

CONSOLIDATED FINANCIAL STATEMENTS

FGIC Corporation and Subsidiaries
Year Ended December 31, 2009
With Report of Independent Auditors

FGIC Corporation and Subsidiaries

Consolidated Financial Statements

Year Ended December 31, 2009

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Report of Independent Auditors

The Board of Directors and Stockholders of
FGIC Corporation

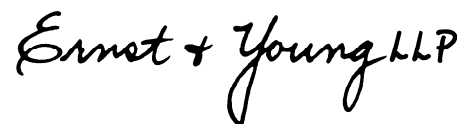
We have audited the accompanying consolidated balance sheets of FGIC Corporation and subsidiaries (the “Company”) as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders’ equity, and cash flows for each of the three years ended December 31, 2009. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2009 and 2008, and the consolidated results of its operations and its cash flows for each of the three years ended December 31, 2009 in conformity with U.S. generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Notes 2 and 3 to the financial statements, sustained deterioration in the U.S. housing and mortgage markets and the global credit markets has continued to adversely impact the business, results of operations and financial condition of the Company’s sole operating subsidiary, Financial Guaranty Insurance Company. This continued adverse development has caused the subsidiary’s statutory policyholders’ surplus to fall below the minimum required under New York State Insurance Law. Under these circumstances, the New York State Superintendent of Insurance could seek court appointment as rehabilitator or liquidator of Financial Guaranty Insurance Company. In addition, as discussed in Note 21, on January 15, 2010, FGIC Corporation has defaulted on its Credit Agreement and Senior Notes. As such, there is a substantial doubt regarding the Company’s ability to continue as a going concern. Management’s plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 7 to the consolidated financial statements, effective January 1, 2009, the Company adopted the guidance of FASB ASC Topic 944 for financial guarantee insurance contracts issued by insurance enterprises.



New York, New York
February 17, 2010

FGIC Corporation and Subsidiaries

Consolidated Balance Sheets (Dollars in thousands, except per share amounts)

	December	
	2009	2008
Assets		
Fixed maturity securities, available for sale, at fair value (amortized cost of \$1,367,149 in 2009 and \$2,470,949 in 2008)	\$ 1,440,670	\$ 2,450,652
Variable interest entity fixed maturity securities, held to maturity at amortized cost	750,000	750,000
Short-term investments	118,980	151
Total investments	2,309,650	3,200,803
Cash and cash equivalents	295,022	523,010
Accrued investment income	18,729	34,503
Reinsurance recoverable on paid and unpaid losses	99,599	126,254
Prepaid reinsurance premiums	930,301	967,811
Policy acquisition costs deferred	110,287	107,053
Property and equipment, net of accumulated depreciation of \$3,521 in 2009 and \$4,697 in 2008	3,636	6,692
Derivative assets	139	647
Premiums receivable	647,991	11,262
Income taxes receivable	24,430	-
Other assets – FGIC insured securities, at fair value	41,933	3,576
Other assets	13,273	47,470
Total assets	\$ 4,494,990	\$ 5,029,081
Liabilities and stockholders' equity		
Liabilities:		
Unearned premiums	\$ 1,641,038	\$ 1,039,192
Loss and loss adjustment expense reserves	2,365,041	1,775,507
Deferred ceding commission income	203,251	205,741
Ceded reinsurance balances payable	63,216	2,313
Accounts payable, accrued expenses, and other liabilities	53,843	126,158
Derivative liabilities	264,709	1,103,100
Variable interest entity floating rate notes	750,000	750,000
Accrued interest expense – variable interest entity	465	473
Income taxes payable	468	1,923
Debt and other borrowings	306,644	369,421
Total liabilities	5,648,675	5,373,828
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 December 31, 2009 and December 31, 2008	344,774	322,679
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 December 31, 2009 and December 31, 2008, 2,405,817 and 2,404,117 shares issued and outstanding at December 31, 2009 and December 31, 2008, respectively	24	24
Treasury stock	(165)	(165)
Additional paid-in capital	1,454,090	1,453,040
Accumulated other comprehensive income (loss), net of tax	48,405	(19,887)
Retained loss	(3,300,813)	(2,400,438)
Total FGIC Corp. stockholders' deficit	(1,453,685)	(644,747)
Preferred stock of FGIC	300,000	300,000
Total deficit	(1,153,685)	(344,747)
Total liabilities and stockholders' equity	\$ 4,494,990	\$ 5,029,081

See accompanying notes.

FGIC Corporation and Subsidiaries

Consolidated Statements of Operations

(Dollars in thousands)

	Years Ended December		
	2009	2008	2007
Revenues:			
Gross direct and assumed premiums written	\$ (65,862)	\$ 110,295	\$ 418,099
Ceded premiums written, net	4,108	(872,152)	(103,509)
Net premiums written	<u>(61,754)</u>	<u>(761,857)</u>	<u>314,590</u>
Change in net unearned premiums	122,468	1,151,290	(39,432)
Net premiums earned	<u>60,714</u>	<u>389,433</u>	<u>275,158</u>
Change in fair value of credit derivatives:			
Net realized (losses) gains	(175,404)	(358,884)	30,751
Net unrealized gains (losses)	837,883	836,210	(1,937,160)
Net change in fair value of credit derivatives	<u>662,479</u>	<u>477,326</u>	<u>(1,906,409)</u>
Net investment income	80,242	148,382	157,970
Interest income – investments held by variable interest entity	15,823	33,045	41,691
Net investment realized (losses) gains	(17,347)	(16,616)	962
Gain on extinguishment of debt	58,493	-	-
Other income (loss) on FGIC insured securities	33,657	(4,890)	-
Other income	<u>25,613</u>	<u>5,718</u>	<u>3,679</u>
Total revenues	<u>919,674</u>	<u>1,032,398</u>	<u>(1,426,949)</u>
Expenses:			
Loss and loss adjustment expenses	1,761,347	1,096,732	1,226,775
Operating expenses	69,610	205,171	131,790
Policy acquisition costs deferred	7,092	730	(57,459)
Amortization of policy acquisition costs deferred	13,328	41,378	19,409
Ceding commission (income) expense on assumed policies	(6,440)	(3,222)	1,258
Ceding commission expense (income) on ceded policies	1,215	(188,160)	(28,797)
Ceding commission expense (income) on ceded policies deferred	(1,339)	185,650	27,844
Amortization of ceding commission income deferred	(33,109)	(28,308)	(3,757)
Interest expense – debt held by variable interest entity	15,823	33,045	41,691
Interest expense	18,444	24,947	19,500
Total expenses	<u>1,845,971</u>	<u>1,367,963</u>	<u>1,378,254</u>
Loss before income tax	<u>(926,297)</u>	<u>(335,565)</u>	<u>(2,805,203)</u>
Income tax (benefit) expense:			
Current	(30,506)	1,597	(82,522)
Deferred	(33,875)	836,325	(913,787)
Total income tax (benefit) expense	<u>(64,381)</u>	<u>837,922</u>	<u>(996,309)</u>
Net loss	<u>(861,916)</u>	<u>(1,173,487)</u>	<u>(1,808,894)</u>
Preferred stock dividends	<u>(22,095)</u>	<u>(20,758)</u>	<u>(14,566)</u>
Net loss to common stockholders	<u>\$ (884,011)</u>	<u>\$ (1,194,245)</u>	<u>\$ (1,823,460)</u>

See accompanying notes.

FGIC Corporation and Subsidiaries

Consolidated Statements of Stockholders' Equity

	Preferred Stock	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss), Net of Tax	Retained Earnings (Loss)	Total
<i>(Dollars in Thousands)</i>							
Balance at January 1, 2007	\$ 287,355	\$ 24	\$ 1,442,077	\$ –	\$ 7,237	\$ 617,267	\$ 2,353,960
Net loss	–	–	–	–	–	(1,808,894)	(1,808,894)
Other comprehensive income (loss):							
Change in fixed maturity securities available for sale, net of tax	–	–	–	–	22,144	–	22,144
Change in foreign currency translation adjustment, net of tax	–	–	–	–	7,941	–	7,941
Amortization of gain on interest rate lock	–	–	–	–	(13)	–	(13)
Total comprehensive income							(1,778,822)
Repurchase of treasury stock	–	–	–	(165)	–	–	(165)
Amortization of stock options and restricted stock	–	–	9,453	–	–	–	9,453
Accrued dividends	14,566	–	–	–	–	(14,566)	–
Balance at December 31, 2007	301,921	24	1,451,530	(165)	37,309	(1,206,193)	584,426
Net loss	–	–	–	–	–	(1,173,487)	(1,173,487)
Other comprehensive loss:							
Change in fixed maturity securities available for sale, net of tax	–	–	–	–	(34,558)	–	(34,558)
Change in foreign currency translation adjustment, net of tax	–	–	–	–	(22,625)	–	(22,625)
Amortization of gain on interest rate lock	–	–	–	–	(13)	–	(13)
Total comprehensive loss							(1,230,683)
Amortization of stock options and restricted stock	–	–	1,510	–	–	–	1,510
Accrued dividends	20,758	–	–	–	–	(20,758)	–
Balance at December 31, 2008	322,679	24	1,453,040	(165)	(19,887)	(2,400,438)	(644,747)
Net loss	–	–	–	–	–	(861,916)	(861,916)
Other comprehensive loss:							
Change in fixed maturity securities available for sale, net of tax	–	–	–	–	60,755	–	60,755
Change in foreign currency translation adjustment, net of tax	–	–	–	–	7,742	–	7,742
Amortization of gain on interest rate lock	–	–	–	–	(205)	–	(205)
Total comprehensive loss							(793,624)
Cumulative effect of adoption of accounting principle	–	–	–	–	–	(16,364)	(16,364)
Amortization of stock options and restricted stock	–	–	1,050	–	–	–	1,050
Accrued dividends	22,095	–	–	–	–	(22,095)	–
Balance at December 31, 2009	\$ 344,774	\$ 24	\$ 1,454,090	\$ (165)	\$ 48,405	\$ (3,300,813)	\$ (1,453,685)

See accompanying notes.

FGIC Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Years Ended December 31		
	2009	2008	2007
Operating activities			
Net loss	\$ (861,916)	\$ (1,173,487)	\$ (1,808,894)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Amortization of policy acquisition costs deferred	13,328	41,378	19,409
Amortization of deferred ceding commission income	(33,109)	(28,308)	(3,757)
Policy acquisition costs deferred	7,092	730	(57,459)
Deferred ceding commission (expense) income	(1,339)	185,650	27,844
Depreciation of property and equipment	3,056	12,370	1,758
Amortization of debt issuance costs and discount	68	97	93
Gain on extinguishment of debt	(58,493)	-	-
Amortization of fixed maturity securities	7,458	30,063	35,365
Amortization of short-term investments	0	80	(150)
Net realized losses (gains) on investments	17,347	16,616	(962)
Change in FGIC insured securities	(38,357)	(3,576)	-
Impairment of cash equivalents	(6,786)	(3,062)	-
Stock compensation expense	1,050	1,510	9,453
Change in accrued investment income, premium receivable, other assets and interest expense, net	173,601	27,046	(15,886)
Change in unrealized (gain)/loss on credit derivatives	(837,883)	(836,210)	1,937,160
Change in prepaid reinsurance premiums	160,200	(742,295)	(68,808)
Change in reinsurance recoverable on paid and unpaid losses	16,225	(117,814)	(7,208)
Change in unearned premiums	(269,724)	(410,327)	111,121
Change in loss and loss adjustment expense reserves	666,626	508,087	1,227,121
Change in ceded reinsurance balances payable, accounts payable and accrued expenses and other liabilities	(91,616)	22,960	10,420
Change in current income taxes	(25,885)	118,689	(139,375)
Change in deferred income taxes	(6,017)	870,300	(910,867)
Net cash (used in) provided by operating activities	<u>(1,165,075)</u>	<u>(1,479,503)</u>	<u>366,378</u>
Investing activities			
Sales and maturities of fixed maturity securities	1,170,326	1,440,128	229,718
Purchases of fixed maturity securities	(106,161)	(24,930)	(564,884)
Purchases, sales and maturities of short-term investments, net	(118,829)	119,875	101,547
Receivable for securities sold	-	-	20
Payable for securities purchased	-	-	(10,770)
Purchase of fixed assets	-	(2,535)	(15,816)
Net cash provided by (used in) investing activities	<u>945,336</u>	<u>1,532,538</u>	<u>(260,185)</u>
Financing activities			
Borrowing under revolving credit facility	-	46,000	-
Proceeds from issuance of preferred stock of subsidiary	-	300,000	-
Cash paid to extinguish debt	(3,736)	-	-
Purchase of treasury stock	-	-	(165)
Net cash (used in) provided by financing activities	<u>(3,736)</u>	<u>346,000</u>	<u>(165)</u>
Effect of exchange rate changes on cash	<u>(4,513)</u>	<u>(16,615)</u>	<u>1,284</u>
Net (decrease) increase in cash and cash equivalents	<u>(227,988)</u>	<u>382,420</u>	<u>107,312</u>
Cash and cash equivalents at beginning of period	<u>523,010</u>	<u>140,590</u>	<u>33,278</u>
Cash and cash equivalents at end of period	<u>\$ 295,022</u>	<u>\$ 523,010</u>	<u>\$ 140,590</u>
Supplemental disclosure of cash flow information			
Income taxes (refunds received) paid	\$ (5,150)	\$ (115,991)	\$ 51,713
Interest paid – debt	24,000	19,500	19,500
Interest paid – debt held by variable interest entity	15,831	33,780	41,781

See accompanying notes.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

December 31, 2009

1. Organization and Background

FGIC Corporation (“FGIC Corp.”) is an insurance holding company incorporated in the State of Delaware whose wholly owned subsidiary, Financial Guaranty Insurance Company, a New York stock insurance corporation (“FGIC”), provided credit enhancement through the issuance of financial guaranty insurance policies and other forms of credit enhancement in respect of public finance, structured finance obligations and other financial obligations. In addition, FGIC UK Limited, a wholly owned United Kingdom insurance subsidiary of FGIC (“FGIC UK Ltd”), was engaged in the business of writing financial guaranties in the United Kingdom and in other European Union member countries. As used in these notes, the term “Company” refers to FGIC Corp. and its subsidiaries.

PMI Mortgage Insurance Co. (“PMI”) is the largest stockholder of FGIC Corp., owning approximately 42% of its common stock at December 31, 2009 and 2008. Affiliates of the Blackstone Group L.P. (“Blackstone”), the Cypress Group L.L.C. (“Cypress”) and CIVC Partners L.P. (“CIVC”) own approximately 23%, 23% and 7% of FGIC Corp.’s common stock, respectively, at December 31, 2009 and 2008. As of December 31, 2009 an affiliate of General Electric Capital Corp. (“GE Capital”) owned 2,346 shares, or 100%, of FGIC Corp.’s senior participating mandatorily convertible modified preferred stock (the “Senior Preferred Shares”), with an aggregate liquidation preference of \$344,774, and approximately 5% of FGIC Corp.’s outstanding common stock.

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 through the fourth quarter of 2009, has adversely affected the Company’s business, results of operations and financial condition. Specifically, the Company incurred significant losses related to its 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 first-lien or second-lien mortgages, because FGIC experienced a material increase in anticipated claims on its guarantees of RMBS and ABS CDOs. These losses have resulted in a substantial reduction of FGIC’s statutory policyholders’ surplus over time. As a result, FGIC is in a policyholders’ surplus deficit position of approximately \$1,281,420 as of December 31, 2009. Under New York State Insurance Law (the “Insurance Law”), FGIC, as a financial guaranty insurance company also licensed to transact credit insurance and surety, must maintain policyholders’ surplus of at least \$66,400.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

2. Recent Developments (continued)

The Company's financial strength and credit ratings were downgraded during 2008 and 2009 and subsequently withdrawn by Moody's Investor Services Inc. (March 2009), Standard & Poor's Rating Services (April 2009) and Fitch Ratings, Inc. (November 2008). As of December 31, 2009, FGIC's aggregate net liability under its insured exposures continued to exceed the aggregate risk limit prescribed by the Insurance Law and FGIC's insured exposure under individual policies continued to exceed the applicable single risk limits prescribed by the Insurance Law.

Due to the adverse developments described above, FGIC and FGIC UK Ltd. voluntarily ceased writing financial guaranty policies concerning new or additional risks in January 2008. On July 1, 2009, FGIC UK Ltd. filed a voluntary variation of permission with the U.K. Financial Services Authority ("UK FSA"), its principal regulator, to remove its ability to write new insurance contracts. This filing was approved on July 10, 2009. Neither FGIC nor FGIC UK Ltd. currently has any plans to recommence writing new financial guaranty business.

On November 24, 2009, the New York Insurance Department (the "NYID") issued an order pursuant to Section 1310 of the Insurance Law (the "NYID Order") requiring FGIC, effective that day, to suspend paying any and all claims and prohibiting FGIC from writing any new policies. Accordingly, FGIC immediately suspended all claims payments. FGIC had previously ceased writing any new policies in January 2008. The NYID Order also directed FGIC to submit a plan to the New York State Superintendent of Insurance (the "Superintendent") to eliminate the impairment of FGIC's policyholders' surplus by January 5, 2010 and to take such steps as may be necessary to remove the impairment of its capital and to return to compliance with its minimum policyholders' surplus requirement by no later than March 25, 2010, or such subsequent date as the Superintendent deems appropriate. FGIC may only operate in the ordinary course of business and as necessary to effectuate its plan to eliminate FGIC's policyholders' surplus deficit. The NYID Order does not limit in any way the Superintendent's ability to seek rehabilitation or liquidation of FGIC prior to such date.

