	1,562
Long-term debt and other borrowings	573,402	323,397
Total liabilities	6,139,479	5,844,941
Stockholders' equity:		
Senior Participating Mandatorily Convertible Modified Preferred Stock, par value \$0.01 per share; 2,500 shares authorized, 2,346 shares issued and outstanding at March 31, 2008 and December 31, 2007	301,921	301,921
Preferred stock, par value \$0.01 per share; 47,500 shares authorized, none issued and outstanding	–	–
Common stock, par value \$0.01 per share; 6,000,000 shares authorized at March 31, 2008 and December 31, 2007, 2,404,117 and 2,403,223 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	24	24
Treasury stock	(165)	(165)
Additional paid-in capital	1,452,725	1,451,530
Accumulated other comprehensive income, net of tax	33,246	37,309
Retained (loss)	(1,239,548)	(1,206,193)
Total stockholders' equity	548,203	584,426
Total liabilities and stockholders' equity	\$ 6,687,682	\$ 6,429,367

See accompanying notes.

FGIC Corporation and Subsidiaries

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands)

	Three months ended March 31,	
	2008	2007
Revenues:		
Gross direct and assumed premiums written	\$ 36,675	\$ 97,041
Ceded premiums written	(6,181)	(12,137)
Net premiums written	<u>30,494</u>	84,904
Change in net unearned premiums	39,497	(14,397)
Net premiums earned	<u>69,991</u>	70,507
Change in fair value of credit derivatives:		
Realized gains and other settlements	8,416	6,076
Unrealized gains	157,017	462
Net change in fair value of credit derivatives	<u>165,433</u>	6,538
Net investment income	40,989	37,772
Interest income – investments held by variable interest entity	9,942	11,357
Net realized (losses) gains	(102)	261
Other income	1,942	412
Total revenues	<u>288,195</u>	126,847
Expenses:		
Loss and loss adjustment expenses	279,200	1,182
Underwriting expenses	35,503	28,753
Policy acquisition costs deferred, net	457	(13,973)
Amortization of policy acquisition costs deferred	3,754	3,783
Other operating expenses	3,039	1,646
Interest expense – debt held by variable interest entity	9,942	11,357
Interest expense	6,332	4,875
Total expenses	<u>338,227</u>	37,623
(Loss) income before income tax	(50,032)	89,224
Total income tax (benefit) expense	<u>(16,677)</u>	15,838
Net (loss) income	(33,355)	73,386
Preferred stock dividends	–	(4,856)
Net (loss) income available to common stockholders	<u>\$ (33,355)</u>	<u>\$ 68,530</u>

See accompanying notes.

FGIC Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Three months ended March 31,	
	2008	2007
Operating activities		
Net (loss) income	\$ (33,355)	\$ 73,386
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Amortization of policy acquisition costs deferred	3,754	3,783
Policy acquisition costs deferred, net	457	(13,973)
Depreciation of property and equipment	668	319
Amortization of debt issuance costs and discount	23	28
Amortization of fixed maturity securities	8,795	8,671
Amortization of short-term investments	(21)	73
Net realized losses (gains) on investments	102	(261)
Stock compensation expense	1,195	2,087
Change in accrued investment income, premium receivable, and other assets, net	(2,635)	(5,817)
Change in unrealized gain/loss on credit derivative contracts	(157,017)	(462)
Change in reinsurance recoverable on losses	(31,473)	302
Change in prepaid reinsurance premiums	5,307	(4,541)
Change in unearned premiums	(45,319)	18,969
Change in loss and loss adjustment expenses	271,217	1,056
Change in ceded reinsurance balances payable, accounts payable and accrued expenses and other liabilities	(25,523)	(24,727)
Change in current income taxes	57,009	6,311
Change in deferred income taxes	419	3,973
Net cash provided by operating activities	53,603	69,177
Investing activities		
Sales and maturities of fixed maturity securities	66,769	61,386
Purchases of fixed maturity securities	-	(99,606)
Purchases, sales and maturities of short-term investments, net	64,017	58,185
Receivable for securities sold	-	20
Payable for securities purchased	-	(10,770)
Purchase of fixed assets	(1,078)	(168)
Net cash used in investing activities	129,708	9,047
Financing activities		
Borrowing under revolving credit facility	250,000	-
Repurchase of treasury stock	-	(165)
Net cash (used in) provided by financing activities	250,000	(165)
Effect of exchange rate changes on cash	2,466	55
Net increase (decrease) in cash and cash equivalents	435,777	78,114
Cash and cash equivalents at beginning of period	140,590	33,278
Cash and cash equivalents at end of period	\$ 576,367	\$ 111,392

