

STATUTORY-BASIS FINANCIAL STATEMENTS AND  
OTHER FINANCIAL INFORMATION

Financial Guaranty Insurance Company  
Years Ended December 31, 2009 and 2008  
With Report of Independent Auditors

Financial Guaranty Insurance Company

Statutory-Basis Financial Statements  
and Other Financial Information

Years Ended December 31, 2009 and 2008

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## Report of Independent Auditors

The Board of Directors and Stockholder of  
Financial Guaranty Insurance Company

We have audited the accompanying statutory-basis balance sheets of Financial Guaranty Insurance Company (the “Company”) as of December 31, 2009 and 2008, and the related statutory-basis statements of operations, changes in capital and surplus, and cash flows for the years then ended. 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.

As described in Note 4 to the financial statements, the Company presents its financial statements in conformity with accounting practices prescribed or permitted by the State of New York Insurance Department, which practices differ from accounting principles generally accepted in the United States. The variances between such practices and accounting principles generally accepted in the United States are described in Note 4.

In our opinion, because of the effects of the matter described in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States, the financial position of Financial Guaranty Insurance Company at December 31, 2009 and 2008, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the State of New York Insurance Department.

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 Company's business, results of operations and financial condition. This continued adverse development has caused the Company'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 the Company. 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.

*Ernst & Young LLP*

New York, New York  
February 17, 2010

# Financial Guaranty Insurance Company

## Statutory-Basis Balance Sheets

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
	<i>(Dollars in Thousands, except per share amounts)</i>	
<b>Admitted assets</b>		
Fixed maturity securities, available for sale at amortized cost (fair value of \$1,309,393 in 2009 and \$2,181,702 in 2008)	<b>\$ 1,235,501</b>	\$ 2,188,043
Fixed maturity securities, available for sale at fair value (amortized cost of \$87,640 in 2009 and \$223,284 in 2008)	<b>87,640</b>	223,284
Preferred stock (fair value of \$6,853 in 2009 and \$7,894 in 2008)	<b>3,713</b>	7,894
Common stock	<b>4,728</b>	29,192
Common stock – investment in subsidiaries	-	17,105
Other invested assets	<b>25,672</b>	3,863
Short-term investments, at cost, which approximates fair value	<b>170,651</b>	6,212
Cash and cash equivalents	<b>195,525</b>	416,310
Total cash and invested assets	<b>1,723,430</b>	2,891,903
Accrued investment income	<b>17,575</b>	33,525
Other assets	<b>8,578</b>	23,071
Receivable from parent and subsidiaries	<b>2,757</b>	3,974
Federal and foreign income tax receivable	<b>26,997</b>	798
Deferred federal income tax asset, net	-	32,502
Total admitted assets	<b>\$ 1,779,337</b>	\$ 2,985,773
<b>Liabilities and capital and surplus</b>		
<b>Liabilities:</b>		
Losses	<b>\$ 2,597,687</b>	\$ 2,069,096
Loss adjustment expenses	<b>11,060</b>	14,330
Unearned premiums	<b>246,205</b>	267,940
Provision for reinsurance	<b>5,385</b>	-
Contingency reserves	<b>168,284</b>	48,015
Accounts payable and accrued expenses	<b>29,842</b>	78,545
Ceded balances payable	<b>2,294</b>	2,313
Total liabilities	<b>3,060,757</b>	2,480,239
<b>Capital and surplus (deficit):</b>		
Common stock, par value \$1,500 per share; 10,000 shares authorized, issued, and outstanding	<b>15,000</b>	15,000
Redeemable preferred stock, par value \$1,000 per share; 3,000 shares authorized, issued and outstanding	<b>300,000</b>	300,000
Paid-in surplus	<b>439,551</b>	438,502
Unassigned deficit	<b>(2,035,971)</b>	(247,968)
Total capital and surplus (deficit)	<b>(1,281,420)</b>	505,534
Total liabilities and capital and surplus (deficit)	<b>\$ 1,779,337</b>	\$ 2,985,773