FGIC has since formulated a comprehensive restructuring plan (the "Surplus Restoration Plan") to fulfill the requirements set forth in the NYID Order and with a view to remediate its RMBS, ABS CDO and other exposures, remove its capital impairment and return FGIC to compliance with the applicable minimum policyholders' surplus requirement. FGIC submitted the Surplus

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

2. Recent Developments (continued)

Restoration Plan to the NYID on December 22, 2009. The Surplus Restoration Plan contemplates the following key loss mitigation components: (i) remediating a substantial portion of FGIC's exposure to RMBS and asset-backed securities ("ABS") insured by FGIC in the primary market and for which it has established statutory loss reserves, including by the consensual "stripping" of FGIC insurance on all or a substantial portion of such RMBS and ABS through an offer to exchange or through various other consensual remediation transactions and (ii) commuting, terminating, restructuring or reinsuring a substantial portion of FGIC's remaining exposure to ABS CDOs and to certain other obligations for which it has established statutory loss reserves, including RMBS insured by FGIC in the secondary market, pursuant to consensual transactions.

There can be no assurance that FGIC will successfully effectuate the Surplus Restoration Plan.

In the absence of a successful restructuring that achieves remediation of RMBS and other exposures of the magnitude contemplated by the Surplus Restoration Plan and the successful completion of the other remediation transactions and measures as described in the Surplus Restoration Plan, FGIC will continue to report a deficit in policyholders' surplus and (i) the Superintendent could seek court appointment as rehabilitator or liquidator of FGIC or (ii) in the exercise of its fiduciary duties, the FGIC Board of Directors may request the Superintendent to seek, and in such event it is likely that the Superintendent would seek, such court appointment.

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan

As a result of uncertainties described below, management has concluded that there is substantial doubt about the ability of the Company to continue as a going concern. The Company's financial statements as of December 31, 2009 and 2008 and for the years ended December 31, 2009, 2008, and 2007 are prepared assuming the Company continues as a going concern and do not include any adjustment that might result from its inability to continue as a going concern.

The principal factors that may affect FGIC's ability to continue as a going concern are the risks of (i) rehabilitation or liquidation at any time by the Superintendent given FGIC's policyholders' surplus deficit and (ii) FGIC's failure to successfully consummate the Surplus Restoration Plan by the date required in the NYID Order or otherwise. The Superintendent could seek court

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan (continued)

appointment as rehabilitator or liquidator of FGIC at any time because FGIC is out of compliance with the \$66,400 minimum policyholders' surplus requirement under the Insurance Law as of December 31, 2009. Moreover, there can be no assurance that FGIC will successfully effectuate the Surplus Restoration Plan. If the Surplus Restoration Plan is not successfully effectuated, FGIC may be unable to remediate its policyholders' surplus deficit, which likely would result in the NYID's intervention and FGIC's inability to continue as a going concern. However, even upon a successful restructuring, there can be no assurances provided regarding (a) the Company's future financial condition, (b) future intervention by the NYID or (c) the Company's ability to perform under its insurance policies in the future. Even if FGIC's Surplus Restoration Plan is successfully consummated, there is a risk that continuing, adverse loss development on its remaining in-force business in excess of the benefits it could potentially obtain from such loss mitigation efforts and transactions would cause FGIC to again report policyholders' surplus below the \$66,400 minimum requirement under the Insurance Law. Based on these factors and the continuing risks and uncertainties summarized below, management has concluded that there is substantial doubt about FGIC's ability to continue as a going concern.

In particular, the Company continues to be materially exposed to certain significant risks and uncertainties that could materially adversely affect its results of operations, financial condition and liquidity, including the following:

- The Company continues to be materially exposed to risks associated with any continuing deterioration in the U.S. residential housing and mortgage markets and the global credit markets, as well as the spread of such deterioration to other sectors of the economy to which the Company has material business exposure, including collateralized loan obligations ("CLOs"). The extent and duration of any continued deterioration of these markets is unknown, as is the effect, if any, on potential claim payments and the ultimate amount of losses the Company may incur on obligations it has guaranteed. In addition to exposure to general economic factors, including those as a result of the recent financial crisis, FGIC is exposed to the specific risks faced by the particular businesses, municipalities or pools of assets covered by its financial guaranty products. Businesses and municipalities are facing financial difficulties due to the current economic and financial crisis. Establishment of reserves for unpaid losses and loss adjustment expenses on the Company's remaining insured portfolio, and assessing the amount of anticipated

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan (continued)

claims and recoveries on the remaining credit default swap ("CDS") contracts insured by the Company, requires the use and exercise of significant judgment by management, including estimates regarding the likelihood of occurrence and amount of a loss on a guaranteed obligation. However, there remains a considerable amount of uncertainty relating to risks in home prices, credit markets and the economy as a whole, and there is no historical precedent for the current economic conditions. Small changes in assumptions underlying these estimates could result in significant changes in FGIC's loss expectations. Actual experience may differ from estimates and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred and, in certain cases, are expected to occur over many years in the future. Examples of these events include changes in the level of interest rates, home prices and consumer costs, unemployment rates and general economic conditions, government programs, credit deterioration of guaranteed obligations, and changes in the value of specific assets supporting guaranteed obligations. Both qualitative and quantitative factors are used in making such estimates. Any estimate of future losses and claims is subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and claims will vary, perhaps materially, from any estimate. See Note 15 for further information.

- FGIC-insured CDS contracts have provisions that may give certain FGIC counterparties the right to require FGIC to make mark-to-market termination payments following any payment default by FGIC under the CDS or following the occurrence of certain events that are outside FGIC's control. Specifically, it would be an event of default under certain of the CDS contracts insured by FGIC if FGIC is insolvent within the meaning of the CDS contracts and under most of such CDS contracts if FGIC should be placed into rehabilitation or liquidation by the Superintendent. In addition, the NYID has ordered FGIC to suspend paying claims under its policies and some CDS contracts insured by FGIC contain certain cross default event of default provisions, meaning that certain defaults by FGIC relating to payments due on its debt or other CDS contracts or policies, including such failures or defaults caused by the NYID Order, would give rise to an event of default under such CDS contracts. Upon termination of a CDS contract insured by FGIC as a result of any such applicable events of default, FGIC may be liable for

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan (continued)

payment of a termination payment. Such termination payments are generally calculated either based on "market quotation" or "loss" (each as defined in the Master Agreement published by the International Swaps and Derivatives Association, Inc (the "ISDA Master Agreement")). If any such events were to occur, the aggregate termination payments that may be asserted against FGIC would significantly exceed its available claims paying resources and liquidity funds. In addition, the insolvency (as defined in the applicable CDS contracts), rehabilitation or liquidation of FGIC may constitute an event of default under certain CDS contracts insured by FGIC UK Ltd., and ultimately may result in the liquidation, administration or rehabilitation of FGIC UK Ltd., which may have a material adverse impact on FGIC's business, results of operations, and financial condition. FGIC has been in discussions with a group of certain of its CDS counterparties about eliminating its exposure to such termination payments in connection with its current circumstances, which could become a component of the Surplus Restoration Plan.

- Although FGIC intends to continue to pursue various loss mitigation measures as described above in Note 2, FGIC may be unable to consummate loss mitigation transactions sufficient to restore FGIC's surplus to policyholders to a level in excess of the \$66,400 minimum required by the Insurance Law. In the absence of significant successful loss mitigation transactions, FGIC will continue to report a deficit in surplus to policyholders and the Superintendent may seek a court order for appointment to act as rehabilitator or liquidator of FGIC. Moreover, in the absence of these successful transactions and in the exercise of its fiduciary duties, FGIC's Board of Directors may request the Superintendent to seek such court appointment. In such circumstances, it is likely that the Superintendent would institute such proceedings. If the Superintendent were to rehabilitate or liquidate FGIC, it would have a material adverse impact on FGIC's business, results of operations and financial condition.
- There can be no assurance when or if claim payments by the Company will recommence. Any continued suspension of FGIC's ability to make claim payments could have a number of material adverse consequences, including, but not limited to, (i) litigation, (ii) the occurrence of an event of default under FGIC Corp.'s and FGIC's Revolving Credit Agreement dated December 12, 2005, as amended (the "Credit Agreement"), which would permit the lenders thereunder to accelerate the repayment by FGIC Corp. of

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan (continued)

\$46,000 of debt outstanding thereunder, (iii) the loss of access and control rights under certain FGIC-insured transactions, (iv) subordination or withholding of certain premium and/or reimbursement payments, and (v) the assertion of mark-to-market termination payments by counterparties to FGIC-insured CDS contracts with respect to contracts on which FGIC fails to pay a claim or under which an event of default otherwise occurs as a result of such suspension, as described above. There can be no assurance there would not be other material adverse consequences for FGIC if FGIC is unable to recommence claims payments. FGIC has received notices from trustees on certain transactions that assert that FGIC is in default with respect to its obligations relating to such transactions as a result of the suspension of claims payments and reserving the applicable trustee's rights in connection with such default and, in some cases, asserting that such trustee is withholding certain amounts otherwise payable to FGIC or that FGIC no longer has control rights in relation to the underlying trusts.

- FGIC's ability to pay dividends on its common stock and on its preferred stock to the holders thereof is subject to restrictions contained in the Insurance Law. Due to FGIC's statutory earned surplus deficit at December 31, 2009, FGIC is prohibited by the Insurance Law from paying dividends on its common stock or preferred stock. FGIC Corp.'s primary source of funds is dividend receipts from FGIC; therefore, FGIC Corp.'s ability to make debt service payments under the 6% Senior Notes due 2034 issued by FGIC Corp. under the Indenture dated January 12, 2004 and to meet its other cash needs is materially adversely impacted by FGIC's inability to pay dividends. Due to the limited funds available to FGIC Corp. to service its debts, FGIC Corp did not make the January 15, 2010 interest payment on such Senior Notes when due. See Note 21.
- FGIC has been named as a defendant in various lawsuits, and is subject to various governmental inquiries. FGIC also faces the risk of litigation due to the suspension of claims payments. It is not possible to predict whether additional suits will be filed or whether additional inquiries or requests for information will be made, and it is also not possible to predict the outcome of litigation, inquiries or requests for information. Management is unable to make a meaningful estimate of the amount or range of loss that could result from unfavorable outcomes but, under some circumstances, adverse results in any such proceedings could have a material and adverse impact on FGIC's business, results of operations, and financial condition. The outcome of some of these legal

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

3. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan (continued)

- proceedings and other contingencies could require FGIC to take or refrain from taking actions which could adversely affect its business or could require FGIC to pay substantial amounts of money. See Note 26 for further information.

4. 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.

These financial statements have been prepared in accordance with guidance included in the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). 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. Certain 2008 and 2007 amounts have been reclassified to conform to the 2009 presentation.

5. Summary of Significant Accounting Policies

The Company's significant accounting policies are as follows:

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 carried at fair value, which approximates cost. Bond discounts and premiums are amortized over the remaining terms of the respective securities.

ASC Topic 320 was amended in 2009 to clarify guidance on the recognition and measurement of other-than-temporary impairment. The Company adopted the guidance in the Topic effective April 1, 2009. The adoption did not have a material impact on the Company's consolidated

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

net income or financial position. If the fair value of a debt security is less than its amortized cost basis and the Company either intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, an other-than-temporary impairment has occurred and the difference between the amortized cost and fair value is recognized in earnings as a net realized investment loss. If the Company does not intend to sell or it is more-likely-than-not that the Company will not have to sell prior to recovery, the portion of the total impairment that is attributable to a credit loss is recognized in earnings, and the remaining difference between the debt security's amortized cost basis and its fair value is included in other comprehensive income. Beginning June 30, 2009, the Company determined that it either had the intent to sell or it was more likely than not that it would be required to sell its fixed maturity securities before recovery of their amortized cost bases, therefore, all unrealized losses are recorded through earnings while any unrealized gains are recorded to other comprehensive income, net of tax.

For periods prior to June 30, 2009, unrealized gains and losses were recorded as a separate component of accumulated other comprehensive income (loss), net of applicable income taxes, in the consolidated statements of stockholders' equity for those securities that the Company determined it had the intent to hold until their fair value would exceed amortized cost. For those securities that the Company determined it did not have the intent to hold until their fair value exceeds amortized cost, the Company recognized an other-than-temporary realized loss in the statement of operations.

Variable interest entity ("VIE") fixed maturity securities are carried at amortized cost.

Cash and Cash Equivalents

The Company considers all bank deposits, highly liquid securities, money market securities and certificates of deposit with maturities of three months or less at the date of purchase to be cash equivalents. In general, cash equivalents are carried at cost, which approximates fair value. In the event that a highly liquid or money market security is determined to be impaired, the security is adjusted to fair value.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

Premium Revenue Recognition

During 2009, the Company recorded premiums related to financial guaranty (non-derivative) insurance policies in accordance with ASC Topic 944 that became effective January 1, 2009. ASC Topic 944 requires the Company to recognize a liability for unearned premiums at policy inception on a contract-by-contract basis. An unearned premium revenue liability is recognized regardless of whether the premium is paid upfront or whether the premium is paid in installments. For policies where premiums are paid upfront (at policy inception) the unearned premium is equal to the premium collected. For financial guaranty contracts where the Company receives premiums in installments, unearned premiums and a receivable for future premiums collections are recognized at policy inception, measured at the present value of premiums expected to be collected over the contract period or expected period discounted using a risk-free rate.

ASC Topic 944 only allows the expected period to be used in the present value determination of unearned premium revenue and receivable for future premiums for contracts where (a) the insured obligation is contractually prepayable, (b) prepayments are probable, (c) the amount and timing of prepayments are reasonably estimable, and (d) a homogenous pool of assets is the underlying collateral for the insured obligation. The Company has determined that its installment contracts that insure mortgage-backed securities and collateralized debt obligations of asset-backed securities meet the conditions required by ASC Topic 944 to be treated as expected period contracts. For these contracts, when there are changes in premiums expected to be received, the unearned premiums and receivable for future installments are adjusted by equal amounts with no immediate impact to earnings, and the risk-free rate used to discount the future premiums is updated. For contracts where the expected period is not used, the unearned premiums and receivable for future installments are adjusted as early payments occur. For these contracts, the risk-free rate does not change as it is based on the contractual maturity of the contract.

The receivable for future premiums is reduced as installment premiums are collected. The Company reports the accretion of the discount on installment premiums receivable as premium revenue. The Company assesses the receivable for future premiums for collectability each reporting period, adjusts the receivable for uncollectible amounts and recognizes any write-off as operating expense. There have been no amounts written off during the year ended December 31, 2009.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

ASC Topic 944 requires the Company to recognize premium revenue over a period in proportion to the amount of insurance protection provided. Premium revenue is measured by applying a constant rate to the insured principal amount outstanding in a given period to recognize a proportionate share of the premium received or expected to be received on a financial guaranty insurance contract. A constant rate for each respective financial guaranty insurance contract is determined as the ratio of (a) the premium received or the present value of premium expected to be received to (b) the sum of all insured principal amounts outstanding during each period over the term of the contract. As premium revenue is recognized, the unearned premium revenue liability is reduced.

For the years ended December 31, 2008 and 2007, upfront premiums were earned over the period of risk based upon the principal and interest amortized during the period as compared to the original principal and interest outstanding and installment premiums, including premiums received on CDS's, were earned pro rata over the payment period.

A refunding occurs when a financial guaranty contract is extinguished. Under ASC Topic 944, this may occur when an insured obligation is called or upon termination of the policy prior to stated maturity. For years ended December 31, 2008 and 2007 a refunding was also considered to have occurred when an insured obligation was legally defeased. 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 that represents cash received is recognized. If a contract that pays in installments is refunded, the premium receivable and unearned premium that represented amounts that will no longer be received are taken to zero through premium written. Net premiums earned on refundings were \$(3,426), \$208,988, and \$43,717 for the years ended December 31, 2009, 2008, and 2007, respectively.

Gross direct and assumed premiums written for the years ended December 31, 2009, 2008, and 2007 include \$(14,769), \$(14,226) and \$3,639, respectively, of assumed premiums written. During 2009, the Company reduced the expected future premiums to be received on certain assumed policies. The Company commuted certain assumed policies during the year ended December 31, 2008. Ceded premiums are recognized in a manner consistent with the premium earned on the underlying policies.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

Policy Acquisition Costs

Policy acquisition costs include only those expenses that relate directly to and vary with premium production. Such costs include compensation of employees involved in marketing, underwriting and policy issuance functions, rating agency fees, premium taxes, ceding commissions paid on assumed policies and certain other expenses.

In determining policy acquisition costs, the Company must estimate and allocate the percentage of its costs and expenses that are attributable to premium production. Policy acquisition costs are deferred and amortized over the period in which the related premiums are earned.

Anticipated loss and loss adjustment expenses, future maintenance costs on in-force business and net investment income are considered in determining the recoverability of acquisition costs.

Ceding Commission Income

The Company receives ceding commission income on policies it has ceded to reinsurers. The commission is deferred and amortized over the period in which the related premiums are earned.

Loss and Loss Adjustment Expense Reserves

Loss reserves and loss adjustment expenses are regularly reviewed and updated based on claim payments and the results of ongoing insured portfolio surveillance. The Company conducts ongoing insured portfolio surveillance seeking to identify a complete population of impaired obligations and enable the Company to establish reserves.

During the year ended December 31, 2009, the Company recognized loss reserves in accordance with ASC Topic 944 which requires a loss reserve to be recognized on a contract-by-contract basis for non-derivative insured obligations when the present value of expected net cash outflows to be paid under the contract using a risk-free rate as of the measurement date exceeds the unearned premium revenue. The loss reserve is subsequently remeasured each reporting period using the current risk-free rate for expected increases or decreases due to changes in the

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

likelihood of default and potential recoveries. Subsequent changes to the measurement of claim liability are recognized as claim expense in the period of change. The Company's loss and loss adjustment expenses incurred are disclosed in Note 15. During the years ended December 31, 2008 and 2007, the Company recorded loss reserves without considering the amount of unearned premium revenue.