See accompanying notes.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

1. Business and Organization

FGIC Corporation (“FGIC Corp.”) is an insurance holding company whose wholly owned subsidiary, Financial Guaranty Insurance Company (“FGIC”), provides financial guaranty insurance and other forms of credit enhancement for public finance and structured finance obligations. FGIC’s guaranties typically cover scheduled payments of principal and interest on an issuer’s obligations when due. FGIC is licensed to write financial guaranty insurance in all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, and, through a branch, the United Kingdom. In addition, FGIC UK Limited, a wholly owned United Kingdom subsidiary of FGIC (“FGIC UK Ltd.”) is authorized to write financial guaranty business in the United Kingdom and has passport rights to write business in other European Union member countries. FGIC Corp. has a wholly owned subsidiary in Australia that acts as a marketing office. When credit enhancement is provided in credit default swap (“CDS”) form, the CDS is entered into by FGIC Credit Products LLC (“FGIC Credit Products”), a wholly owned subsidiary of FGIC. As used in these notes, the term “Company” refers to FGIC Corp. and its subsidiaries.

2. Recent Developments

The deterioration in the U.S. housing and mortgage markets and the global credit markets, which accelerated in the fourth quarter of 2007 and continued during the first quarter of 2008, has adversely affected the Company’s business, results of operations and financial condition. During the first quarter of 2008, the Company’s financial strength and credit ratings were downgraded by various rating agencies. As of June 13, 2008, the financial strength of FGIC and FGIC UK Ltd. was rated BBB by Fitch Ratings Inc. (rating outlook negative), Baa3 by Moody’s Investor Services Inc. (on review for possible downgrade) and BB by Standard & Poor’s Rating Services (CreditWatch with negative implications). The financial strength ratings downgrades have adversely impacted the Company’s ability to generate new business and, unless restored, will impact the Company’s future business, operations and financial results. During the first quarter of 2008, the Company increased reserves established for the Company’s exposure to certain collateralized debt obligations of asset-backed securities (“ABS CDOs”), which are backed primarily by subprime residential mortgage-backed securities, and to certain residential mortgage-backed securities (“RMBS”), primarily backed by second-lien mortgages.

As a result of these developments, the Company ceased writing new business during the first quarter of 2008 for a period of time to preserve capital and is considering various alternatives to enhance its capital, restructure its operations and mitigate losses. However, no assurance can be given that any action taken by the Company will improve its current ratings, that further rating downgrades will not occur, or that the Company will be able to recommence writing new business in the near term or at all. FGIC has proposed a significant restructuring of its insurance operations to the New York State Insurance Department (the “NYSID”), including the organization of a new financial guaranty insurer to be domiciled in New York to provide support

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

2. Recent Developments (continued)

for global public finance and infrastructure obligations previously insured by FGIC and to write new business to serve those markets. Any restructuring will require approval from the NYSID, among other requirements, and significant new capital investment. No assurance can be given that such restructuring or investment will be completed.

As of December 31, 2007, FGIC established statutory loss reserves related to its exposure on certain ABS CDOs and RMBS, which substantially reduced FGIC's statutory capital and surplus position. During the quarter ended March 31, 2008, FGIC reduced its aggregate statutory loss provision by \$116,921 and recorded statutory net income of \$172,413. However, as of March 31, 2008, FGIC's aggregate net liability under its insured exposures continued to exceed the aggregate risk limit prescribed by New York State Insurance Law (although the amount of such excess was less than at year-end 2007), and FGIC's insured exposure under certain individual policies continued to exceed the applicable single risk limits prescribed by New York State Insurance Law (although the number of affected policies was lower than at year-end 2007). As required by New York State Insurance Law, FGIC submitted a plan to the Superintendent of the NYSID on April 11, 2008 detailing the steps that FGIC has taken and will seek to take to reduce its exposure to loss to no more than the permitted amounts. Following the evaluation of the plan, after notice and hearing, the Superintendent could require FGIC to cease transacting any new financial guaranty business until its exposure to loss no longer exceeds said limits. As noted above, FGIC has already voluntarily ceased writing new business for a period of time to preserve capital.