*See accompanying notes.*

# Financial Guaranty Insurance Company

## Statutory-Basis Statements of Operations

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
	<i>(Dollars in Thousands)</i>	
Premiums earned	\$ 120,052	\$ 431,212
Losses incurred	<b>(1,800,926)</b>	(1,130,188)
Loss adjustment expenses incurred	<b>(4,600)</b>	(15,873)
Other underwriting expenses incurred	<b>(55,465)</b>	(179,333)
Ceding commission (expense)	<b>(2,044)</b>	191,386
Underwriting loss	<b>(1,742,983)</b>	(702,796)
Net investment income	<b>80,688</b>	144,451
Net realized capital losses, net of (benefit) of \$0 and (\$393) for the years ended December 31, 2009 and 2008, respectively	<b>(5,977)</b>	(730)
Net investment gain	<b>74,711</b>	143,721
Other income	<b>20,048</b>	119
Loss after capital losses and before all other federal and foreign income taxes	<b>(1,648,224)</b>	(558,956)
Federal and foreign income tax (benefit) expense	<b>(30,964)</b>	1,662
Net loss	<b>\$ (1,617,260)</b>	<b>\$ (560,618)</b>

*See accompanying notes.*

Financial Guaranty Insurance Company

Statutory-Basis Statements of Changes in Capital and Surplus

Years Ended December 31, 2009 and 2008

	Common Stock	Redeemable Preferred Stock	Paid-in Surplus	Unassigned Surplus (Deficit)	Total Capital and Surplus
	<i>(Dollars in Thousands)</i>				
Balance, January 1, 2008	\$ 15,000	\$ —	\$ 436,992	\$ (191,083)	\$ 260,909
Net loss	—	—	—	(560,618)	(560,618)
Change in non-admitted assets	—	—	—	(247,991)	(247,991)
Change in contingency reserves	—	—	—	527,770	527,770
Change in foreign exchange adjustment	—	—	—	(24,595)	(24,595)
Change in net unrealized losses	—	—	—	20,876	20,876
Amortization of stock options and restricted stock	—	—	1,510	—	1,510
Redeemable preferred stock issuance	—	300,000	—	—	300,000
Change in net deferred income tax	—	—	—	227,013	227,013
Change in provision for reinsurance	—	—	—	660	660
Balance, December 31, 2008	15,000	300,000	438,502	(247,968)	505,534
Net loss	—	—	—	(1,617,260)	(1,617,260)
Change in non-admitted assets	—	—	—	(618,545)	(618,545)
Change in provision for reinsurance	—	—	—	(5,385)	(5,385)
Change in contingency reserves	—	—	—	(120,269)	(120,269)
Change in foreign exchange adjustment	—	—	—	7,133	7,133
Change in net unrealized losses	—	—	—	2,783	2,783
Amortization of stock options and restricted stock	—	—	1,049	—	1,049
Change in net deferred income tax	—	—	—	563,540	563,540
Balance, December 31, 2009	<b>\$ 15,000</b>	<b>\$ 300,000</b>	<b>\$ 439,551</b>	<b>\$ (2,035,971)</b>	<b>\$ (1,281,420)</b>

*See accompanying notes.*

# Financial Guaranty Insurance Company

## Statutory-Basis Statements of Cash Flow

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
	<i>(Dollars in Thousands)</i>	
<b>Operations</b>		
Premiums collected (paid), net of reinsurance	\$ 102,020	\$ (746,130)
Losses paid	(1,267,129)	(995,624)
Underwriting expenses paid	(108,433)	(164,196)
Ceding commission (expense) paid	(2,044)	191,386
Net investment income received	101,660	189,104
Other income (disbursements)	19,231	(105)
Federal income tax refunds	5,150	144,743
Net cash used in operations	<u>(1,149,545)</u>	<u>(1,380,822)</u>
<b>Investment activities</b>		
Proceeds from sales, maturities, or repayments of investments:		
Bonds and Stocks	1,203,218	1,425,647
Other invested assets	2,297	52,434
Total investment proceeds	<u>1,205,515</u>	<u>1,478,081</u>
Cost of investments acquired:		
Bonds	(94,858)	(24,475)
Common stocks	-	(56,459)
Other invested assets	(21,737)	(45,673)
Total investments acquired	<u>(116,595)</u>	<u>(126,607)</u>
Net cash provided by investment activities	<u>1,088,920</u>	<u>1,351,474</u>
<b>Financing and miscellaneous activities</b>		
Other cash provided (applied):		
Proceeds from issuance of preferred stock	-	300,000
Capital and surplus paid in	1,049	1,510
Dividends paid to stockholder	-	(10,000)
Other cash applied	3,230	(1,445)
Total other cash provided	<u>4,279</u>	<u>290,065</u>
Net (decrease) increase in cash, cash equivalents and short-term investments	<u>(56,346)</u>	<u>260,717</u>
Cash, cash equivalents and short-term investments:		
Beginning of year	422,522	161,805
End of year	<u>\$ 366,176</u>	<u>\$ 422,522</u>