The future expected net cash outflows are determined using internally developed models and represent an estimate of the anticipated shortfall between (1) payments on insured obligations plus anticipated loss adjustment expenses and (2) anticipated cash flow from, and proceeds to be received on, sales of any collateral supporting the obligation and/or other anticipated recoveries.

The Company's cash flow projection models are dependent on a number of assumptions that require management to make judgments about the outcome of future events using historical and current market data. Significant assumptions include the liquidation value of the assets supporting the insured obligations, the volume and timing of collateral cash flows and the behavior of the underlying borrower. Changes in any significant assumptions from time to time will affect the Company's reserves and financial results, possibly materially.

Reinsurance recoverable on losses is calculated in a manner consistent with the calculation of loss and loss adjustment expenses. A valuation allowance is established against any uncollateralized reinsurance recoverable when the reinsurer is rated below investment grade.

Income Taxes

Deferred tax assets and liabilities are recognized to reflect the tax impact attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases.

Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period in which the change occurs. A valuation allowance is established for deferred tax assets that are not expected to be realized.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

The Company recognizes accrued interest and penalties related to unrecognized tax benefits where the ultimate recognition is uncertain.

Property and Equipment

Property and equipment consists of office furniture, fixtures, computer equipment and software and leasehold improvements that are reported at cost less accumulated depreciation. Office furniture and fixtures are depreciated on a straight-line basis over five years. Leasehold improvements are amortized over their estimated service lives or over the life of the lease, whichever is shorter. Computer equipment and software are depreciated over three years. Maintenance and repairs are charged to expense as incurred.

The Company capitalizes certain computer software and development costs when incurred in connection with developing or obtaining computer software for internal use. Capitalized software costs are amortized over three years.

Foreign Currency Translation

The Company has an established foreign branch and three subsidiaries in the United Kingdom, a subsidiary in Australia and insured exposure from a former branch in France. The Company has determined that the functional currencies of these operations are their respective local currencies. Accordingly, the assets and liabilities of these operations are translated into U.S. dollars at the rates of exchange at December 31, 2009 and 2008, and revenues and expenses are translated at average monthly exchange rates. The cumulative translation gains (losses) at December 31, 2009 and 2008 were \$192 and (\$7,934), respectively, net of tax expense of \$1,614 and \$439, respectively, and are reported as separate components of accumulated other comprehensive income in the consolidated statements of stockholders' equity.

Stock Compensation Plan

FGIC Corp. has a stock incentive plan that provides for stock-based compensation, including stock options, restricted stock awards and restricted stock units. Stock options are granted for a fixed number of shares with an exercise price equal to or greater than the estimated fair value of the common stock at the date of the grant. Restricted stock awards and units are valued at the estimated fair value of the common stock on the grant date.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

Compensation cost includes all share-based compensation granted prior to, but not yet vested as of, January 1, 2006, based on the fair value at the grant date estimated in accordance with ASC 5. Summary of Significant Accounting Policies Topic 718. The Company estimated the fair value of all stock options at the date of grant using the Black-Scholes-Merton option pricing model.

Variable Interest Entities

ASC Topic 810 provides accounting and disclosure rules for determining whether certain entities should be consolidated in the Company's consolidated financial statements. An entity is a VIE, if it has (i) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support or (ii) equity investors that cannot make significant decisions about the entity's operations or that do not absorb the majority of expected losses or receive the majority of expected residual returns of the entity.

Under ASC Topic 810, a VIE is consolidated by its primary beneficiary, which is the party that has a majority of the expected losses of the VIE or a majority of the expected residual returns of the VIE, or both. ASC Topic 810 requires disclosures for companies that have either a primary or significant variable interest in a VIE.

As part of its structured finance business, the Company insures debt obligations or certificates issued by special purpose entities. The Company has evaluated the relevant transactions and does not believe any such transactions require consolidation or disclosure under ASC Topic 810, other than as disclosed in Note 16.

Derivative Instruments

Under ASC Topic 815, all derivative instruments are recognized on the consolidated balance sheet at their fair value, and changes in fair value are recognized immediately in earnings unless the derivatives qualify as cash flow hedges.

Certain financial guaranty contracts (primarily CDS's) issued by the Company are considered derivatives under ASC Topic 815. Accordingly, these contracts are recognized on the Consolidated Balance Sheet at their fair value, and changes in fair value are recognized

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

currently in earnings. The Company considers these contracts to be a normal extension of its financial guaranty insurance business. Under the terms of these credit derivative contracts, the Company is not required to post collateral, and if the underlying obligation were to be in default, payments would not be accelerated and would be made on a pay-as-you-go basis.

Changes in fair value are recorded in “Net change in fair value of credit derivatives” on the Consolidated Statements of Operations. The “Net Realized (losses) gains” component of this line includes premiums received and receivable on written derivative contracts and losses paid and payable to counterparties due to the occurrence of a credit event or settlement. Losses payable may include anticipated claims payable after the occurrence of a credit event that requires payment under the contract terms. The “Net unrealized gains (losses)” component of the line includes all other changes in fair value.

Commitments

Although commitments are not insurance policies, commitments to issue financial guaranty insurance policies are generally accounted for in the same manner as issued insurance policies. However, fees received related to a commitment to issue a financial guaranty insurance policy are deferred until a policy is issued, if any, and if the Company determines that it is unlikely that an insurance policy will be issued, the commitment fee received is earned over the commitment period.

New Accounting Pronouncements

ASC Topic 810 requires reporting entities to present noncontrolling (minority) interest as equity (rather than as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. The presentation and disclosure requirements are to be applied retrospectively. The Company adopted this guidance on January 1, 2009, and this resulted in preferred stock issued by FGIC being reclassified from minority interest to a separate component of equity. The adoption of this guidance did not have a material impact on the Company’s consolidated balance sheets, results of operations or cash flows.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

ASC Topic 815 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 Topic 815, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. This guidance is effective for fiscal years and interim periods beginning after November 15, 2008. The Company adopted this guidance effective January 1, 2009.

The requirements for recognizing other-than-temporarily-impaired debt securities and changes to the existing impairment model for such securities were amended in Topic 320. The amendment changes presentation of other-than-temporary impairment losses and increases the frequency of and expands required disclosures about other-than-temporary impairment for debt and equity securities. The amendment is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted the amendment as of April 1, 2009. The adoption did not have a material impact on the Company's consolidated balance sheets, results of operations or cash flows.

ASC Topic 855 updated standards for disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The updated guidance is effective for interim periods ending after June 15, 2009. The Company adopted the guidance in the period ended June 30, 2009. The adoption of the guidance did not have a material impact on the Company's consolidated balance sheets, results of operations or cash flows. The date through which subsequent events have been evaluated was February 17, 2010, the same date on which the financial statements were issued.

In September 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-17 to ASC Topic 810, *Improvements to Financial Reporting by Enterprises Involved with VIEs*. ASU No. 2009-17 amends Topic 810 to eliminate the quantitative approach required to determine the primary beneficiary of a variable interest entity, which was based on determining which enterprise absorbs the majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both. ASU No. 2009-17 replaces this approach with an analysis that identifies the primary beneficiary based on a qualitative analysis of the entities that have the power to direct the activities of a variable interest entity and the obligation to absorb losses or the right to receive benefits from a variable interest entity. ASC Topic 810 will now require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

5. Summary of Significant Accounting Policies (continued)

Historically, ASC Topic 810 required reconsideration of whether an enterprise is the primary beneficiary of a variable interest entity only when specific events occurred. ASU No. 2009-17 is effective for fiscal years, and interim periods beginning after November 15, 2009. Early application is prohibited. The Company may determine not to adopt, and there can be no assurance that the Company will be able to adopt, ASU No. 2009-17. If the Company does not adopt ASU No. 2009-17, the Company will not publish GAAP financial statements for any period beginning after December 31, 2009.

In September 2009, the FASB issued ASU No. 2009-16 to ASC Topic 860, *Accounting for Transfers of Financial Assets*. ASU No. 2009-16 removes the concept of a qualifying special-purpose entity (“QSPE”) that was previously established and removes the exception from applying ASC Topic 810 to variable interest entities that are QSPEs. ASU No. 2009-16 also provides further guidance on accounting for asset transfers. ASU No. 2009-16 is effective for fiscal years and interim periods beginning after November 15, 2009. Early application is prohibited. Adoption of ASU No. 2009-16 is not expected to have a material effect on the Company’s consolidated financial position or results of operations. The Company will adopt ASU No. 2009-16 effective January 1, 2010, contingent upon the adoption of ASU No. 2009-17 discussed above.

Debt

The carrying amount of the Company’s debt is net of the unamortized balance of the issuance discount and capitalized debt issuance costs.

6. Statutory Surplus and Accounting Practices

Statutory-basis (deficit) surplus of FGIC at December 31, 2009 and 2008 was \$(1,281,420) and \$505,534, respectively. Statutory-basis net loss for the years ended December 31, 2009, 2008 and 2007 was \$(1,617,260), (\$560,618), and (\$1,502,511) respectively. The Company’s statutory contingency reserves were \$168,284 and \$48,015 as of December 31, 2009 and 2008, respectively.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

The following is a reconciliation of net loss and stockholder's deficit for FGIC presented on a GAAP basis to the corresponding amounts prepared and reported under statutory accounting principles prescribed or permitted by the NYID:

	2009		2008	
	Net Loss	Stockholders' Deficit	Net Loss	Stockholders' Deficit
GAAP-basis amount	\$ (893,802)	\$ (848,714)	\$ (1,105,490)	\$ (7,631)
Unrealized (gains) losses on fixed maturity securities held at fair value, net of tax	–	(46,741)	–	13,223
Unrealized losses (gains) from subsidiaries:				
FGIC Credit Products LLC (CDS issuer)	(848,871)	240,828	(755,906)	1,090,475
All other subsidiaries	–	(25,475)	(20,117)	
Premium revenue recognition	54,697	(179,503)	38,819	(272,342)
FGIC insured securities	(16,317)	(16,559)	–	–
Foreign exchange	(20,324)	–	83	–
Amortization / deferral of acquisition costs and ceding commission income	(20,276)	108,058	199,450	92,318
Mark-to-market losses (gains) on financial guaranty insurance treated as derivatives under GAAP	7,950	12,031	(85,558)	3,942
Non-admitted assets	–	(29,452)	–	(719,058)
Loss reserves (primarily related to insurance of CDS contracts)	152,549	(342,447)	361,908	(428,335)
Contingency reserve	–	(168,284)	–	(48,015)
Provision for reinsurance	–	(5,385)	–	–
Deferral of income taxes	(33,583)	(9,656)	799,699	762,167
Recognition of profit commission	–	–	4,654	–
Purchase accounting adjustments, net of tax	968	29,879	3,151	19,168
Capital lease obligation	(251)	–	(1,311)	251
Other	–	–	–	(629)
Statutory-basis amount	\$ (1,617,260)	\$ (1,281,420)	\$ (560,618)	\$ 505,534

Statutory practices differ in some respects from GAAP. Significant accounting policies, and variances from GAAP, where applicable, are as follows:

Investments

Under statutory reporting, bonds and short-term investments are stated at amortized cost. Under GAAP, bonds and short-term investments are stated at fair value.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

Under GAAP, subsidiaries are consolidated with the Company. For statutory reporting purposes, investments in wholly owned subsidiaries are recorded under the statutory equity method based on the underlying GAAP equity and reported as common stock investments. Changes in the value of subsidiaries are recorded as unrealized gains and losses and reported as a component of unassigned surplus. Investments in subsidiaries are non-admitted if their aggregate amount is in excess of fifty percent of policyholders' surplus.

Under statutory reporting, the reporting entity can discontinue applying the equity method when the investment in a subsidiary is reduced to zero, and statutory reporting does not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee. In connection with the issuance of a CDS by FGIC Credit Products LLC ("FGIC Credit Products"), FGIC issued a financial guaranty contract for the benefit of the counterparty guaranteeing timely payment of FGIC Credit Products' payment obligations under the CDS. For statutory purposes, FGIC accounts for the financial guaranty as insurance, and records losses as incurred.

FGIC insured securities

FGIC insured securities are RMBS securities insured by FGIC that were purchased as part of loss mitigation efforts. Under statutory reporting, these securities are carried at the lower of amortized cost or fair value. Under GAAP, these securities are carried at fair value.

Premium Revenue Recognition

For statutory purposes, premiums collected in a single payment at a policy's inception are earned in proportion to the scheduled principal and interest payments under the policy and premiums collected as installments (including CDS premiums) are earned pro rata over the payment period.

Beginning January 1, 2009, for GAAP purposes, for financial guaranty contracts where the Company receives premiums in installments, unearned premiums and a receivable for future premiums collections are recognized at policy inception, measured at the present value of premiums expected to be collected over the contract period or expected period discounted using a risk-free rate. The Company reports the accretion of the discount on installment premiums receivable as premium revenue. Premium revenue is measured by applying a constant rate to the insured principal amount outstanding in a given period to recognize a proportionate share of the premium received or expected to be received on a financial guaranty insurance contract.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

For the years ended December 31, 2008 and 2007, upfront premiums were earned over the period of risk based upon the principal and interest amortized during the period as compared to the original principal and interest outstanding and installment premiums, including premiums received on CDS's, were earned pro rata over the payment period.

A refunding occurs when a financial guaranty contract is extinguished. For GAAP purposes, this may occur when an insured obligation is called or upon termination of the policy prior to stated maturity. For statutory purposes, a refunding is also considered to have occurred when an insured obligation is legally defeased.

Policy Acquisition Costs and Ceding Commission Income

For statutory purposes, policy acquisition costs and ceding commission income are charged to expense or income as incurred; under GAAP, they are deferred and amortized over the period during which the related premiums are earned.

Credit Derivative Contracts

Under GAAP, financial guaranty contracts, including the guaranty of a CDS, that guaranty the payment obligation under a derivative contract are recorded at fair value. These financial guaranty contracts are accounted for as insurance for statutory purposes.

Non-admitted Assets

Certain assets are charged directly against surplus, but are reflected as assets under GAAP. Such assets principally include prepaid expenses, property and equipment and adjusted gross deferred tax assets. In accordance with the Insurance Law, investments in subsidiaries are non-admitted if their aggregate is in excess of fifty percent of the surplus to policyholders or sixty percent of the surplus of such insurer, whichever is greater.

Loss and Loss Adjustment Expense and Loss Reserves

For statutory purposes, loss reserves are established for watchlist risk category 4 credits. Loss reserves are established for the value of estimated losses on particular insured obligations that are currently or likely to be in payment default, and for which a future loss is probable and can be

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

reasonably estimated. These reserves represent an estimate of the present value of the anticipated shortfall, net of reinsurance, between (1) payments on insured obligations plus anticipated loss adjustment expenses and (2) anticipated cash flow from, and proceeds to be received on, sales of any collateral supporting the obligation and/or other anticipated recoveries. The discount rate is based upon the pretax yield of admitted assets. Under GAAP, unpaid losses and loss adjustment expenses are reported on a gross basis (i.e., before reinsurance), are discounted based on the risk-free rate for the anticipated shortfall. Beginning January 1, 2009, loss reserves are recognized when the present value of expected net cash outflows to be paid under the contract using a risk-free rate as of the measurement date exceeds the unearned premium revenue.

In addition, under GAAP, the Company also establishes loss reserves for watchlist risk category 3 credits to recognize the potential for claims against the Company on insured obligations that are not currently in payment default, but that have migrated to an impaired level, where there is a substantially increased probability of default. These reserves reflect a reasonable estimate of probable loss given evidence of impairment, and a reasonable estimate of the amount of loss in the event of default.

Contingency Reserves

Contingency reserves are computed on the basis of statutory requirements for the security of all policyholders, regardless of whether loss contingencies actually exist. Changes in the contingency reserve are recorded directly to statutory surplus. For the years ended December 31, 2009 and 2008, contingency reserve releases of \$34,416 and \$427,613, respectively, were recorded by the Company and approved by NYID. Under GAAP, contingency reserves are not required.

Foreign exchange

There are foreign exchange gains (losses) recognized for GAAP balance sheet items that are recorded in non functional currency.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

Unauthorized Reinsurance

For statutory purposes, a liability is recorded for uncollateralized amounts due from reinsurers not authorized to do business in New York State. Changes in this liability are charged or credited directly to unassigned surplus. Under GAAP, a valuation allowance is established against any uncollateralized reinsurance recoverable when the reinsurer is rated below investment grade.

Federal Income Taxes

For statutory purposes, federal income tax expenses or refunds are provided only with respect to taxable income for which income taxes are currently payable or receivable. Deferred income tax assets and liabilities arising from differences between the financial reporting and tax bases of assets and liabilities are recorded as a component of surplus. Under GAAP, deferred income tax assets and liabilities arising from differences between financial reporting and tax bases of assets and liabilities are recorded as a component of federal income tax expense. For both GAAP and statutory purposes, deferred tax assets are reduced by a valuation allowance if it is determined that some portion or all of the deferred tax assets will not be realized. Under statutory accounting, net deferred tax assets after accounting for a valuation allowance not meeting the criteria for admissibility are non-admitted.