FGIC's statutory-basis surplus at March 31, 2008 and December 31, 2007 was \$366,112 and \$260,909, respectively. Under New York State Insurance Law, FGIC must maintain surplus to policy holders of at least \$65,000. Should FGIC be required to increase its loss reserves in future periods, this could cause FGIC's surplus to fall below that minimum amount. If FGIC is unable to meet the minimum surplus requirements, the Superintendent could seek an order to place FGIC under regulatory control.

As a result of establishing loss reserves related to its potential exposure on certain ABS CDOs, the statutory capital and surplus of FGIC UK Ltd. as of December 31, 2007, fell below certain minimum statutory requirements. FGIC UK Ltd. is prohibited from writing new business until the shortfall is corrected. FGIC UK Ltd. has submitted a plan to its primary regulator to address this shortfall.

FGIC's ability to pay dividends to FGIC Corp. is subject to restrictions contained in the New York State Insurance Law. Due to FGIC's statutory earned surplus deficit at March 31, 2008, FGIC does not currently have the capacity to pay dividends without the prior approval of the NYSID. FGIC Corp.'s ability to meet its cash needs may be adversely impacted by FGIC's

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

2. Recent Developments (continued)

inability to pay dividends. However, FGIC Corp. believes that its cash resources are sufficient to fund its obligations as they come due for at least the next 12 months.

3. Basis of Presentation

The consolidated financial statements include the accounts of FGIC Corp. and all other entities in which FGIC Corp. has a controlling financial interest. All significant intercompany balances have been eliminated.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ from those estimates, and those differences could be material. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three-month period ended March 31, 2008 are not necessarily indicative of results that may be expected for the year ending December 31, 2008. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2007, including the accompanying notes.

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

4. Review of Financial Guaranty Industry Accounting Practices

On May 23, 2008, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 163, entitled *Accounting for Financial Guarantee Insurance Contracts, an Interpretation of FASB Statement No. 60*. The standard addresses accounting by financial guarantors for loss reserving, premium recognition and additional disclosures regarding financial guaranty insurance contracts. Currently, the financial guaranty industry accounts for financial guaranty insurance contracts under SFAS No. 60, *Accounting and Reporting by Insurance Enterprises*, which was developed prior to the emergence of the financial guaranty industry. As SFAS No. 60 does not specifically address financial guaranty contracts, there has been diversity in the manner in which different financial guarantors account for these contracts.

The purpose of the new standard is to provide authoritative guidance on accounting for financial guaranty contracts that are not accounted for as derivative contracts under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The standard is effective for fiscal years beginning after December 15, 2008, with earlier implementation in the

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

4. Review of Financial Guaranty Industry Accounting Practices (continued)

third quarter of 2008 for certain disclosure requirements. Under the new standard, the Company, along with other companies in the financial guaranty industry, will be required to change certain aspects of accounting for loss reserves, premium income and disclosures. The Company is currently evaluating the provisions of the proposed pronouncement to determine the effect on the Company's consolidated financial position and results of operations.

5. New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and requires additional disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted SFAS No.157 effective January 1, 2008. SFAS No. 157 requires that the fair value of a liability be calculated based on the exit price to transfer a liability to an entity that is assumed to have the same level of nonperformance risk or credit standing as the entity holding the liability. As a result of adopting SFAS 157, the Company recorded a benefit due to the consideration of its credit standing in calculating the fair value of CDS contracts. (See Note 6.)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value but does not require any new fair value measurements. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted FAS No. 159 effective January 1, 2008 but did not change the measurement of any financial instruments not already measured at fair value. The adoption did not have any impact on the Company's consolidated financial position or results of operations.