See accompanying notes.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements

December 31, 2009  
(Dollars in thousands)

### 1. Organization and Background

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

PMI Mortgage Insurance Company, an affiliate of the PMI Group, Inc. (“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”) owned approximately 23%, 23% and 7% of FGIC Corp.’s common stock, respectively, at December 31, 2009 and 2008. As of December 31, 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. 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 2. Recent Developments (continued)

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 claim 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 the impairment of FGIC’s policyholder surplus. 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” or the “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 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **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**

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.

As a result of uncertainties associated with the aforementioned factors and continuing risks, 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 December 31, 2008 and for the years ended December 31, 2009 and 2008 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. The Superintendent could seek court 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 report in 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **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)**

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 case basis reserves for unpaid losses and loss adjustment expenses on the Company's remaining insured portfolio, and assessing the amount of anticipated 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 11 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **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)**

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 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 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **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)**

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 \$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's 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 15.
- 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 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 18 for further information.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies

The accompanying financial statements of the Company have been prepared in conformity with statutory accounting practices prescribed or permitted by the State of New York Insurance Department (SAP). The preparation of financial statements in conformity with SAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates, and those differences could be material.

Statutory practices differ in some respects from accounting principles generally accepted in the United States (GAAP). Significant accounting policies, and variances from GAAP, where applicable, are as follows:

#### Investments

Investments in bonds, preferred stock, and common stock are valued in accordance with the requirements of the National Association of Insurance Commissioners (NAIC).

Bonds are generally stated at amortized cost, with premiums and discounts amortized to net income using the effective interest method over the remaining term of the securities. Bonds with NAIC ratings of 3 or lower are carried at the lower of amortized cost or fair value as determined by the Securities Valuation Office.

Preferred stock is stated at cost.

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. 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, 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. Under GAAP, subsidiaries are consolidated with the Company.

Short-term investments are stated at amortized cost, which approximates fair value. Realized gains and losses on the sale of investments are determined based on the specific identification method.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

All single class and multiclass mortgage-backed/asset-backed securities are valued at amortized cost using the interest method, including anticipated prepayments. Prepayment assumptions are obtained from dealer surveys or internal estimates and are based on the current interest rate and economic environment. All such securities are adjusted for the effects of changes in prepayment assumptions on the related accretion of discount or amortization of premium of such securities using the retrospective method.

Investments (excluding investment in wholly owned subsidiaries) that are determined to be other-than-temporarily impaired are reduced to realizable value, establishing a new cost basis, with a charge to realized loss at such date. As of 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 basis. Therefore, all unrealized losses are recorded through earnings and the new cost basis is not adjusted for subsequent recoveries in fair value.

#### **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 and included in "Other invested assets" on the Balance Sheets. Under GAAP, these securities are carried at fair value.

#### **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. 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 and included as Common Stock in accordance with NAIC regulations. Under GAAP, these securities are adjusted to fair value and included in cash and cash equivalents.

#### **Premium Revenue Recognition**

For statutory purposes, premiums collected in a single payment at policy inception are earned in proportion to the scheduled principal and interest payments rather than over a period in proportion to the amount of insurance protection provided, as is the case under GAAP. Premiums collected periodically are reflected in income pro rata over the period covered by the premium payment. The liability for unearned premiums is reflected net of reinsurance. Ceded premiums are earned in a manner consistent with the underlying policies. Under GAAP, ceded unearned premiums are reported as an asset. When an obligation insured by the Company is refunded prior to the end of the expected policy coverage period, any

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **4. Significant Accounting Policies (continued)**

remaining unearned premium is recognized at that time. A refunding occurs when an insured obligation is retired or legally defeased prior to stated maturity. Net premiums earned on refundings were \$9,871 and \$253,850 for the years ended December 31, 2009 and 2008, respectively.

#### **Policy Acquisition Costs**

Policy acquisition costs include 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, offset by ceding commission income on premiums ceded to reinsurers. For statutory purposes, such costs are charged to expense as incurred; under GAAP, they are deferred and amortized over the period in which the related premiums are earned.