Profit Commission

Under the terms of certain reinsurance agreements, the Company is entitled to receive profit commissions if the actual loss experience for a particular underwriting year is less than a prescribed level. For statutory purposes, the Company records such profit commissions when received. For GAAP purposes, management's best estimate of the ultimate amount recoverable by the Company is accrued and the change each year is recorded in the statement of operations. As of December 31, 2008, the balance of profit commission receivable was eliminated as a result of the reinsurance transaction with MBIA Insurance Corporation ("MBIA") (see Note 14).

Purchase Accounting

In a business combination under GAAP, the assets and the liabilities of the acquired entity are recorded at fair value and the purchase price is pushed down to the subsidiary, with the differences between the purchase price and the sum of the fair value of tangible and identifiable

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

6. Statutory Surplus and Accounting Practices (continued)

intangible assets acquired less liabilities assumed, if positive, recorded as goodwill. For statutory purposes, these adjustments are not recorded.

Capital Leases

Under GAAP reporting, certain leases are treated as capital leases, and a liability is established for the present value of the minimum payments under such leases. For statutory purposes, these leases are treated as operating leases and rental payments are charged to expense over the lease term.

7. Financial Guaranty Contracts

The Company adopted the guidance in Topic 944 effective January 1, 2009 and recorded a charge of \$16,364 to retained earnings, representing the cumulative effect of initial adoption. The following table summarizes the adjustment made to the Company's consolidated assets and liabilities as of January 1, 2009.

	Increases / (Decreases)
Assets:	
Reinsurance recoverable on losses	\$ (10,430)
Prepaid reinsurance premiums	122,690
Policy acquisition costs deferred	22,024
Premiums receivable	761,290
Liabilities:	
Unearned premium	877,111
Loss and loss adjustment expense reserves	(77,088)
Deferred ceding commission income	31,723
Ceded reinsurance balances payable	71,521
Accounts payable and accrued expenses (premium tax liability)	8,671

As of December 31, 2009, the Company has a premium receivable of \$647,992 that represents the present value of future expected premiums on contracts where premiums will be collected over the contract term. This amount is included in "Premiums receivable" on the Consolidated

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

7. Financial Guaranty Contracts (continued)

Balance Sheets. The weighted average risk-free rate used to discount the premium receivable was 3.03% as of December 31, 2009. The weighted average expected collection term of the premium receivable is 24 years as of December 31, 2009. As of December 31, 2009 the unearned premium revenue on these contracts is \$507,762 and is included in “Unearned premiums” on the Consolidated Balance Sheets. The Company recorded accretion of \$18,797 on the discounted premium receivable for the year ended December 31, 2009. This amount is included in “Change in net unearned premiums” on the Consolidated Statements of Operations.

As of December 31, 2009, the Company has a reinsurance premium payable of \$60,920, which represents the portion of the Company’s present value of future expected premiums (premiums receivable) that are due to reinsurers. The reinsurance premium payable will be accreted and paid as premiums due to the Company are accreted and collected.

The following is a rollforward of the premiums receivable for the year ended December 31, 2009:

	Premiums Receivable
Beginning premiums receivable at December 31, 2008	\$ 11,262
Transition adjustment	761,290
Premium payments received	(98,839)
New business written	—
Adjustments for changes in expected premiums	(89,513)
Accretion of discount	18,797
Foreign exchange movement	44,995
Ending premiums receivable at December 31, 2009	<u>\$ 647,992</u>

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

7. Financial Guaranty Contracts (continued)

The following is a schedule of premiums expected to be collected related to the premium receivable on financial guaranty contracts as of December 31, 2009. These amounts are based on circumstances as of December 31, 2009 and could change as a result of changes affecting the underlying insured obligations.

	Premium Expected to be Collected
Twelve months ended:	
December 31, 2010	\$ 84,686
December 31, 2011	74,852
December 31, 2012	64,092
December 31, 2013	54,707
Five years ended:	
December 31, 2018	199,887
December 31, 2023	139,813
December 31, 2028	111,807
December 31, 2033	72,724
December 31, 2038	42,652
December 31, 2043	20,033
December 31, 2048	6,880
December 31, 2053	3,685

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

7. Financial Guaranty Contracts (continued)

The following table presents the expected unearned premiums and the expected future premium earnings as of and for the periods presented. These amounts are based on circumstances as of December 31, 2009 and could change as a result of changes affecting the underlying insured obligations.

Year ended:	Unearned Premiums	Expected Future Premium Earnings		Accretion	Total Expected Future Premium Earnings
		Upfront	Installments		
December 31, 2009	\$1,641,038	\$ —	\$ —	\$ —	\$ —
Twelve months ended:					
December 31, 2010	1,481,888	82,200	76,950	18,520	177,670
December 31, 2011	1,337,848	77,152	66,889	16,786	160,826
December 31, 2012	1,208,995	72,247	56,606	15,302	144,155
December 31, 2013	1,093,541	67,631	47,823	14,033	129,487
Five years ended:					
December 31, 2018	656,687	270,306	166,548	55,980	492,833
December 31, 2023	372,701	173,373	110,613	39,060	323,046
December 31, 2028	186,735	103,614	82,352	25,130	211,096
December 31, 2033	82,777	53,655	50,303	14,586	118,545
December 31, 2038	35,557	17,182	30,037	7,069	54,289
December 31, 2043	15,201	4,557	15,799	2,801	23,157
December 31, 2048	6,434	298	8,469	1,019	9,785
December 31, 2053	1,902	10	4,522	242	4,774
December 31, 2058	—	—	1,902	—	1,902

8. Fair Value Measurements

The Company adopted the guidance in ASC Topic 820 effective January 1, 2008 and recorded a benefit due to the consideration of its credit standing in calculating the fair value of CDS contracts. ASC Topic 820 specifies a fair value hierarchy based on whether the inputs to

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

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 ASC Topic 820, 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 December 31, 2009 by level within the ASC Topic 820 fair value hierarchy. As required by ASC Topic 820, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	As of December 31, 2009			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Fixed maturity securities, available for sale	\$	–	\$ 1,440,670	\$ –
Short-term investments		118,980		118,980
Other assets – FGIC insured securities		–	41,933	41,933
Derivative assets		–	139	139
Total assets at fair value	\$	–	\$ 1,559,650	\$ 42,072
				\$ 1,601,722
Financial liabilities:				
Derivative liabilities	\$	–	\$	264,709
Total liabilities at fair value	\$	–	\$	264,709

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

	As of December 31, 2008				
	Level 1	Level 2	Level 3	Total	
Financial assets:					
Fixed maturity securities, available for sale	\$	–	\$ 2,450,652	\$ –	\$ 2,450,652
Short-term investments	–	151	–	–	151
Other assets – FGIC insured securities	–	–	3,576	–	3,576
Derivative assets	–	–	647	–	647
Total assets at fair value	\$	–	\$ 2,450,803	\$ 4,223	\$ 2,455,026
Financial liabilities:					
Derivative liabilities	\$	–	\$	–	\$ 1,103,100
Total liabilities at fair value	\$	–	\$	–	\$ 1,103,100

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. 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.

FGIC insured securities

FGIC insured securities are RMBS securities insured by FGIC that were purchased as part of loss mitigation efforts. Similar to the fixed income securities described above, these securities do not trade on a daily basis. Therefore 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. The market value is then adjusted for the estimated value of the FGIC insurance that is embedded in the market price.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

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 ASC Topic 815. Accordingly, these contracts are recognized on the Consolidated Balance Sheets 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 over time in accordance with the payment terms specified in the CDS.

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 Operations 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 indicative prices for the underlying bonds, credit spreads and yield curves. The models calculate a theoretical exit price and reflect management's best judgment about current 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 December 31, 2009 does not reflect the potential impact, if any, of ongoing commutation, settlement and restructuring efforts by the Company. 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.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

As discussed in Note 3, FGIC-insured CDS contracts have provisions that may give certain FGIC counterparties the right to require FGIC to make mark-to-market termination payments following any payment default by FGIC under the CDS or following the occurrence of certain events that are outside FGIC's control. Specifically, it would be an event of default under certain of the CDS contracts insured by FGIC if FGIC is insolvent within the meaning of the CDS contracts and under most of such CDS contracts if FGIC should be placed into rehabilitation or liquidation by the Superintendent. In addition, the NYID has ordered FGIC to suspend paying claims under its policies and some CDS contracts insured by FGIC contain certain cross default event of default provisions, meaning that certain defaults by FGIC relating to payments due on its debt or other CDS contracts or policies, including such failures or defaults caused by the NYID Order, would give rise to an event of default under such CDS contracts. Upon termination of a CDS contract insured by FGIC as a result of any such applicable events of default, FGIC may be liable for payment of a termination payment. Such termination payments are generally calculated either based on "market quotation" or "loss" (each as defined in the ISDA Master Agreement). If any such events were to occur, the aggregate termination payments that may be asserted against FGIC would significantly exceed its available claims paying resources and liquidity funds. In addition, the insolvency (as defined in the applicable CDS contracts), rehabilitation or liquidation of FGIC may constitute an event of default under certain CDS contracts insured by FGIC UK Ltd., and ultimately may result in the liquidation, administration or rehabilitation of FGIC UK Ltd., which may have a material adverse impact on FGIC's business, results of operations, and financial condition. FGIC has been in discussions with a group of certain of its CDS counterparties about eliminating its exposure to such termination payments in connection with its current circumstances, which could become a component of the Surplus Restoration Plan. The fair value of the derivatives at December 31, 2009 does not reflect the potential mark-to-market effect of termination.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

The following tables show a summary of changes in the fair value of the Company's Level 3 financial assets and liabilities for the year ended December 31, 2009. 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 predominantly by unobservable inputs.

Level 3 Financial Assets and Liabilities Accounted for at Fair Value

	Years Ended December 31	
	2009	2008
Net balance, beginning of period	\$ (1,098,877)	\$ (1,938,663)
Net change in fair value included in earnings	675,343	477,326
Purchases, issuances and settlements	200,898	358,884
Transfers in and /or out of Level 3	-	-
Net balance, end of period	(222,637)	(1,102,453)
Change in unrealized gains and losses relating to assets and liabilities held at the reporting date	\$ 522,806	\$ 386,655

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

	Year Ended December 31, 2009	
	Change in Fair Value of Credit Derivatives: Realized (Losses) Gains and Other Settlements	Change in Fair Value of Credit Derivatives: Unrealized Gains (Losses)
Total gains (losses) included in earnings for the period	\$ 175,404	\$ 837,883
Change in unrealized gains (losses) relating to assets and liabilities held at the reporting date	-	522,806

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

8. Fair Value Measurements (continued)

	<u>Year Ended December 31, 2008</u>	
	<u>Change in Fair Value of Credit Derivatives: Realized (Losses) Gains and Other Settlements</u>	<u>Change in Fair Value of Credit Derivatives: Unrealized Gains (Losses)</u>
Total gains (losses) included in earnings for the period	\$ (358,884)	\$ 836,210
Change in unrealized gains (losses) relating to assets held at the reporting date	–	386,655

9. Investments

The amortized cost and fair values of investments classified as fixed maturity securities are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
At December 31, 2009				
Available for sale:				
Obligations of states and political subdivisions	\$ 1,061,609	\$ 53,181	\$ –	\$ 1,114,790
Asset- and mortgage-backed securities	171,213	11,228	–	182,441
U.S. Treasury securities and obligations of U.S. government corporations and agencies	47,602	2,093	–	49,695
Corporate bonds	45,615	2,031	–	47,646
Debt securities issued by foreign governments	37,397	1,848	–	39,245
Preferred stock	3,713	3,140	–	6,853
Total fixed maturity securities	<u>1,367,149</u>	<u>73,521</u>	<u>–</u>	<u>1,440,670</u>
Short-term investments	118,980	–	–	118,980
Held to maturity:				
Variable interest entity fixed maturity securities	750,000	–	–	750,000
Total investments	<u>\$ 2,236,129</u>	<u>\$ 73,521</u>	<u>\$ –</u>	<u>\$ 2,309,650</u>

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

9. Investments (continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2008				
Available for sale:				
Obligations of states and political subdivisions	\$ 2,060,257	\$ 29,115	\$ 52,264	\$ 2,037,108
Asset- and mortgage-backed securities	238,715	4,409	12,059	231,065
U.S. Treasury securities and obligations of				
U.S. government corporations and agencies	64,109	8,541	—	72,650
Corporate bonds	54,623	611	1,886	53,348
Debt securities issued by foreign governments	45,351	3,239	3	48,587
Preferred stock	7,894	—	—	7,894
Total fixed maturity securities	2,470,949	45,915	66,212	2,450,652
Short-term investments	151	—	—	151
Held to maturity:				
Variable interest entity fixed maturity securities	750,000	—	—	750,000
Total investments	\$ 3,221,100	\$ 45,915	\$ 66,212	\$ 3,200,803

Investments in fixed maturity securities carried at fair value of \$4,612 and \$5,458 as of December 31, 2009 and 2008, respectively, were on deposit with various regulatory authorities, as required by law.

The amortized cost and fair values of investments in fixed maturity securities available for sale at December 31, 2009 are shown below by contractual maturity date. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

9. Investments (continued)

	Fixed Maturity Securities By Contractual Maturity Date	
	As of 12/31/09	
	Amortized Cost	Fair Value
Fixed Maturity Securities		
Due within one year	\$ 25,355	\$ 25,691
Due after one year through five years	238,990	251,124
Due after five years through ten years	295,621	310,315
Due after ten years	635,970	671,099
Asset – and mortgage-backed securities	171,213	182,441
Total	<u>\$ 1,367,149</u>	<u>\$ 1,440,670</u>

During 2008 and 2009, the Company determined that it either did not have the intent to hold certain fixed income securities until their fair value exceeded their amortized cost or that it had the intent to sell its fixed income securities or it is more likely than not that the Company will be required to sell these securities before recovery of their amortized cost bases. As a result, the Company recorded other-than-temporary impairment losses on its fixed income securities of \$54,348 and \$37,835 for the years ended December 31, 2009 and 2008, respectively. These losses are included in “Net investment realized (losses) gains” in the Consolidated Statements of Operations and represent the difference between the amortized cost basis and its fair value at the balance sheet date. Net investment realized losses for the years ended December 31, 2009 and 2008 also includes \$6,786 and \$3,062, respectively, of a realized loss on cash equivalents related to an other-than-temporary impairment.

For the years ended December 31, 2009, 2008 and 2007, proceeds from sales of fixed maturity securities, available for sale, were \$1,067,657, \$1,239,624 and \$20,407, respectively. For the years ended December 31, 2009, 2008 and 2007, gross gains of \$46,407, \$28,330 and \$523, respectively, and gross losses of \$2,587, \$1,037 and \$192, respectively, were realized on such sales. In 2009 and 2008, \$2 and \$53 of gross realized gains on sales of short-term investments were included in the “Net investment realized (losses) gains” on the Consolidated Statements of Operations, respectively.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

9. Investments (continued)

Net investment income of the Company was derived from the following sources:

	Years Ended December 31		
	2009	2008	2007
Income from fixed maturity securities	\$ 82,010	\$ 134,377	\$ 148,634
Income from short-term investments	1,260	18,028	12,604
Total investment income	83,270	152,405	161,238
Investment expenses	(3,028)	(4,023)	(3,268)
Net investment income	80,242	148,382	157,970
Interest income – investments held by variable interest entity	15,823	33,045	41,691
Total	\$ 96,065	\$ 181,427	\$ 199,661

As of December 31, 2009, the Company did not have more than 6% of its investment portfolio (excluding variable interest entity fixed maturity securities) concentrated in a single issuer or industry; however, the Company had the following investment concentrations by state:

	<u>Fair Value</u>
New York	\$ 96,456
Texas	93,811
California	90,735
Illinois	90,465
Massachusetts	78,526
Michigan	69,411
Florida	44,198
New Jersey	39,984
Wisconsin	28,501
Arizona	28,257
	<hr/>
	660,344
All other states	322,923
All other investments	576,383
Total investments	<u>\$ 1,559,650</u>

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

10. Property and Equipment

The components of property and equipment at December 31, 2009 and 2008 were as follows:

	2009	2008
Artwork	\$ 348	\$ 371
Computer equipment	1,491	1,730
Furniture and fixtures	1,161	2,264
Leasehold improvements	3,215	6,082
Capitalized software	942	942
	7,157	11,389
Accumulated depreciation and amortization	(3,521)	(4,697)
Total Property and equipment, net	\$ 3,636	\$ 6,692

For the years ended December 31, 2009, 2008 and 2007, depreciation expense was \$2,610, \$2,805 and \$1,758, respectively.

11. Business Restructuring

During the fourth quarter of 2008, the Company initiated a workforce reduction and incurred a restructuring charge of \$19,905 that was included in “Operating expenses” on the Consolidated Statements of Operations. During the fourth quarter of 2008, \$2,709 of involuntary termination benefits and \$2,137 of other restructuring related charges were paid. The terms of the workforce reduction, including the involuntary termination benefits to be received by affected employees, were communicated by the Company in the fourth quarter of 2008. The Company incurred additional expense of \$2,016 during the year ended December 31, 2009 in relation to a further workforce reduction. As of December 31, 2009, \$13,198 of involuntary termination benefits were paid and the balance of \$3,879 is recorded in “Accounts payable and accrued expenses” on the Consolidated Balance Sheet. The Company expects to pay the majority of this balance prior to December 31, 2010.