The Company is a member of the Association of Financial Guaranty Insurers ("AFGI"). As a result of guidance provided by the staffs of the Office of the Chief Accountant and the Division of Corporation Finance of the Securities and Exchange Commission to AFGI, the Company reclassified the presentation of net mark-to-market (losses) gains on credit derivative contracts for the three months ended March 31, 2008 and 2007 to a new caption, "Change in fair value of credit derivatives", in the Consolidated Statements of Income. The new presentation does not change the Company's net income or shareholders' equity. (See Note 10.)

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of Accounting Research Bulletin No. 51. SFAS No. 160 requires reporting entities to present noncontrolling (minority) interests as equity (rather than as a liability or mezzanine equity) and provides guidance on accounting for transactions between

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

5. New Accounting Pronouncements (continued)

an entity and noncontrolling interests. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company is currently evaluating the provisions of SFAS No. 160, and adoption of this guidance is not expected to have a material effect on the Company's consolidated financial position or results of operation.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of SFAS No. 133. SFAS No. 161 requires entities to provide greater transparency about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the provisions of the proposed pronouncement to determine the effect on the Company's consolidated financial position and results of operations.

6. Fair Value Measurements

SFAS No. 157 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions about market participants' assumptions based on the best information available in the circumstances. In accordance with SFAS No. 157, the fair value hierarchy prioritizes model inputs into three broad levels: quoted prices for identical instruments in active markets are Level 1 inputs; quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets are Level 2 inputs; and model-driven valuations in which one or more significant inputs or significant value drivers are unobservable are Level 3 inputs.

The following table sets forth the Company's financial assets and liabilities that were accounted for at fair value as of March 31, 2008 by level within the SFAS No. 157 fair value hierarchy. As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

6. Fair Value Measurements (contined)

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<i>Financial assets:</i>				
Fixed maturity securities, available for sale	\$ –	\$ 3,901,964	\$ –	\$ 3,901,964
Short-term investments	–	58,048	–	58,048
Derivative assets	–	–	18	18
Total assets at fair value	\$ –	\$ 3,960,012	\$ 18	\$ 3,960,030
<i>Financial liabilities:</i>				
Derivative liabilities	–	–	1,781,664	1,781,664
Total liabilities at fair value	\$ –	\$ –	\$1,781,664	\$ 1,781,664

Fixed maturity securities and short-term investments

All of the Company's fixed maturity securities are classified as available for sale and are recorded at fair value on the trade date. Short-term investments are fixed maturity securities that are due to mature within one year of the balance sheet date and are carried at fair value, which approximates cost. Unrealized gains and losses on these investments are recorded as a separate component of accumulated other comprehensive income (loss), net of applicable income taxes. Because many fixed income securities do not trade on a daily basis, information including benchmark curves, benchmarking of like securities and matrix pricing are utilized to value the securities. Inputs to the valuation process include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and other reference data.

Derivative assets and liabilities

Derivative assets and liabilities include the fair value of certain financial guaranty contracts (primarily CDS contracts) issued by the Company that are considered derivatives under SFAS No. 133. Accordingly, these contracts are recognized on the Consolidated Balance Sheet at their fair value, and changes in fair value are recognized currently in earnings. The Company considers these contracts to be a normal extension of its financial guaranty insurance business. Under the terms of the CDS, the Company is not required to post collateral, and if the underlying obligation were to be in default, payments typically would not be accelerated and would be made on a pay-as-you-go basis.

Since quoted market values are not available for the Company's credit derivative contracts, the estimated unrealized gains and losses attributable to these contracts are recognized in the Consolidated Statements of Income by recording their fair value, as determined each quarter based on internally developed models. These models require third-party and market-driven inputs, including dealer quotes for the underlying bonds, credit spreads and yield curves. The models calculate a theoretical exit price and reflect management's best judgment about current

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

6. Fair Value Measurements (continued)

market conditions. The fair value of credit derivatives that are in a liability position is also adjusted to reflect the Company's own credit risk.