In connection with the workforce reduction, the Company ceased using approximately 50% of its leased office space in the fourth quarter of 2008. Accordingly, the Company recorded a liability of \$1,391 in the fourth quarter of 2008, representing the Company’s liability for the remaining lease term reduced by estimated sublease rentals. During the year ended December 31, 2009, the Company ceased using an additional 25% of its leased office space. During the year ended

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

11. Business Restructuring (continued)

December 31, 2009, the Company incurred additional expense of \$6,343 as it increased the liability due to ceasing use of the additional space and adjustments to estimated net cash flows. The liability will be adjusted in future periods to reflect revisions to estimated cash flows. The liability is recorded as a component of “Accounts payable and accrued expenses” on the Consolidated Balance Sheet at December 31, 2009 and the corresponding expense was recorded in “Operating expenses” in the Consolidated Statements of Operations. The Company also recorded a write-off of leasehold improvements in the amount of \$9,498 in fourth quarter of 2008 related to the vacated office space. The Company recorded a write-off of leasehold improvements of \$501 for the year ended December 31, 2009. The charges for the write-off of leasehold improvements were included in Operating expenses in the Consolidated Statements of Operations.

As discussed in Note 2 above, FGIC has formulated a comprehensive restructuring plan. Amounts related to this plan will be expensed as incurred.

12. Derivative Instruments

Prior to ceasing writing new business, the Company issued CDS to certain buyers of credit protection by entering into contracts that referenced collateralized debt obligations from cash and synthetic structures backed by pools of RMBS, corporate, consumer or structured finance debt. It also offered credit protection on public finance and structured finance obligations in CDS form. The Company considered these contracts to be a normal extension of its financial guaranty insurance business and its policy was to hold the CDS contracts to maturity. However, in certain circumstances, the Company may commute, settle or terminate CDS contracts prior to maturity for risk management purposes. These CDS agreements and certain other financial guaranty contracts are considered derivatives under ASC Topic 815.

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 over time in accordance with the payment terms specified in the CDS. Gross derivative assets and liabilities are presented at fair value on the Consolidated Balance Sheets. (See Note 8)

As discussed in Note 3, FGIC-insured CDS contracts have provisions that may give certain FGIC counterparties the right to require FGIC to make mark-to-market termination payments following any payment default by FGIC under the CDS or following the occurrence of certain

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

12. Derivative Instruments (continued)

events that are outside FGIC's control. Specifically, it would be an event of default under certain of the CDS contracts insured by FGIC if FGIC is insolvent within the meaning of the CDS contracts and under most of such CDS contracts if FGIC should be placed into rehabilitation or liquidation by the Superintendent. In addition, the NYID has ordered FGIC to suspend paying claims under its policies and some CDS contracts insured by FGIC contain certain cross default event of default provisions, meaning that certain defaults by FGIC relating to payments due on its debt or other CDS contracts or policies, including such failures or defaults caused by the NYID Order, would give rise to an event of default under such CDS contracts. Upon termination of a CDS contract insured by FGIC as a result of any such applicable events of default, FGIC may be liable for payment of a termination payment. Such termination payments are generally calculated either based on "market quotation" or "loss" (each as defined in the ISDA Master Agreement). If any such events were to occur, the aggregate termination payments that may be asserted against FGIC would significantly exceed its available claims paying resources and liquidity funds. In addition, the insolvency (as defined in the applicable CDS contracts), rehabilitation or liquidation of FGIC may constitute an event of default under certain CDS contracts insured by FGIC UK Ltd., and ultimately may result in the liquidation, administration or rehabilitation of FGIC UK Ltd., which may have a material adverse impact on FGIC's business, results of operations, and financial condition. FGIC has been in discussions with a group of certain of its CDS counterparties about eliminating its exposure to such termination payments in connection with its current circumstances, which could become a component of the Surplus Restoration Plan. The fair value of the Company's CDS contracts recorded in its financial statements at December 31, 2009 does not reflect the potential effect of mark-to-market termination payments.

The Company uses Risk Categories to define and monitor insured financial obligations including CDS contracts. See Note 15 for the definitions of the Risk Categories. The following table summarizes the net principal outstanding for CDS contracts, by the Company's Risk Categories, for each major category as of December 31, 2009:

Risk Categories	CDO of ABS	CLO	Utility	Other
1	\$ —	\$ 5,131,057	\$ 1,958,763	\$ 3,999,296
2	—	7,160,065	—	100,000
3	—	—	—	—
4	2,300,477	—	—	81,759

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

12. Derivative Instruments (continued)

The table below summarizes information by major category as of December 31, 2009:

	<u>CDO of ABS</u>	<u>CLO</u>	<u>Utility</u>	<u>Other</u>
Number of CDS transactions	6	69	16	29
Remaining weighted average life of obligation (in years)	28	6	11	12
Net principal outstanding	\$ 2,300,477	\$ 12,291,122	\$ 1,958,763	\$ 4,181,055

The maximum amount of potential future payments under the Company's CDS contracts is generally the principal outstanding. These CDS contracts and certain other financial guaranty contracts are considered derivatives under ASC Topic 815.

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

	Years Ended December 31		
	2009	2008	2007
Change in fair value of credit derivatives			
Net realized (losses) gains:			
Credit derivative premiums received and receivable	\$ 20,711	\$ 33,261	\$ 30,751
Credit derivative losses paid and payable	(196,115)	(392,145)	-
Total net realized (losses) gains	<u>(175,404)</u>	<u>(358,884)</u>	<u>30,751</u>
Net unrealized gains (losses)	<u>837,883</u>	836,210	(1,937,160)
Net change in fair value of credit derivatives	<u>\$ 662,479</u>	<u>\$ 477,326</u>	<u>\$ (1,906,409)</u>

13. Income Taxes

The Company files a consolidated federal income tax return. The method of allocation between FGIC Corp. and its subsidiaries is determined under a tax sharing agreement approved by the Company's Board of Directors and the NYID, and is based upon separate return calculations. As of December 31, 2009, FGIC has a receivable from FGIC Corp. of \$27,915 for income taxes. The receivable was settled in January 2010.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

13. Income Taxes (continued)

The following is a reconciliation of foreign and domestic income taxes computed at the statutory income tax rate and the (benefit) provision for foreign and domestic income taxes:

	Years Ended December 31		
	2009	2008	2007
Income taxes computed on loss before provision for federal income taxes, at the statutory income tax rate	\$ (324,204)	\$ (117,448)	\$ (981,821)
State and local income taxes, net of federal income taxes	(124)	806	(775)
Tax effect of:			
Tax-exempt interest	(19,301)	(34,330)	(39,393)
Foreign subsidiary adjustments	562	10,624	5,955
Valuation allowance	284,071	973,765	31,410
Reductions in tax contingent liabilities	(6,332)	–	(12,773)
Other, net	947	4,505	1,088
(Benefit) provision for income taxes	\$ (64,381)	\$ 837,922	\$ (996,309)

Following are the foreign and domestic components of the (benefit) provision for income taxes:

	Years Ended December 31		
	2009	2008	2007
Foreign			
Current	\$ 714	\$ 809	\$ (662)
Deferred	111	(480)	3,128
Domestic			
Current	(31,221)	788	(81,859)
Deferred	(33,985)	836,805	(916,916)
Total	\$ (64,381)	\$ 837,922	\$ (996,309)

As of December 31, 2009, the Company had a domestic net operating loss carryforward of \$3,690,764 for tax purposes, which will be available to offset future taxable income. If not used, the carryforward will start expiring in 2027 through 2029 depending on the originating year.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

13. Income Taxes (continued)

The Worker, Homeownership, and Business Assistance Act of 2009 (the “Act”), passed November 6, 2009, permits taxpayers to carryback 2008 or 2009 net operating losses (“NOLs”) for up to five years. The Act also suspended the 90-percent income limitation on the use of NOLs for determining alternative minimum tax (“AMT”) for any of the carryback years. In December 2009, the Company filed a refund claim with the IRS in the amount of \$25,334 by electing to carryback a portion of its 2008 NOL. As a result, the Company realized a \$25,334 tax benefit in 2009. The 2009 tax benefit was realized as previously recorded deferred tax assets for NOL carryforwards and AMT credits had been offset by a full valuation allowance. As of December 31, 2009, there are no AMT credits available for use in future periods as the 2008 NOL carryback utilized all prior years’ AMT credits. The refund was received on January 21, 2010.

In accordance with ASC Topic 740, the Company evaluates its deferred income tax asset to determine if valuation allowances are required. ASC Topic 740 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a “more likely than not” standard. In making such judgments, significant weight is given to evidence that can be objectively verified. Management believes it is more likely than not that the amortization of the net unearned premium reserve on non-derivative contracts, collection of future installment premiums on derivative contracts already written, and income from the investment portfolio will not generate sufficient taxable income to realize the deferred tax asset that currently exists. Accordingly, a full valuation allowance was established against the Company’s domestic net deferred tax asset of \$1,277,682 as of December 31, 2009. The Company will continue to analyze the need for a valuation allowance on a quarterly basis.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

13. Income Taxes (continued)

The tax effects of temporary differences that give rise to significant portions of the net deferred tax asset at December 31, 2009 and 2008 are presented below:

	2009	2008
Deferred tax assets:		
Net mark-to-market losses on credit derivative contracts	\$ 98,862	\$ 295,643
AMT credit carryforward	–	20,416
Impairment of investments	22,442	14,954
Property and equipment	2,224	3,777
Deferred compensation	4,287	8,663
Capital lease	1,642	1,728
Net operating loss carryforward foreign subsidiaries	16,143	14,794
Net operating loss carryforward	1,291,767	719,191
Net unrealized loss on investments	–	1,887
Deferred ceding commission income	69,942	72,009
Accrued liabilities	14,014	4,012
Other	3,173	1,834
Total gross deferred tax assets	1,524,496	1,158,908
Deferred tax liabilities:		
Loss and loss adjustment expense reserves	126,026	55,941
Net unrealized gains on fixed maturity securities available for sale	32,878	–
Deferred acquisition costs	33,398	31,181
Premium revenue recognition	28,349	65,064
Unrealized gains on foreign currency	8,698	439
Other	1,708	1,108
Total deferred tax liabilities	231,057	153,733
Net deferred tax asset	1,293,438	1,005,175
Valuation allowance	1,293,438	1,005,175
Net deferred tax asset	\$ –	\$ –

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

13. Income Taxes (continued)

As of December 31, 2009 and 2008, the Company had gross foreign deferred tax assets of \$16,334 and \$14,910, respectively, and gross foreign deferred tax liabilities of \$577 and \$683, respectively. The net operating losses on foreign subsidiaries of \$68,889 as of December 31, 2009 were generated by FGIC's United Kingdom subsidiaries. The United Kingdom does not allow net operating losses to be carried back, but does permit them to be carried forward indefinitely. Based upon projections of future taxable income over the periods in which the deferred tax assets are deductible and the estimated reversal of future taxable temporary differences, the Company does not anticipate realizing the benefits of these deductible differences and, therefore, established a valuation allowance at December 31, 2009 and 2008 of \$15,756 and \$14,227, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits as of December 31, 2009 and 2008 is as follows:

	Years Ended December 31	
	2009	2008
Balance at January 1	\$ 6,933	\$ 6,598
Additions for tax positions of prior years	317	335
Reductions for tax positions of prior year	(6,332)	—
Balance at December 31	\$ 918	\$ 6,933

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 \$(44), \$335 and \$440 during the years ended December 31, 2009, 2008, and 2007, respectively. Approximately \$556 and \$601 were accrued for the payment of interest and penalties at December 31, 2009 and 2008, 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. federal 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 federal income tax examination by the IRS for years before 2005.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

13. Income Taxes (continued)

Upon completion of the audit, previously unrecognized tax benefits of \$5,353 relating to the years under examination were recognized. Further, the Company, in connection with the examination, agreed to an IRS adjustment related to the deductibility of transaction costs associated with the sale of FGIC Corp. in 2003. As a result, the Company believes that the uncertainty regarding the deductibility of such transaction costs was reduced to a level that no longer required the Company to maintain an unrecognized tax benefit for this position. Consequently, the Company recognized a tax benefit of \$7,420 in 2007, which represents the difference between the liability accrued by the Company for this tax position and the agreed upon adjustment.

During the third quarter of 2008, the IRS commenced an examination of the Company's consolidated U.S. federal income tax returns for the years ended December 31, 2005, 2006 and 2007. During 2009, the IRS commenced an examination of the Company's consolidated U.S. federal income tax return for the year ended December 31, 2008. In the opinion of management, adequate provision has been made for any additional taxes that may become due as a result of current or future examinations by tax authorities.

The tax returns filed for the Company's subsidiaries that are subject to taxation in the United Kingdom for the years ended December 31, 2006 and 2007 are subject to examination through January 31, 2010. The tax returns filed for the year ended December 31, 2008 for these subsidiaries are subject to examination through December 31, 2010. The tax return for FGIC Credit Products Limited for the period ended June 30, 2009 is subject to examination through June 30, 2011.

14. Reinsurance

Reinsurance is a commitment by one insurance company (the reinsurer) to reimburse another insurance company (the ceding company) for a specified portion of the insurance risks under policies issued by the ceding company in consideration for a portion of the related premiums received. The ceding company typically will receive a ceding commission from the reinsurer.

The Company used reinsurance to increase its capacity to write insurance for obligations of large, frequent issuers; to meet internal, rating agency or regulatory single risk limits; to diversify risk; and to manage rating agency and regulatory capital requirements. The Company arranged reinsurance on both a facultative (transaction-by-transaction) basis and on a proportional share basis.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

14. Reinsurance (continued)

In 2008, the Company reinsured a significant portion of its public finance portfolio as described below. The reinsurance transaction was approved by the NYID.

As a primary insurer, the Company is required to fulfill all its obligations to policyholders even if a reinsurer fails to perform its obligations under the applicable reinsurance agreement. The Company regularly monitors the financial condition of its reinsurers. The Company evaluated the financial condition of its reinsurers and recorded an allowance for unrecoverable reinsurance of \$1,025 as of December 31, 2009 for a reinsurer that was rated below investment grade.

Under most of the Company's reinsurance agreements, the Company has the right to reassume all the exposure ceded to a reinsurer (and receive all the remaining unearned premiums ceded) in the event of a ratings downgrade of the reinsurer or the occurrence of certain other events. In certain of these cases, the Company also has the right to impose additional ceding commissions.

Under certain reinsurance agreements, the Company holds collateral in the form of letters of credit and trust agreements. Such collateral totaled \$183,407 at December 31, 2009 and can be drawn on in the event of default by a reinsurer.

The effect of reinsurance on premiums written and earned was as follows:

	Years Ended December 31					
	2009		2008		2007	
	Written	Earned	Written	Earned	Written	Earned
Direct	\$ (51,093)	\$ 219,154	\$ 93,579	\$ 516,932	\$ 414,460	\$ 307,786
Assumed	(14,769)	(2,222)	16,716	2,434	3,639	2,194
Ceded	4,108	(156,218)	(872,152)	(129,933)	(103,509)	(34,822)
Net premiums	<u>\$ (61,754)</u>	<u>\$ 60,714</u>	<u>\$ (761,857)</u>	<u>\$ 389,433</u>	<u>\$ 314,590</u>	<u>\$ 275,158</u>

On September 30, 2008, FGIC entered into a reinsurance agreement with MBIA, under which MBIA reinsured certain policies covering approximately \$188 billion of FGIC's U.S. public finance insured par outstanding. The reinsurance provided by MBIA will enable covered policyholders to make claims for payment directly against MBIA in accordance with the terms of the reinsurance agreement. FGIC paid a reinsurance premium to MBIA of \$915,479, net of existing reinsurance associated with the covered policies. The reinsurance agreement also provided for MBIA to pay FGIC a ceding commission of \$196,721. The ceding commission was

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

14. Reinsurance (continued)

deferred and will be recognized over the remaining term of the policies. In connection with the MBIA reinsurance transaction, FGIC reassumed from third party reinsurers certain policies covering approximately \$14 billion of FGIC's U.S. public finance insured par outstanding risk, and FGIC contemporaneously ceded approximately \$12 billion of this risk to MBIA. The MBIA reinsured par outstanding, reinsurance premium and ceding commission include amounts related to these policies. In February 2009, MBIA announced that, effective as of January 1, 2009, with the prior approval of the NYID, it had assigned its rights and obligations under the reinsurance agreement and the related trust agreement to National Public Finance Guarantee Corporation ("National") an Illinois stock insurance company, which has assumed MBIA's responsibility for providing reinsurance for these policies.

For the years ended December 31, 2009, 2008 and 2007, reinsurance recoveries reduced loss and loss adjustment expenses incurred by \$57,083, \$135,158 and \$7,287, respectively.

FGIC assumed exposure of approximately \$848,300 in par amount as of December 31, 2008, from certain other financial guarantors ("ceding companies") under reinsurance agreements. As a result of the downgrade in the Company's financial strength ratings, a ceding company may have the ability either to reassume the exposures ceded and receive the remaining unearned premiums, or to impose additional ceding commissions.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves

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

	Years Ended December 31		
	2009	2008	2007
Balance at beginning of period:			
Watchlist risk category 4 reserves	\$ 1,760,782	\$ 1,259,202	\$ 28,558
Watchlist risk category 3 reserves	14,725	8,218	11,741
Total	1,775,507	1,267,420	40,299
Less reinsurance recoverable on unpaid losses	(120,418)	(8,653)	(1,485)
Net balance at beginning of period	1,655,089	1,258,767	38,814
FAS 163 transition adjustment, net	(66,658)	–	–
Net balance	1,588,431	1,258,767	38,814
Incurred related to:			
Current period	141,259	670,452	1,239,069
Prior periods	1,620,089	426,280	(12,294)
Total incurred	1,761,348	1,096,732	1,226,775
Paid related to:			
Current period	(22,583)	(31,989)	(7,880)
Prior periods	(1,060,895)	(661,313)	3,894
Total paid, net of recoveries	(1,083,478)	(693,302)	(3,986)
Foreign exchange on FGIC UK Ltd. reserves	–	(7,108)	(2,836)
Net balance	2,266,301	1,655,089	1,258,767
Plus reinsurance recoverable on unpaid losses	98,740	120,418	8,653
Watchlist risk category 4 reserves	2,354,439	1,760,782	1,259,202
Watchlist risk category 3 reserves	10,602	14,725	8,218
Balance at end of period	\$ 2,365,041	\$ 1,775,507	\$ 1,267,420

Watchlist risk category 4 reserves at December 31, 2009 were discounted at a weighted-average risk-free rate of 4.10%. Watchlist risk category 4 reserves at December 31, 2009 increased to \$2,354,439 from \$1,760,782 at December 31, 2008. The increase was mainly attributable to incurred losses for financial guaranty obligations covering RMBS and ABS CDOs as a result of continued deterioration, partially offset by a reduction in reserves for claim payments made

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

during the year and the completion of loss mitigation transactions in respect of various ABS CDO and RMBS transactions. Reserves at December 31, 2009 relate predominantly to RMBS transactions.

The net loss and loss adjustment expense activity for the year ended December 31, 2008 primarily consists of the establishment of additional loss reserves for financial guaranty obligations impacted by the deterioration in mortgage underwriting quality in the U.S. mortgage market during 2007 and 2006 offset by the reduction of loss reserves related to the settlement of an outstanding commitment agreement.

As of December 31, 2009, the Company has received, but as a result of the NYID Order, has not paid \$179,255 in claims.

The Company recorded an incurred loss, net of reinsurance, of \$80,320 and \$54,724 on its guarantees of sewer revenue warrants issued by Jefferson County, Alabama (“Jefferson County guarantees”) for the years ended December 31, 2009 and 2008, respectively. For the years ended December 31, 2009 and 2008, the Company paid claims, net of reinsurance, of \$96,061 and \$3,304 on the Jefferson County guarantees. At December 31, 2009 and 2008 loss reserves, net of reinsurance, was \$35,678 and \$51,420, respectively. The estimated incurred losses were recorded based on management’s assessment that the revenues from the sewer system will be insufficient to pay scheduled principal and interest. The estimated incurred losses were necessarily based upon estimates and subjective judgments about the outcomes of future events. The incurred losses will be adjusted as additional information becomes available and differences between estimated and actual results may be material. At December 31, 2009, the net principal outstanding on the Jefferson County guarantees was \$1,177,333.

The Company incurred loss adjustment expenses, net of reinsurance, of \$724 and \$5,754 on the Jefferson County guarantees for the years ended December 31, 2009 and 2008, respectively. For the years ended December 31, 2009 and 2008, the Company paid loss adjustment expenses, net of reinsurance, of \$2,798 and \$2,828 on the Jefferson County guarantees. At December 31, 2009 and 2008, the liability for loss adjustment expenses, net of reinsurance, was \$852 and \$2,926, respectively.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

ASC Topic 944 requires a loss reserve to be recognized on a contract-by-contract basis when the present value of expected net cash outflows to be paid under the contract using a risk-free rate as of the measurement date exceeds the related unearned premium reserve. Loss expenses incurred includes a benefit of \$9,686 for the year ended December 31, 2009 that represents the increase in unearned premium reserve netted against loss reserves during that period.

FGIC's liability in securitization transactions is governed by the structure of the waterfall of cash flows in the transaction documents. In certain cases, these transaction documents are subject to interpretation. Loss reserves have been established based on the impact that the performance of the underlying collateral has on FGIC's duty to support the cash flows of the transaction. If the Company identifies credit impairment, a provision for loss and loss adjustment expense is recorded. At each reporting date loss reserves are evaluated and may be adjusted to reflect the impact of any loss mitigation efforts, including the purchase of, or the effective removal of insurance coverage on, FGIC insured securities by FGIC, that have yielded results that are probable and estimable. The Company believes that the reserve for estimated losses as of December 31, 2009 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 in the assumptions 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 or be less than its reserves at December 31, 2009, 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. Loss and loss adjustment expense reserves at December 31, 2009 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.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

The Company evaluates the portfolio of insured financial obligations on a regular basis to determine if there has been credit deterioration. The Company evaluates such factors as rating agency downgrades, significant changes in a specific industry or specific events impacting a particular credit, such as a negative credit event, performance below expectations, breaches of representations, warrants, covenants or deal triggers, changes of management, regulatory changes, material litigation or other legal issues. Based on the evaluation of these criteria the Company assigns credits to risk ratings categories, which then determines the level of on-going monitoring and surveillance efforts required, and whether loss reserves are recognized.

The Company uses the following risk categories to define and monitor insured financial obligations:

Risk Category 1 – Performing Credits

Transactions are performing with no expectation of loss. Financial strength of the transaction would enable it to withstand volatility in performance without risk of non-payment on timely debt service. Transaction is considered to be investment grade by the Company. Although rating changes may occur, it is not expected that a downgrade would be to below investment grade.

Risk Category 2 – Watchlist Credits under heightened surveillance

Credits in this category typically would be considered marginal investment grade or higher rated “non-investment grade”. Credits in this risk category have been determined to require heightened surveillance, taking into account the totality of circumstances surrounding the particular credit, but have not deteriorated to the level that they would be considered impaired and require a loss reserve.

Risk Category 3 – Watchlist Credits experiencing credit deterioration

Credit deterioration has occurred and there is substantial uncertainty as to the credit’s ability or willingness to pay its debt service obligations in a timely manner. Credits in this category typically would have suffered sustained negative trends or would have been the subject of a significant adverse event, but are currently not in payment default. Credits in this category have been determined to be impaired, and there is an increased probability of default. As a result, for

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

GAAP financial statements, watchlist risk category 3 reserves are established for credits in this category. Credits in this category would be considered non-investment grade. Credits in risk category 3 are reviewed and updated on at least a quarterly basis for any change in status.

Risk Category 4 – Watchlist Credits currently or likely to be in payment default

Credits that have deteriorated to the point where payment default on their debt service obligations has occurred or is probable and the ultimate loss can be reasonably estimated. Reserves are established on a case basis and are inclusive of any anticipated recoveries. Insured credits in this category would be consistent with the lowest or in-default credit ratings. Credits in risk category 4 are reviewed and updated on at least a quarterly basis for any change in status.

The following table is a breakdown, as of December 31, 2009, of the Company's portfolio of insured financial obligations by risk categories 3 and 4:

	Risk Category		
	3	4	Total
Number of policies	2	144	146
Remaining weighted-average contract period (in years)	16	26	–
Insured contractual payments outstanding:			
Principal	\$ 45,315	\$ 17,584,720	\$ 17,630,035
Interest	28,477	3,637,613	3,666,090
Total	73,792	21,222,333	21,296,125
Gross loss reserves, excluding loss adjustment expenses	10,602	5,538,173	5,548,775
Less:			
Gross projected recoveries	–	(2,050,851)	(2,050,851)
Discount, net	–	(1,058,025)	(1,058,025)
Gross loss reserves, net of discount	10,602	2,429,297	2,439,899
Unearned premiums	–	86,200	86,200
Gross claim liability reported in the consolidated balance sheet	10,602	2,343,097	2,353,699
Reinsurance recoverable on unpaid losses reported in the consolidated balance sheet	\$ –	\$ 98,456	\$ 98,456

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

The Company's insured financial obligations are structured to provide for rights and remedies in order to mitigate claim loss exposure. Loss mitigation activities may include making repurchase claims or pursuing other claims for breaches of representations and warranties by the originator or others, obtaining appraisals of collateral or reviews of loan files, enforcing collateral provisions and covenants of the servicer or others, more frequent meetings with the issuer or servicer, evaluating the financial position of the originator or servicer, renegotiation of financial covenants, triggers, or terms of servicing, enforcing rights to remove and replace the servicer, evaluation of restructuring plans or bankruptcy proceedings, and in some cases, litigation or arbitration as and where appropriate.

Loss adjustment expenses incurred, excluding reinsurance, were \$4,465 and \$18,573 for the years ended December 31, 2009 and 2008, respectively. These expenses are incurred for loss mitigation activity. The liability for loss adjustment expenses, excluding reinsurance, was \$11,352 and \$15,682 at December 31, 2009 and December 31, 2008, respectively, for the claim mitigation activity. The liability for loss adjustment expenses, net of reinsurance, was \$11,067 and \$14,338 at December 31, 2009 and December 31, 2008, respectively, for the claim mitigation activity.

"Other Assets – FGIC insured securities" on the Consolidated Balance Sheets of \$41,933 and \$3,576 as of December 31, 2009 and December 31, 2008, respectively, reflects the fair value of FGIC insured securities that were purchased as part of loss mitigation efforts.

In June 2007, FGIC UK Ltd. entered into a commitment agreement (the "Commitment Agreement") with Havenrock II Limited, a special purpose vehicle created by IKB Deutsche Industriebank, under which, in consideration for the payment of certain commitment and guarantee fees, and on the satisfaction of certain conditions, FGIC UK Ltd. agreed 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. Calyon, a French bank, was a third party beneficiary with respect to FGIC UK Ltd.'s obligation, if any, to issue a financial guaranty policy pursuant to the Commitment Agreement, and certain other obligations of FGIC UK Ltd. under the Commitment Agreement. Calyon had also entered into certain credit default swaps with Havenrock II, pursuant to which Calyon had purchased credit protection with respect to the same securities as the Reference Portfolio.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

15. Loss and Loss Adjustment Expense Reserves (continued)

On August 25, 2008, FGIC, FGIC UK Ltd. and Calyon executed a deed of settlement agreeing not to pursue actual and potential monetary claims that each party may have against the other in connection with the Commitment Agreement and the Havenrock II transaction. As consideration for the settlement, \$200,000 was paid to Calyon. The Company had no loss reserves recorded for the Commitment Agreement at December 31, 2009 and 2008 as a result of the settlement.

16. Variable Interest Entities

ASC Topic 810 provides accounting and disclosure rules for determining whether certain entities should be consolidated in the Company's consolidated financial statements. An entity is subject to FIN 46-R, and is called a variable interest entity ("VIE"), if it has (i) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support or (ii) equity investors that cannot make significant decisions about the entity's operations or that do not absorb the majority of its expected losses or receive the majority of its expected residual returns. A VIE must be consolidated by its primary beneficiary, which is the party that has a majority of the VIE's expected losses or a majority of its expected residual returns, or both.

As part of its structured finance business, the Company insures debt obligations or certificates issued by special purpose entities. During the first quarter of 2006, the Company consolidated a VIE as a result of financial guarantees provided by the Company on one transaction related to the securitization of life insurance reserves.

This third-party VIE had assets of \$750,000 and an equal amount of liabilities at December 31, 2009 and 2008, which are shown under "Assets – Variable interest entity fixed maturity securities, held to maturity at amortized cost" and "Liabilities – Variable interest entity floating rate notes," respectively, on the Consolidated Balance Sheets. In addition, accrued investment income includes \$465 and \$473 related to the VIE's fixed income maturity securities, and the corresponding liability is shown under "Accrued interest expense-variable interest entity" on the Consolidated Balance Sheets.

Although the third-party VIE is included in the consolidated financial statements, its creditors do not have recourse to the general assets of the Company outside of the financial guaranty policy covering certain obligations of the VIE. Interest income of \$15,823 and \$33,045 and interest

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

16. Variable Interest Entities

expense of \$15,823 and \$33,045, respectively, were recognized in the years ended December 31, 2009 and 2008 on the assets and liabilities of the VIE and are included on the Consolidated Statements of Operations in “Interest income – investments held by variable interest entity” and “Interest expense – debt held by variable interest entity,” respectively.

The Company has evaluated its other structured finance transactions and does not believe any of the third-party entities involved in these transactions requires consolidation or disclosure under FIN 46-R.

17. Related Party Transactions

FGIC Corp. and GE Capital entered into an agreement effective as of September 30, 2008, which, among other things, provided for the modification of certain terms of the Senior Preferred Shares (see Note 23).

FGIC Corp. is party to monitoring fee agreements with each of PMI, Blackstone, Cypress and CIVC (collectively, the “Investor Group”). Pursuant to these agreements, each member of the Investor Group receives, in exchange for providing certain financial advisory services on behalf of FGIC Corp., its pro rata share of an aggregate \$5,000 annual monitoring fee. FGIC Corp. may defer paying the monitoring fee in certain circumstances. During 2009 and 2008, FGIC Corp. paid the members of the Investor Group an aggregate of \$0 and \$1,211, respectively, of monitoring fees for those years. As of December 31, 2009 and 2008, the Company had \$10,000 and \$5,000, payable to the Investor Group for the monitoring fee. Pursuant to the monitoring fee agreements, FGIC Corp. has agreed to indemnify the members of the Investor Group and their respective affiliates and other related parties for losses relating to services provided under the monitoring fee agreements.

In 2007, FGIC engaged Blackstone Advisory Partners L.P., (“Blackstone Advisory”) an affiliate of Blackstone, to provide loss mitigation and remediation services related to the Company’s insured exposure to ABS CDOs and RMBS, as well as assisting with developing proposals for restructuring the Company’s insurance operations. For the years ended December 31, 2009 and 2008, the Company recorded loss adjustment expenses of \$0 and \$4,064, respectively, and consulting expenses of \$(2,500) and \$2,500, respectively, for these services. In April 2008, FGIC and Syncora Guarantee Inc. engaged Blackstone Advisory to provide loss mitigation and remediation services related to the debt obligations of a certain local government entity, which

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

17. Related Party Transactions (continued)

they had insured. The Company recorded loss adjustment expenses of \$581 and \$728 for the years ended December 31, 2008 and 2009, respectively related to this agreement. In addition, for the year ended December 31, 2007, FGIC paid Blackstone Advisory fees of \$522, for loss mitigation and remediation advisory services related to an investor-owned utility located in the City of New Orleans.

In 2009, FGIC and their legal counsel engaged Blackstone Advisory to be the exclusive financial advisor in connection with the Surplus Restoration Plan. The Company incurred expenses related to Blackstone Advisory work on the Surplus Restoration Plan of \$499 during the year ended December 31, 2009.

In 2005, FGIC issued a financial guaranty insurance policy with respect to an accounts receivable securitization sponsored by a company in which Blackstone was contemporaneously acquiring a minority interest. In connection with this transaction, FGIC recorded premiums written of \$3,197 and \$3,223 in 2008 and 2007, respectively. This policy was terminated in January 2009.

FGIC, in the normal course of operations, has entered into reinsurance transactions with PMI Mortgage Insurance Co. Ltd. (“PMI Mortgage”), a wholly owned subsidiary of PMI. For the years ended December 31, 2009, 2008 and 2007, ceded premiums written were \$824, \$1,138 and \$1,621, respectively, and ceding commission income was \$12, \$48 and \$67, respectively, with PMI Mortgage. Accounts payable due to PMI Mortgage on received premiums was \$(3) and \$46 at December 31, 2009 and 2008 respectively. Reinsurance recoverable on paid and unpaid losses from PMI Mortgage was \$6,786, \$56,220, and \$2,371 at December 31, 2009, 2008 and 2007, respectively.

FGIC, in the normal course of operations, has entered into reinsurance transactions with PMI Guaranty Co. a wholly owned subsidiary of PMI. In June 2008, PMI Guaranty Co., Assured Guaranty Re Ltd. (“AG Re”) and FGIC entered into an agreement pursuant to which all of the direct financial guaranty obligations of FGIC that had been reinsured by PMI Guaranty Co. were recaptured by FGIC and then ceded to AG Re. The Company recorded no premium or ceding commission in connection with the transfer during 2008. For the year ended December 31, 2007, ceded premiums written to PMI Guaranty Co. were \$5,272 and ceding commission income was \$933.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

17. Related Party Transactions (continued)

FGIC, in the normal course of operations, has entered into reinsurance transactions with RAM Reinsurance Company Ltd (“RAM Re”), in which PMI had a minority ownership interest through December 2009 when it sold its entire investment in RAM Re. For the years ended December 31, 2009, 2008 and 2007, ceded premiums written for these transactions were \$297, \$3,209 and \$29,517, respectively, and ceding commission income was \$77, \$943 and \$8,831 respectively. Accounts payable due to RAM Re on received premiums was \$621 and \$401 at December 31, 2009 and 2008 respectively. See Note 25 for reinsurance recoverable from RAM Re.

On December 1, 2008, FGIC and RAM Re entered into a Settlement, Reassumption and Release Agreement (the “Settlement Agreement”) between FGIC and RAM Re, which was pre-approved by the NYID. Under the terms of the Settlement Agreement, FGIC and RAM Re agreed to settle certain disputes relating to cessions under certain reinsurance agreements between them and the ceding commission payable to FGIC under said agreements, and to obtain RAM Re’s consent to a bulk reinsurance transaction between FGIC and MBIA, which would include policies covered under the referenced RAM Re reinsurance agreements. Under the terms of the Settlement Agreement, RAM Re paid FGIC \$3,124.

Cypress owns approximately 16% of Scottish Re Group Limited (“Scottish Re”). During 2006, FGIC insured a structured finance transaction and also assumed exposure from another monoline insurer in respect of another structured finance transaction, in each case in which subsidiaries of Scottish Re were involved. Neither transaction involves (a) a guaranty by FGIC of any obligation of Scottish Re, or (b) the payment of any fees or other amounts between FGIC and Scottish Re. As of December 31, 2009, there were no amounts due to or from Scottish Re. For the years ended December 31, 2009, 2008 and 2007, gross direct and assumed premiums written of \$(6,341), \$1,281 and \$1,160, and premiums earned of \$(1,282), \$1,261 and \$699, respectively, were recorded relating to these transactions. During the year ended December 31, 2009, the Company recorded a loss reserve for these transactions of \$22,565.