There is likely to be volatility in the third-party and market-driven inputs obtained from an illiquid market for CDS and the underlying bonds and other obligations, and differences are likely to exist between available market data and assumptions used by management to estimate the fair value of these instruments. Accordingly, the valuation results from the model are likely to differ, possibly materially, from amounts that would be realized in the market if the derivatives were traded. Moreover, volatile market conditions are likely to cause future valuations to differ, possibly materially, from those reflected in the current period.

The Company's estimate of fair value at March 31, 2008 does not reflect the potential impact, if any, of ongoing commutation, settlement and restructuring efforts. As discussed above, the fair value of the Company's CDS contracts has been determined based on internally developed models. At each reporting date, the Company's fair value assessment is evaluated to reflect the current credit quality and spread environment of the CDS contracts as well as changes in the Company's own credit risk. The fair value may also be adjusted to reflect the impact of the commutation, settlement or restructuring efforts.

The following table shows a summary of changes in the fair value of the Company's Level 3 financial assets and liabilities for the three months ended March 31, 2008. The net derivative assets (liabilities) are classified as Level 3 since there is significant reliance on unobservable inputs. Thus, the gains and losses presented below include changes in the fair value driven predominately by unobservable inputs.

Level 3 Financial Assets and Liabilities Accounted for at Fair Value	
	Three months ended March 31, 2008
Net balance, beginning of period	\$ (1,938,663)
Unrealized gains included in earnings	157,017
Purchases, issuances and settlements	-
Transfers in and /or out of Level 3	-
Net balance, end of period	<u>(1,781,646)</u>
Change in unrealized gains and losses relating to assets held at the reporting date	<u>\$ 152,721</u>

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

6. Fair Value Measurements (continued)

Gains and losses (realized and unrealized) included in earnings for the period are reported as follows in the Consolidated Statement of Income:

	Change in fair value of credit derivatives: Realized gains and other settlements	Change in fair value of credit derivatives: Unrealized gains and losses
Total gains or losses included in earnings for the period	\$ 8,416	\$ 157,017
Change in unrealized gains or losses relating to assets held at the reporting date	–	152,721

7. Premium Refundings

Unearned premiums represent the portion of premiums received applicable to future periods on insurance policies in force. When an obligation insured by the Company is refunded by the issuer prior to the end of the expected policy coverage period, any remaining unearned premium is recognized. A refunding occurs when an insured obligation is called or legally defeased by the issuer prior to stated maturity. Premiums earned on refundings were \$10,827 and \$15,072 for the three months ended March 31, 2008 and 2007, respectively.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

8. Loss and Loss Adjustment Expenses Reserves

Activity in the reserves for loss and loss adjustment expenses is summarized as follows:

	Three months ended March 31,	
	2008	2007
Balance at beginning of period:		
Case reserves	\$ 1,259,202	\$ 28,558
Watchlist reserves	8,218	11,741
Total	1,267,420	40,299
Less reinsurance recoverable on unpaid losses	8,653	1,485
Net balance at beginning of period	1,258,767	38,814
Incurred related to:		
Current period	84,738	–
Prior periods	194,462	1,182
Total incurred	279,200	1,182
Paid (recovered) related to:		
Current period	–	–
Prior periods	39,395	(176)
Total paid (recovered), net	39,395	(176)
Foreign exchange on FGIC UK Ltd. reserves	219	–
Net balance	1,498,791	40,172
Plus reinsurance recoverable on unpaid losses	39,846	1,183
Case reserves	1,525,791	29,938
Watchlist reserves	12,846	11,417
Balance at end of period	\$ 1,538,637	\$ 41,355

Case reserves increased to \$1,525,791 at March 31, 2008 from \$1,259,202 at December 31, 2007. The increase was mainly attributable to the establishment of loss reserves for financial guaranty obligations impacted by the deterioration in mortgage underwriting quality in the U.S. mortgage market during 2007 and 2006. Reserves at March 31, 2008 relate predominantly to ABS CDOs and RMBS transactions. Approximately 80% of the reserves at March 31, 2008 relate to an outstanding commitment to provide financial guaranties with respect to a referenced portfolio of ABS CDOs upon satisfaction of certain conditions. (See Note 14.)