FGIC believes that the terms of the transactions described above were completed on an arm’s length basis.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

18. Compensation Plans

Since January 1, 2004, the Company has offered a defined contribution savings plan under Section 401(k) of the Internal Revenue Code (the “401(k) Plan”). This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis (for 2009, up to \$16.5 for employees under age 50, plus an additional “catch up” contribution of up to \$5.5 for employees 50 and older). The Company may also make discretionary contributions to the plan on behalf of employees. The Company contributed \$763, \$380 and \$5,027 to the plan on behalf of employees for the years ended December 31, 2009, 2008 and 2007, respectively.

The Company also has a non-qualified deferred compensation plan for certain employees whose cash compensation equals or exceeds the limit under the 401(k) Plan. These employees may defer up to 100% of their pre-tax incentive compensation to a future date and accumulate tax-deferred earnings on this compensation. The Company may also make discretionary contributions to the plan on behalf of employees. The Company contributed \$0, \$1,692 and \$1,348 to the Plan on behalf of employees for the years ended December 31, 2009, 2008 and 2007, respectively.

19. Stock Compensation Plan

Employees of the Company may receive stock-based compensation under a FGIC Corp. incentive stock plan that provides for stock-based compensation, including stock options, restricted stock awards and restricted stock units. Stock options are granted for a fixed number of shares with an exercise price equal to or greater than the fair value of the shares at the date of the grant. Restricted stock awards and restricted stock units are valued at the fair value of the stock on the grant date, with no cost to the grantee.

Stock options granted in 2007 and 2006 vest ratably over four years and expire seven years from the date of grant, except as otherwise noted below. All stock options granted prior to December 31, 2005 vest ratably over five years and expire ten years from the date of grant, except as otherwise noted below. If, prior to the expiration date of an option, employment is terminated either voluntarily or involuntarily, the vested portion of an option remains exercisable until the earlier of the expiration date or the last business day in the month of January following the end of the fiscal year in which such termination occurs.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

19. Stock Compensation Plan (continued)

A summary of option activity for the years ended December 31, 2009, 2008 and 2007 is as follows:

	Number of Shares Subject to Options	Weighted Average Exercise Price per Share
Balance at December 31, 2006:	171,031	\$ 815
Granted	49,058	971
Exercised	—	—
Forfeited	(4,042)	847
Expired	—	—
Balance at December 31, 2007:	<u>216,047</u>	<u>850</u>
Granted	—	—
Exercised	—	—
Forfeited	(27,240)	884
Expired	(460)	713
Balance at December 31, 2008:	<u>188,347</u>	<u>845</u>
Granted	—	—
Exercised	—	—
Forfeited	(3,723)	930
Expired	(136,280)	841
Balance at December 31, 2009	<u>48,344</u>	<u>\$ 851</u>
Shares subject to options exercisable at:		
December 31, 2009	36,456	\$ 831
December 31, 2008	156,635	836
December 31, 2007	106,616	818

Exercise prices for the stock options outstanding at December 31, 2009 range from \$600 to \$1,080 per share.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

19. Stock Compensation Plan (continued)

There were no stock options granted during the years ended December 31, 2009 and 2008. The weighted average per share fair value of the stock options granted during the year ended December 31, 2007 was \$234.00 estimated at the date of grant, using the Black-Scholes-Merton option valuation model based on the following assumptions:

	Years Ended December 31 2007
Expected life	3.8 Years
Risk-free interest rate	4.50%
Volatility factor	20.70%
Dividend yield	—

The total fair value of stock options granted at the time of grant during the year ended December 31, 2007 was \$11,480. The Company recorded \$726, \$599 and \$8,414 in compensation expense related to the grant of stock options for the years ended December 31, 2009, 2008 and 2007, respectively. As of December 31, 2009, the Company had \$157 unrecognized compensation cost related to unvested stock options.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

19. Stock Compensation Plan (continued)

Restricted Stock Units

The Company recorded \$323, \$911 and \$1,028 in compensation expense related to the grant of restricted stock units for the years ended December 31, 2009, 2008 and 2007, respectively. A summary of restricted stock units is as follows:

	Shares	Weighted Average Grant Date Fair Value
Balance at December 31, 2006:	2,736	\$ 850
Granted	362	971
Delivered	(326)	850
Forfeited	—	—
Balance at December 31, 2007:	2,772	866
Granted	1,160	250
Delivered	(1,164)	888
Forfeited	(100)	850
Balance at December 31, 2008:	2,668	589
Granted	3,769	61
Delivered	(1,962)	495
Forfeited	—	—
Balance at December 31, 2009:	4,475	\$ 185

As of December 31, 2009 there was \$19 of total unrecognized compensation cost related to unvested restricted stock units. These costs are expected to be recognized through January 31, 2010.

20. Dividends

Under the Insurance Law, FGIC may pay dividends on its common stock to FGIC Corp. and on its preferred stock to the holders thereof only from earned surplus, subject to the following limitations: (a) FGIC's statutory surplus after any dividend may not be less than the minimum required paid-in capital, which was \$72,500 in 2009, 2008 and 2007, and (b) dividends may not exceed the lesser of 10% of its surplus or 100% of adjusted net investment income, as defined by

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

20. Dividends (continued)

the Insurance Law, for the preceding twelve-month period, without the prior approval of the Superintendent. Due to FGIC's deficit in earned surplus at December 31, 2009, FGIC does not currently have the capacity to pay dividends. In addition, the terms of FGIC's preferred stock impose certain restrictions on FGIC's ability to declare and pay dividends on its common stock to FGIC Corp (see Note 23).

During the years ended December 31, 2009, 2008 and 2007, FGIC declared dividends totaling \$0, \$0 and \$20,000, respectively, on its common stock and paid dividends of \$0, \$10,000 and \$20,000, respectively. FGIC Corp.'s ability to meet its cash needs has been adversely impacted by FGIC's inability to pay dividends.

The stockholders' agreement among members of the Investor Group and FGIC Corp. restricts the payment of dividends by FGIC Corp. The agreement provides that FGIC Corp. will not declare or pay cash dividends to holders of its Common Stock prior to the redemption of FGIC Corp.'s Senior Preferred Shares.

In addition, as long as any Senior Preferred Shares are outstanding, FGIC Corp.'s Certificate of Incorporation generally prohibits the payments of dividends or other amounts on any of FGIC Corp.'s capital stock, except the Senior Preferred Shares, without the consent of the holders of two-thirds of the Senior Preferred Shares.

In accordance with the terms of the Credit Agreement, FGIC Corp. is prohibited from paying cash dividends on its capital stock, including its Common Stock and the Senior Preferred Shares, without the requisite consent of the lenders participating in the Credit Agreement. FGIC Corp. is further restricted in the payment of dividends by the terms of its 6% Senior Notes, due 2034 (see Note 21). Except as described in the following sentence, FGIC Corp. may not pay dividends unless the amount of the dividends, together with other similar payments, or restricted payments, during any fiscal year does not exceed the greater of (1) 30% of the net income of the Company for the previous fiscal year and (2) 2.5% of the stockholders' equity on the consolidated balance sheet of the Company as of the end of the previous fiscal year. FGIC Corp. may make restricted payments regardless of amount as long as the payments would not reasonably be expected to cause an adverse change in either (1) the then current insurance financial strength rating and outlook of FGIC or (2) FGIC Corp.'s then current senior unsecured debt rating and outlook.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

20. Dividends (continued)

The Certificate of Incorporation of FGIC Corp. provides for the payment of dividends on Senior Preferred Shares, if declared by FGIC Corp.'s Board of Directors, at the rate of 1.71875% quarterly through December 2012 and thereafter at a rate between 1.71875% and 2.5% in the form of an increase in the redemption value of the Senior Preferred Shares. As a result of the modification in the terms of the Senior Preferred Shares, effective with the quarterly dividend period ended December 31, 2008 and thereafter, dividends on the Senior Preferred Shares are cumulative and are no longer limited to the earnings of FGIC Corp. For the years ended December 31, 2009, 2008 and 2007, the Company accrued dividends of \$22,095 \$20,758 and \$14,566, respectively, on the Senior Preferred Shares. The Company did not declare dividends on the Senior Preferred Shares during the year ended December 31, 2009. As a result of the net loss for the quarter ended December 31, 2007, the Company did not accrue a dividend on the Senior Preferred Shares for the quarterly dividend period ended December 31, 2007. During the years ended December 31, 2009, 2008 and 2007, FGIC Corp. did not declare or pay dividends on its common stock.

21. 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 April 2009, FGIC Corp. repurchased \$63,105 of the Senior Notes for a cash payment of \$3,376 and recognized a gain on the extinguishment of this debt of \$58,493. The gain represents the difference between the cash paid to repurchase the debt and the amortized carrying amount of the debt net of unamortized debt issuance costs.

Due to the limited funds available to FGIC Corp. to service its debts, FGIC Corp. did not make the January 15, 2010 interest payment on the Senior Notes when due. FGIC Corp. did not cure such default during the thirty day grace period, and as a result, FGIC Corp. is in default under the Senior Notes. FGIC Corp. does not plan to recommence debt service payments in the absence of a successful restructuring of its debts.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

21. Debt and Revolving Credit Facility (continued)

In December 2005, FGIC Corp. and FGIC entered into the Credit Agreement, which provided for a \$250,000 senior unsecured revolving credit facility that matures on December 11, 2010. The Credit Agreement is provided by a syndicate of banks and other financial institutions (the “Banks”). In connection with the Credit Agreement, \$150 of syndication costs were prepaid and will be amortized into expense over the term of the facility.

In February 2008, FGIC Corp. borrowed \$250,000 under the Credit Agreement. On June 13, 2008, the Credit Agreement was amended. In connection with this amendment, (i) FGIC Corp. repaid \$204,000 of the amount previously borrowed, (ii) the amount available under the Credit Agreement was reduced to the \$46,000 in outstanding borrowings by FGIC Corp. and the revolving loan feature was eliminated, (iii) certain waivers and releases were granted by the Banks, (iv) certain waivers and releases were granted by the Company, (v) certain additional restrictions were imposed on FGIC Corp.’s ability to pay dividends or make other distributions or payments to the holders of its capital stock, and (vi) the Company paid certain fees and expenses of the administrative agent and the Banks.

On April 30, 2009, the Credit Agreement was further amended to provide that, among other things, the independent certified accountant’s report and opinion delivered in connection with the Company’s financial statements for the fiscal years ending December 31, 2008 and 2009 may contain a “going concern” or like qualification or exception. The Company’s auditors issued a modified unqualified “going concern” audit opinion in connection with the Company’s financial statements for the fiscal year ending 2008 and 2009, and this amendment eliminates the event of default under the Credit Agreement that may have resulted from the issuance of such audit opinions.

The agent under the Credit Agreement has asserted that an event of default has occurred and is continuing under the Credit Agreement as a result of FGIC’s failure to pay claims when due because of the NYID Order. In addition, the agent under the Credit Agreement may further assert that an event of default has occurred as a result of FGIC Corp.’s failure to pay the January 15, 2010 interest payment on the Senior Notes after the thirty day grace period has passed.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

22. Preferred Trust Securities

FGIC had a \$300,000 “soft capital” facility, consisting of Money Market Committed Preferred Custodial Trust Securities (“CPS Securities”). Under the facility, each of six separate Delaware trusts (the “Trusts”), issued \$50,000 in perpetual CPS Securities on a rolling 28-day auction rate basis. Proceeds from these securities were invested in high quality, short-term securities and were held in the respective Trusts. Each Trust was solely responsible for its obligations and had been established for the purpose of entering into a put agreement with FGIC, which obligated the Trusts, at FGIC’s discretion, to purchase perpetual preferred stock of FGIC. During October and November of 2008, FGIC exercised its put options with the six trusts and issued non-cumulative redeemable preferred stock with a liquidation preference of \$300,000 to the trusts in exchange for an aggregate gross purchase price of \$300,000 in cash. For the years ended December 31, 2009, 2008, and 2007, the fees incurred related to these put options were \$0, \$6,509 and \$2,984, respectively.

23. Senior Participating Mandatorily Convertible Modified Preferred Stock

The Senior Preferred Shares are redeemable, at the option of the Company, at the redemption price provided in the Certificate of Incorporation. At any time, the holders of the Senior Preferred Shares are entitled to convert such shares into Common Stock of FGIC Corp. in accordance with the conversion procedures provided in the Certificate of Incorporation. On or after December 18, 2012, FGIC Corp. may elect to convert the Senior Preferred Shares into Common Stock of FGIC Corp. in accordance with the conversion procedures provided in the Certificate of Incorporation. The Senior Preferred Shares are convertible into a variable number of shares of common stock based on, among other things, the redemption value of the Senior Preferred Shares at the time of conversion, the total stockholders’ equity of FGIC Corp. at the time of conversion, and whether FGIC Corp. or the holders of the Senior Preferred Shares are making the election to convert.

The per share redemption price of the Senior Preferred Shares at any given date is equal to the sum of (i) \$100, plus (ii) the per share amount of previously declared dividends, plus (iii) the per share amount of dividends accrued even though not yet payable or declared. At December 31, 2009 and 2008, the aggregate redemption price of the Senior Preferred Shares was \$344,774 and \$322,679, respectively.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

24. Other

During the first quarter of 2006, the Company replaced a financial services company as the lender in connection with a lease of a utility cooperative's interest in a power plant. As part of the transaction, the utility cooperative also placed a deposit with the Company. Since no right of offset exists between the loan and the deposit, the loan was included in "Other assets" and the deposit was reflected as a component of "Other liabilities" on the Company's consolidated balance sheets. At December 31, 2008, the loan balance included in "Other assets" was \$33,281 and the deposit balance included in "Other liabilities" was \$33,046. During 2009, the transaction was terminated and the loan and deposit assets and liabilities were eliminated.

25. Financial Instruments

Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating the fair values of financial instruments. Fair values estimated based upon internal valuation models are not necessarily indicative of the amount the Company could realize in a current market exchange.

Fixed Maturity Securities including Other assets – FGIC insured securities: Fair values for fixed maturity securities are based on quoted market prices, if available. If a quoted market price is not available, fair values are estimated using quoted market prices for similar securities. Fair value disclosure for fixed maturity securities is included in the consolidated balance sheets and in Notes 8 and 9.

Short-Term Investments: Short-term investments are carried at fair value, which approximates cost.

Cash and Cash Equivalents: The carrying amounts of these items approximate their fair values.

Premiums Receivable: As of December 31, 2009, the premiums receivable amount represents the present value of premiums expected to be collected over the contract period or expected period discounted using a risk-free rate. The carrying amount approximates fair value as of December 31, 2009. As of December 31, 2008, the premiums receivable consists of premiums billed to policyholders but not received. The fair value includes the net present value of future expected installment premiums as of December 31, 2008 of \$643,394.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

25. Financial Instruments (continued)

Unearned premiums: As of December 31, 2009, for policies where premiums are paid upfront, the unearned premium is equal to the premium collected and for financial guaranty contracts where the Company receives premiums in installments, unearned premiums are recognized at policy inception, measured at the present value of premiums expected to be collected over the contract period or expected period discounted using a risk-free rate. The carrying amount approximates fair value as of December 31, 2009. As of December 31, 2008, unearned premium was equal to the premium collected. The fair value includes the net present value of future expected installment premiums as of December 31, 2008 of \$643,394.

Loss and loss adjustment expense reserves, net: The carrying amount of loss reserves is an estimate of the present value of the anticipated shortfall between (1) payments on insured obligations plus anticipated loss adjustment expenses and (2) anticipated cash flow from, and proceeds to be received on, sales of any collateral supporting the obligation and/or other anticipated recoveries. The discount rate used in calculating the net present value of estimated losses is based upon the risk-free rate for the duration of the anticipated shortfall. The carrying amount of watchlist reserves is an estimate of probable loss given evidence of impairment, and a reasonable estimate of the amount of loss given default. Fair value is determined using a credit valuation adjustment calculated using an internally developed model (see Note 8).

Derivative assets and liabilities: Derivative assets and liabilities are carried at fair value, as determined each quarter based on internally developed models. These models require 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 market conditions. There is volatility in the market-driven inputs obtained from an illiquid market for CDS and the underlying bonds and other obligations, and differences may 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 could differ materially from amounts that would be realized in the market if the derivative were traded. Moreover, volatile market conditions are likely to cause future valuations to differ, possibly materially, from those reflected in the current period (see Note 12).