Loss and loss adjustment expense reserves at March 31, 2008 do not reflect the potential impact, if any, of ongoing loss mitigation efforts; however, there can be no assurance that any loss mitigation efforts will be successful, and it is not possible to predict the magnitude of any benefit that might be derived from any such efforts that are successful. Loss reserves have been established based on the performance of the underlying collateral. If the Company identifies credit impairment, a provision for loss and loss adjustment expense is recorded. At each

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

8. Loss and Loss Adjustment Expenses Reserves (continued)

reporting date the reserves are evaluated and may be adjusted to reflect the impact of any loss mitigation efforts that have yielded results that are probable and estimable. The Company believes that the reserve for estimated losses as of March 31, 2008 is adequate to cover expected future net claims. However, the establishment of the appropriate level of reserves is an inherently uncertain process involving numerous estimates and subjective judgments by management. Small changes underlying these estimates could result in significant changes in the Company's loss expectations. At present, there remains a considerable amount of uncertainty relating to risks in real estate prices, credit markets and the economy as a whole, and there is no historical precedent for the current conditions. There can be no assurance that the Company's estimates of probable and estimable losses are accurate. Accordingly, there can be no assurance that actual claims paid by the Company will not exceed its reserves at March 31, 2008, and it is possible that they could significantly exceed those reserves. Additionally, further deterioration in the performance of RMBS, ABS CDOs and other obligations the Company insures could lead to the establishment of additional loss reserves and further loss or reduction to income.

9. Income Taxes

FGIC Corp. and its U.S. subsidiaries file a consolidated U.S. federal tax return. The Company also files separate returns in various state and foreign jurisdictions.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2008	\$	6,598
Additions based on tax positions related to the current year		–
Additions for tax positions of prior years		84
Reductions for tax positions of prior year		–
Balance at March 31, 2008	\$	<u>6,681</u>

The Company recognizes accrued interest and penalties related to unrecognized tax benefits where the ultimate recognition is uncertain. Tax expense related to interest and penalties amounted to approximately \$84 and \$560 for the three months ended March 31, 2008 and 2007. Approximately, \$349 and \$265 were accrued for the payment of interest and penalties at March 31, 2008 and December 31, 2007, respectively, which is included as a component of the balance of unrecognized tax benefits.

In the second quarter of 2006, the Internal Revenue Service (“IRS”) commenced an examination of the Company's consolidated U.S. income tax returns for 2003 and 2004. The examination was completed in the second quarter of 2007. As a result, the Company is not subject to U.S. federal income tax examination by the IRS for years before 2005.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

9. Income Taxes (continued)

The Company's U.S. federal effective corporate tax rates were (33.5)% and 17.8% for the three months ended March 31, 2008 and 2007, respectively. The effective tax rate for the three months ended March 31, 2008 was less than the statutory corporate tax of 35%, primarily due to net operating losses on foreign subsidiaries where the Company does not anticipate realizing the benefits of these deductible losses and, therefore, has established a valuation allowance, offset by tax-exempt interest received on investments. The effective tax rate for the three months ended March 31, 2007 was less than the statutory corporate tax of 35% due to the impact of tax-exempt interest received on investments.

The Company's United Kingdom operations are subject to examination by foreign tax authorities for the years since they commenced operation in 2004.

10. Derivative Instruments

The Company previously provided CDS contracts to certain buyers of credit protection by entering into contracts that referenced collateralized debt obligations from cash and synthetic structures backed by pools of corporate, consumer or structured finance debt. It also offered credit protection on public finance and structured finance obligations in CDS form. The Company considers these contracts to be a normal extension of its financial guaranty insurance business. Under the terms of the CDS contracts, the Company is not required to post collateral, and if the underlying obligation were to be in default, payments typically would not be accelerated and would be made on a pay-as-you-go basis. In certain cases, the Company purchases back-to-back credit protection on all or a portion of the risk written, primarily from reinsurance companies.

The Company's total outstanding principal insured, net of reinsurance, on these contracts was \$33,315,791 and \$34,114,661 as of March 31, 2008 and December 31, 2007, respectively.

These CDS contracts and certain other financial guaranty contracts are considered derivatives under SFAS No. 133. Changes in fair value are recorded in "Net change in fair value of credit derivatives" on the Consolidated Statements of Income. The "Realized gains and other settlements" component of this line includes (i) premiums received and receivable on written derivative contracts, (ii) premiums paid and payable on purchased contracts, (iii) losses paid and payable to counterparties due to the occurrence of a credit event and (iv) losses recovered and recoverable on purchased contracts. Losses payable and recoverable may include anticipated claims payable and anticipated recoveries thereof, respectively, after the occurrence of a credit event that requires payment under the contract terms. The "Unrealized gains and losses" component of the line includes all other changes in fair value. (See Note 6.)

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

10. Derivative Instruments (continued)

The following table provides the components of “Change in fair value of credit derivatives.”

	Three months ended March 31,	
	2008	2007
Change in fair value of credit derivatives:		
Realized gains and other settlements:		
Net credit derivative premiums received and receivable	\$ 8,416	\$ 6,076
Net credit derivative losses paid and payable	–	–
Total realized gains and losses and other settlements	8,416	6,076
Unrealized gains (losses):		
Change in fair value of credit derivatives	157,017	462
Net change in fair value of credit derivatives	\$ 165,433	\$ 6,538

11. Debt and Revolving Credit Facility

On January 12, 2004 and December 7, 2004, FGIC Corp. issued \$250,000 and \$75,000, respectively, of Senior Notes due January 15, 2034 (the “Senior Notes”). The Senior Notes pay interest on January 15 and July 15 of each year at a rate of 6% per annum. The costs of the issuance of the Senior Notes of \$4,822 were capitalized and are amortized to other operating expenses over the term of the Senior Notes. In relation to the issuance of the Senior Notes, FGIC Corp. entered into an interest rate lock from which FGIC Corp. realized a gain of \$1,511 that is recorded as a component of other comprehensive income and is recognized into income over the term of the Senior Notes.

In December 2005, FGIC Corp. and FGIC entered into a \$250,000 senior unsecured revolving credit facility that matures on December 11, 2010. The facility is provided by a syndicate of banks and other financial institutions. In February 2008, FGIC Corp. borrowed \$250,000 under the facility. As of March 31, 2008, the outstanding amount drawn under the facility was \$250,000. On June 13, 2008, the facility was amended. Key amendment terms include 1) the reduction of the facility to \$46,000, 2) delineation of lender rights with respect to a FGIC Corp. and/or FGIC restructuring, and 3) restrictions on payments to shareholders that are not in the ordinary course of business. In connection with the amendment, FGIC Corp. repaid \$204,000 of the amount previously drawn.

FGIC Corp. and FGIC are currently in full compliance with the terms and conditions of the Senior Notes and the credit facility, as amended.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

12. Stock Compensation Plan

Employees of the Company may receive stock-based compensation under a FGIC Corp. stock incentive plan that provides for stock-based compensation, including stock options, restricted stock awards and restricted stock units.

A summary of option activity for the three months ended March 31, 2008 is as follows:

	Number of Shares Subject to Options	Weighted Average Exercise Price per Share
Balance at December 31, 2007:	216,047	\$ 850
Forfeited	(13,606)	891
Expired	-	-
Granted	-	-
	202,441	\$ 847
Balance at March 31, 2008:		
Shares subject to options exercisable at:		
March 31, 2008	126,445	\$ 830
December 31, 2007	106,616	\$ 818

Exercise prices for the stock options outstanding at March 31, 2008 and December 31, 2007 range from \$600 to \$1,080 per share. As of March 31, 2008, there was \$2,020 of total unrecognized compensation cost related to unvested stock options. These costs are expected to be recognized through February 28, 2011.