Debt: The carrying amount of the Company's debt is net of the unamortized balance of the issuance discount and capitalized debt issuance costs. The fair value of the debt is based on a quoted market price adjusted to reflect the Company's own credit risk.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

25. Financial Instruments (continued)

The carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2009 and 2008 were as follows:

	2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash on hand and in-demand accounts	\$ 295,022	\$ 295,022	\$ 523,010	\$ 523,010
Short-term investments	118,980	118,980	151	151
Fixed maturity securities, available for sale	1,440,670	1,440,670	2,450,652	2,450,652
Other assets – FGIC insured securities	41,933	41,933	3,576	3,576
Premiums receivable	647,991	647,991	11,262	654,656
Variable interest entity fixed maturity securities, held to maturity	750,000	750,000	750,000	750,000
Financial liabilities:				
Unearned premiums net of prepaid reinsurance premiums	710,737	710,737	71,381	714,775
Loss and loss adjustment expense reserves, net	2,365,041	383,137	1,649,253	516,216
Derivative liabilities, net	264,570	264,570	1,102,453	1,102,453
Variable interest entity floating rate notes	750,000	750,000	750,000	750,000
Debt	306,644	11,116	369,421	79,313

Concentrations of Credit Risk

The Company's guaranteed (insurance and CDS) portfolio as of December 31, 2009 was diversified by geographic and bond market sector, with no single obligor representing more than 1.8% of the Company's par insured outstanding, net of reinsurance.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

25. Financial Instruments (continued)

The following presents the Company's net par outstanding by category and type of guaranty as of December 31, 2009:

	Net Par Outstanding	% of Total	Insurance	CDS
Public Finance				
General obligation	\$ 4,411,983	5.8%	\$ 4,411,983	\$ —
Leases	1,934,446	2.5	1,934,446	—
Healthcare	166,071	0.2	166,071	—
Other Tax Back	1,597,841	2.1	1,597,841	—
Global Utilities	3,370,499	4.4	3,294,799	75,700
Transportation	537,949	0.7	62,949	475,000
Higher Education	226,700	0.3	226,700	—
Project Finance	4,858,027	6.4	4,516,419	341,608
Housing	1,163,438	1.5	967,958	195,480
Other Public Finance	1,604,975	2.1	1,604,975	—
Total Public Finance	19,871,929	26.1	18,784,141	1,087,788
Structured Finance				
Auto ABS	1,851,067	2.4	1,851,067	—
ABS CDO	16,876,577	22.2	2,284,978	14,591,599
Insurance	1,231,225	1.6	1,071,500	159,725
International – ABS	89,321	0.1	—	89,321
Other Structured Finance	1,624,345	2.1	1,562,706	61,639
Pooled Aircraft/Aircraft Engines	3,425,176	4.5	2,206,588	1,218,588
Receivables	867,067	1.1	867,067	—
RMBS	19,999,692	26.3	19,827,927	171,765
Royalties/Intellectual Property	1,908,002	2.5	1,194,000	714,002
Student Loan	1,021,849	1.3	446,901	574,948
Total Structured Finance	48,894,321	64.2	31,312,734	17,581,587
International				
Airport	169,457	0.2	169,456.69	—
Corporate Obligation	300,776	0.4	208,992.35	91,784.08
Sovereign	158,724	0.2	158,724.06	—
Sub-Sovereign	752,970	1.0	752,970.17	—
Utility	4,991,010	6.6	3,107,946.56	1,883,063.30
Toll Road	970,840	1.3	883,645.38	87,194.88
Total International	7,343,777	9.7	5,281,735	2,062,042
Total	\$ 76,110,027	100.0%	\$ 55,378,610	\$ 20,731,417

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

25. Financial Instruments (continued)

As of December 31, 2009, the Company's total net direct exposure to RMBS aggregated approximately \$19,999,692, representing approximately 26.3% of the Company's total in-force guaranteed net par outstanding at such date. The RMBS exposure consisted of various collateral types as set forth in the table below.

	Number of Policies Outstanding	Net Par Outstanding	% of Total
Alt-A (1 st lien)	29	\$ 1,493,605	7.5%
HELOC	48	6,081,357	30.4
High LTV	13	1,138,443	5.7
Closed end seconds	26	5,628,237	28.1
Subprime (1 st lien)	89	5,283,134	26.4
Prime (1 st lien)	10	374,916	1.9
Total	215	\$ 19,999,692	100.0%

As of December 31, 2009, the Company's total net direct exposure to CDS and to ABS CDOs and collateralized loan obligations guaranteed in financial guaranty form aggregated approximately \$16,876,577, representing approximately 22.2% of the Company's total in-force guaranteed net par outstanding at such date. Such exposure consisted of various collateral types as set forth in the table below.

Underlying Collateral (Form of Guaranty)	Number of Transactions	Net Par Outstanding	% of Total
High Grade ABS (CDS)	2	\$ 2,034,092	12.1%
High Yield Bonds (CDS)	1	104,882	0.6
High Yield Loans (CDS)	36	8,984,363	53.2
High Yield Loans (insurance)	10	1,981,617	11.7
Mezzanine ABS (CDS)	2	266,385	1.6
Mezzanine ABS (insurance)	2	303,360	1.8
International (CDS)	64	3,201,877	19.0
Total	64	\$ 16,876,577	100.0%

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

25. Financial Instruments (continued)

As of December 31, 2009, the concentration of balances related to reinsurers is as follows:

Reinsurer	Reinsurer Rating (S&P / Moody's)	Ceded Principal Outstanding	Prepaid Reinsurance Premiums	Reinsurance Recoverable on Paid and Unpaid Losses
National	A/Baa1	177,142,431	747,382	–
AG Re	AA/A1	2,798,857	64,012	15,745
RAM Re	BB/Ba3	1,608,816	40,315	33,198
Radian Asset Assurance Inc.	BB-/Ba1	1,375,171	19,129	20,991
Assured Guaranty Corp.	AAA/Aa3	545,748	12,500	22,587
Swiss Reinsurance Company	A+/A1	602,492	14,589	–
Assured Guaranty Municipal Corp.	AAA/Aa3	550,800	10,780	–
Syncora Guarantee Inc.	Ca/R	230,468	7,814	–
PMI Mortgage	B+/BA3	186,630	2,285	6,786
AMBAC Assurance Corp.	CC/Caa2	181,808	2,476	–
American Reinsurance Company	AA-/Aa3	58,585	–	–
Other		68,511	9,019	292
Total		185,350,317	930,301	99,599

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

26. Commitments and Contingencies

Lease Obligations

The Company leases office space and equipment under operating lease agreements. Rent expense under operating leases for the years ended December 31, 2009, 2008 and 2007 was \$3,374, \$6,922 and \$6,474, respectively. Leases for previously occupied office space in the United Kingdom and Australia were terminated during 2009. In connection with a workforce reduction, the Company ceased occupying approximately 50% of its leased U.S. office space in the fourth quarter of 2008 and another 25% of the space during 2009 and recorded a lease impairment charge (see Note 11). Future lease payments associated with the remaining U.S. occupied space are as follows as of December 31, 2009:

	Operating Lease Commitment Amount
Year:	
2010	\$ 5,704
2011	5,681
2012	5,778
2013	5,838
2014	6,038
2015 and thereafter	33,651
Total minimum future rental payments	<u>\$ 62,690</u>

Legal Proceedings

FGIC and several other bond insurers have been named as defendants in separate lawsuits filed by the Cities of Los Angeles, Stockton, San Francisco, Oakland, Sacramento and Riverside, California, the Counties of San Mateo, Alameda and Contra Costa, California, the City of Los Angeles Department of Water and Power, the Sacramento Municipal Utility District and the Los Angeles World Airports. The complaints make similar allegations, including (i) that FGIC and the other bond insurer defendants colluded to perpetuate a “dual rating system” used by Moody’s Investors Service Inc., Standard & Poor’s Ratings Services and Fitch Ratings, Inc. (the “Rating Agencies”), pursuant to which the Rating Agencies rated the debt obligations of municipal bond issuers on a different (and allegedly less favorable) scale from the scale used to rate corporate

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

26. Commitments and Contingencies (continued)

debt obligations; (ii) that each of FGIC and the other defendants failed to disclose to the plaintiffs the extent of their respective exposures to mortgage-backed securities and collateralized debt obligations; and (iii) that, as a result of these actions, the plaintiffs incurred higher interest costs and bond insurance premiums in respect of their bond issues. These 12 cases have been coordinated as the *Ambac Bond Insurance Cases* in San Francisco Superior Court. The defendants, including FGIC, have filed a joint demurrer (motion to dismiss) and each defendant, including FGIC, has also filed a supplemental demurrer.

FGIC was named as a defendant, along with a number of other financial institutions and parties, in five purported class actions, *Hinds County, Mississippi v. Wachovia Bank N.A. et al.*, *Fairfax County, Virginia et al. v. Wachovia Bank N.A. et al.*, *Washington County, Tennessee v. Bank of America, N.A. et al.*, *Mayor and City Council of Baltimore v. Wachovia Bank N.A. et al.*, and *Central Bucks School District v. Wachovia Bank, N.A. et al.*, on behalf of all state, local and municipal government entities that purchased municipal guaranteed investment contracts (“GICs”) or derivative products from FGIC or the other defendants in the period from January 1, 1992 through December 31, 2006. The complaints were filed in federal court and allege, *inter alia*, various violations of federal antitrust laws by FGIC and other defendants in connection with the offering and sale of municipal GICs and derivative products (the “Lead Cases”). FGIC was also named as a defendant, along with a number of other financial institutions and parties which also have been named as defendants, in four other similar actions filed in federal court, *City of Oakland, California v. AIG Financial Products Corp. et al.*, *City of Fresno, California v. AIG Financial Products Corp. et al.*, *County of Alameda, California v. AIG Financial Products Corp. et al.*, and *Fresno County Financing Authority v. AIG Financial Products Corp. et al.* (the “AIG Actions”). The Judicial Panel on Multidistrict Litigation issued an order transferring the Lead Cases and the AIG Actions to the Southern District of New York under the caption *In re Municipal Derivatives Antitrust Litigation* for coordinated or consolidated pretrial proceedings. FGIC entered into tolling agreements with the plaintiffs in the Lead Cases in February 2009 and the AIG Actions in April 2009, pursuant to which FGIC was dismissed without prejudice as a defendant in the Lead Cases and the AIG Actions, respectively.

In addition, the Cities of Los Angeles, Stockton and San Diego, California and the Counties of San Mateo and Contra Costa, California have filed lawsuits in California state court against FGIC and a number of other financial institutions and parties (the “State Court Actions”) alleging, *inter alia*, that FGIC and other defendants violated state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the plaintiffs of

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

26. Commitments and Contingencies (continued)

competition in the awarding of municipal GICs and derivative products. The State Court Actions have been removed to federal court and ordered transferred to the Southern District of New York for proceedings before the court in which the Lead Cases are pending. In amended complaints filed in September 2009, the plaintiffs in the State Court Actions have dropped FGIC as a defendant.

FGIC and a number of other defendants have been named in a purported class action case on behalf of customers that paid for sewer service within Jefferson County, Alabama, since January 1, 1993. The complaint alleges, *inter alia*, that the Jefferson County Commissioners, in a conspiracy with several individuals, financial companies, law firms and bond insurers, completed several swap transactions whereby the bonds, which were primarily fixed interest securities, were changed to variable rate and auction rate securities. These swaps, the complaint alleges, were done primarily to facilitate the inappropriate payment of exorbitant fees to several bond brokers and financial advisors. With respect to the bond insurers, including FGIC, the complaint alleges, among other things, that the bond insurers negligently insured the bonds while allowing themselves to become undercapitalized and to have their credit ratings downgraded by the rating agencies, which in turn resulted in the credit ratings of the bonds being downgraded. The plaintiffs allege damages on the ground that their sewer rates are much higher than they otherwise would have been without the wrongdoing of all parties. FGIC has filed a motion to dismiss, which is pending.

In an action brought in the U.S. District Court for the Northern District of Alabama, FGIC, along with other plaintiffs, sued Jefferson County and the County Commissioners for appointment of a receiver. In June 2009, the federal district court judge abstained from appointing a receiver and indicated that such matters should be heard in state court. Jefferson County filed counterclaims against FGIC alleging that FGIC negligently maintained its portfolio by insuring overly risky residential mortgage-backed securities which led to ratings downgrades that caused damage to Jefferson County, and that FGIC breached a purported contractual obligation to provide investment grade insurance.

On January 20, 2010, Societe Generale (“SG”) filed a complaint against FGIC Credit Products LLC and FGIC in the federal court for the Southern District of New York, alleging breach of contract and requesting a declaratory judgment in connection with FGIC Credit Products’ termination of the ISDA Master Agreement, dated July 14, 2005 (the “Master Agreement”), between FGIC Credit Products and SG. On February 4, 2010, SG filed an amended complaint,

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

26. Commitments and Contingencies (continued)

adding the allegation that FGIC, as credit support provider for FGIC Credit Products, had repudiated its obligations under the related insurance policy, resulting in an “Insurer Default” under the Master Agreement, which would permit SG to receive a settlement amount based on market values. The aggregate amount of the reference obligations of the terminated transactions is in excess of \$3,000,000.

FGIC has also been named in two separate lawsuits brought by issuers of FGIC-insured auction rate securities. These issuers allege, inter alia, that they incurred increased interest costs in respect of their securities as a result of misrepresentations by FGIC concerning its exposure to securities backed by residential mortgages and the risk of a downgrade of FGIC’s credit ratings.

A monoline insurance company (the “Ceding Company”) from which FGIC has assumed certain risks under a facultative reinsurance agreement has demanded arbitration to resolve certain disputes relating to the reinsurance agreement. FGIC is disputing the Ceding Company’s purported termination of the reinsurance agreement and demand for a \$46,000 termination payment from FGIC. At the Ceding Company’s request, the arbitration panel has ordered FGIC to post a letter of credit in the amount of \$46,000 to secure any potential award, although the arbitration panel has not made any findings on the merits of the matter. At the Ceding Company’s request, the arbitration panel has extended the deadline for FGIC to post this letter of credit.

A reinsurance company which has assumed risks from FGIC under various reinsurance agreements, has demanded arbitration to resolve certain disputes, including those (i) challenging certain risks ceded by FGIC to the reinsurer and seeking to rescind or reform those cessions, and (ii) seeking to restructure certain loss mitigation transactions undertaken by FGIC.

FGIC has received various regulatory inquiries and requests for information. FGIC has responded to a subpoena issued by the U.S. Department of Justice in November 2006 in connection with its investigation of bidding practices in the market for municipal GICs and derivative products. FGIC also has responded to subpoenas issued by the Attorneys General of the States of Connecticut and Florida relating to their investigations of similar matters. FGIC has executed a tolling agreement with the Attorneys General of Connecticut, Florida and eighteen (18) other states removing FGIC from these investigations. The West Virginia Attorney General is acting independently of these 20 states in conducting its own investigation into bidding practices in the market for municipal GICs and derivative products.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

26. Commitments and Contingencies (continued)

In addition, FGIC has responded to a subpoena from the Connecticut Attorney General with respect to an investigation into municipal bond rating practices employed by the Rating Agencies. The focus of the investigation appears to be the disparity in ratings with respect to municipal credits, on the one hand, and corporate credits, on the other. The Connecticut Attorney General has sought information from FGIC with respect to communications between the credit rating agencies and the financial guaranty insurance industry (acting through the Association of Financial Guaranty Insurers, the industry trade association) in relation to a proposal by Moody's Investors Service Inc. to implement a corporate equivalency rating system with respect to municipal credits. FGIC has also received a document preservation letter from the Attorney General of the State of California relating to its investigation of the credit rating practices for municipal bonds issued by the State of California and its related entities.

It is not possible to predict whether additional suits will be filed or whether additional inquiries or requests for information will be made, and it is also not possible to predict the outcome of litigation, inquiries or requests for information. FGIC intends to vigorously defend against the aforementioned actions in which FGIC is a defendant and against other potential actions. However, it is possible that there could be unfavorable outcomes in these or other proceedings. The outcome of some of these legal proceedings and other contingencies could require FGIC to take or refrain from taking actions which could adversely affect its business or could require FGIC to pay substantial amounts of money. Management is unable to make a meaningful estimate of the amount or range of loss that could result from unfavorable outcomes but, under some circumstances, adverse results in any such proceedings could be material to FGIC's business, operations, financial position, profitability or cash flows. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources away from implementing loss mitigation efforts that are vital to FGIC's ability to continue as a going concern.

The Company has asserted, and from time to time may assert, claims in legal or arbitration proceedings against third parties to recover losses already incurred by the Company or to mitigate future losses that the Company may incur. The amount of losses that the Company may recover or mitigate as a result of these proceedings is uncertain, although, in the event of favorable outcomes or settlements, such amount could be material to the Company's results of operations, financial position, profitability or cash flows.

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

27. 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 (see Note 21). The components of other comprehensive income for the years ended December 31, 2009, 2008 and 2007 are as follows:

	Year Ended December 31, 2009		
	Before		Net of
	Tax	Tax	Tax
	Amount		Amount
Net unrealized holding gains arising during the year	\$ 82,908	\$ (29,018)	\$ 53,890
Reclassification of losses realized in net income	(10,561)	3,696	(6,865)
Change in net unrealized gains (losses)			
on investments	93,469	(32,714)	60,755
Foreign currency translation adjustment	11,910	(4,168)	7,742
Cash flow hedge related to interest rate lock	(315)	110	(205)
Total other comprehensive loss	\$ 105,064	\$ (36,772)	\$ 68,292

	Year Ended December 31, 2008		
	Before		Net of
	Tax	Tax	Tax
	Amount		Amount
Net unrealized holding losses arising during the year	\$ (69,782)	\$ 24,423	\$ (45,359)
Reclassification of losses realized in net income	(16,616)	5,815	(10,801)
Change in net unrealized gains (losses)			
on investments	(53,166)	18,608	(34,558)
Foreign currency translation adjustment	(34,808)	12,183	(22,625)
Cash flow hedge related to interest rate lock	(20)	7	(13)
Total other comprehensive income	\$ (87,994)	\$ 30,798	\$ (57,196)

FGIC Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in thousands, except per share amounts)

27. Comprehensive Income (continued)

	Year Ended December 31, 2007		
	Before Tax Amount	Tax	Net of Tax Amount
Net unrealized holding gains arising during the year	\$ 35,030	\$ (12,260)	\$ 22,770
Reclassification of gains realized in net income	962	(336)	626
Change in net unrealized gains (losses) on investments	34,068	(11,924)	22,144
Foreign currency translation adjustment	12,216	(4,275)	7,941
Cash flow hedge related to interest rate lock	(20)	7	(13)
Total other comprehensive income	<u>\$ 46,264</u>	<u>\$ (16,192)</u>	<u>\$ 30,072</u>