13. Comprehensive Income

Accumulated other comprehensive income (loss) of the Company consists of net unrealized gains and losses on investment securities, foreign currency translation adjustments, and amortization of the realized gain on the interest rate lock. The components of other comprehensive income (loss) for the three months ended March 31, 2008 and 2007 are as follows:

	Three Months Ended March 31,	
	2008	2007
Net (loss) income	\$ (33,355)	\$ 73,386
Other comprehensive loss	(4,063)	(1,433)
Total comprehensive (loss) income	\$ (37,418)	\$ 71,953

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

13. Comprehensive Income (continued)

The components of other comprehensive loss for the three months ended March 31, 2008 and 2007 were as follows:

	Three months ended March 31, 2008		
	Before Tax Amount	Tax	Net of Tax Amount
	Amount	Tax	Amount
Unrealized holding losses arising during the period	\$ (5,073)	\$ 1,775	\$ (3,298)
Reclassification of losses realized in net income	(102)	35	(67)
Unrealized losses on investments	(4,971)	1,740	(3,231)
Foreign currency translation adjustment	(1,275)	446	(829)
Amortization of gain on interest rate lock	(5)	2	(3)
Total other comprehensive loss	\$ (6,251)	\$ 2,188	\$ (4,063)

	Three Months Ended March 31, 2007		
	Before Tax Amount	Tax	Net of Tax Amount
	Amount	Tax	Amount
Unrealized holding losses arising during the period	\$ (2,686)	\$ 939	\$ (1,747)
Reclassification of gains realized in net income	261	(91)	170
Unrealized losses on investments	(2,425)	848	(1,577)
Foreign currency translation adjustment	226	(79)	147
Amortization of gain on interest rate lock	(5)	2	(3)
Total other comprehensive loss	\$ (2,204)	\$ 771	\$ (1,433)

14. Other

In June 2007, FGIC UK Ltd. entered into a commitment agreement (the “Commitment Agreement”) with Havenrock II Limited (“Havenrock II”), a special purpose vehicle created by IKB Deutsche Industriebank (“IKB”) for the sole purpose of the transaction, to issue a financial guaranty policy in respect of up to \$1.875 billion of high-grade and mezzanine ABS CDOs contained in a \$2.5 billion reference portfolio (the “Reference Portfolio”), subject to FGIC UK Ltd.’s rights and defenses and to the terms and conditions of the Commitment Agreement.

On March 10, 2008, FGIC and FGIC UK Ltd. filed a lawsuit against IKB, Havenrock II, IKB Credit Asset Management (“IKB CAM”) and Calyon Crédit Agricole CIB (“Calyon”). FGIC and FGIC UK Ltd. allege in their complaint, filed in the Supreme Court of the State of New York, that IKB and IKB CAM, through a series of fraudulent misrepresentations and omissions regarding IKB’s financial condition and stability, induced FGIC UK Ltd. to enter into the

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited) (continued)

(Dollars in thousands, except per share amounts)

14. Other (continued)

Commitment Agreement. Calyon has answered and made a counterclaim alleging, among other things, fraud on the part of FGIC. IKB has filed motions to dismiss the complaint for, among other things, lack of personal jurisdiction, lack of standing and forum non conveniens. Havenrock II has not yet responded to the complaint.

On March 17, 2008, Calyon issued proceedings in the High Court of England and Wales (Queen's Bench Division, Commercial Court) against FGIC UK Ltd. and Havenrock II seeking a declaration that the Commitment Agreement is valid and enforceable against FGIC UK Ltd. Calyon subsequently withdrew these proceedings.

Under the terms of the Havenrock II transaction, Calyon was required, on March 6, 2008, to seek bids for each of the assets in the Reference Portfolio. Management believes that Calyon failed to do so. On May 12, 2008, FGIC UK Ltd. issued proceedings in England in the High Court of Justice (Chancery Division) against Havenrock II and Calyon, seeking a declaration that each of the assets in respect of which Calyon failed to seek such bids be excluded from coverage by any financial guaranty policy that FGIC UK Ltd. might issue pursuant to the Commitment Agreement. Such excluded assets would comprise substantially all of the Reference Portfolio.

In accordance with and as required under GAAP, management used a model-driven point reserve loss estimate to set the loss reserve related to the Commitment Agreement as of March 31, 2008, without making any adjustment for the above developments. Management is continuing to assess whether the loss reserve related to the Commitment Agreement needs to be adjusted to reflect the impact of ongoing developments related to the Commitment Agreement; any such adjustments could be material.