#### **Credit Derivative Contracts**

In connection with the issuance of a CDS by FGIC Credit Products, FGIC issues 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. Under GAAP, the insurance is considered a derivative and is recorded at fair value.

#### **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 value is in excess of fifty percent of the surplus to policyholders or sixty percent of the surplus of such insurer, whichever is greater.

#### **Ceded Balances Payable**

Reinsurance receivables are netted against ceded balances payable on the statutory-basis balance sheets. Under GAAP, reinsurance receivables are classified as an asset.

#### **Loss and Loss Adjustment Expense Reserves**

A loss reserve is recognized on a contract-by-contract basis for insured obligations as the present value of expected net cash outflows to be paid under the contract using a discount rate as of the measurement date. The discount rate used in calculating the net present value of estimated losses is based upon the average rate of return on the Company's admitted assets. The loss reserve is subsequently remeasured each

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

reporting period using a current discount rate for expected increases or decreases due to changes in the likelihood of default and potential recoveries. Subsequent changes to the measurement of the loss liability are recognized as loss incurred in the period of change. The amount of the discount at December 31, 2009 and 2008 was \$1,951,638 and \$1,716,483, respectively. Losses and loss adjustment expense reserves include amounts discounted at 4.20% and 3.80% at December 31, 2009 and 2008, respectively. Under GAAP, unpaid losses and loss adjustment expenses are reported on a gross basis (i.e., before reinsurance), and are discounted based on the risk-free rate for the anticipated shortfall in excess of the related unearned premium revenue (interest rates ranging from 0.4% to 4.5% and from 0.1% to 2.7% for 2009 and 2008, respectively). The Company's loss and loss adjustment expenses incurred are disclosed in Note 11.

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 liability is recorded for uncollateralized amounts due from reinsurers not authorized to write financial guaranty business in New York.

### 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. The Company establishes contingency reserves in accordance with New York State Insurance Law, which is consistent with the requirements of SSAP 60, *Financial Guaranty Insurance*. Changes in the contingency reserve are charged directly to surplus. Under GAAP, contingency reserves are not required. 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

#### Foreign exchange

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

#### Federal 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 and are recorded as a component of surplus. Under GAAP, 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. Under GAAP and SAP, valuation allowance is established for deferred tax assets that are not expected to be realized.

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

For tax return purposes, financial guaranty insurance companies are permitted to deduct from taxable income, subject to certain limitations, amounts added to statutory contingency reserves. The amounts deducted must be included in taxable income upon their release from the reserves.

The amounts deducted are allowed as deductions from taxable income and thus reduce taxes payable only to the extent that U.S. Government noninterest-bearing tax and loss bonds are purchased and held in an amount equal to the tax benefit attributable to such deductions.

Purchases of tax and loss bonds are reflected as admitted assets, while under GAAP they are recorded as federal income tax payments.

#### Reinsurance

A liability is recorded for uncollateralized amounts due from reinsurers not authorized to write financial guaranty business in New York. Changes in this liability are charged or credited directly to unassigned surplus. Amounts due from carriers that are secured by letters of credit or trust agreements are not included in this liability. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

Reserves for losses and loss adjustment expenses and unearned premiums ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP. Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

#### 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 Statements 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 10).

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

#### Consolidation

The accounts and operations of the Company's subsidiaries are not consolidated with the accounts and operations of the Company, as would be required under GAAP.

As part of its structured finance business, the Company insures debt obligations or certificates issued by special purpose entities. For GAAP purposes, the Company consolidates the assets and liabilities of a variable interest entity (VIE) if the Company is determined to be the primary beneficiary. For statutory purposes, the VIE is not consolidated.

#### Capital Lease

The Company is party to lease agreements covering leasehold improvements and computer equipment. For GAAP reporting, the leases are treated as a capital lease, and a liability is established for the present value of the minimum lease payments. For statutory purposes, the leases are treated as an operating lease and rental payments are charged to expense over the lease term.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

#### Foreign Currency Translation

The Company has an established foreign branch, three wholly-owned subsidiaries in the United Kingdom, and insured exposure from a former branch in France. The Company has determined that the functional currencies of these entities are their local currencies. Accordingly, the assets and liabilities of these foreign entities are translated into U.S. dollars at the rates of exchange existing 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 \$693 and \$(6,440), respectively, and are reported as a component of unassigned surplus.

#### Statements of Cash Flow

The statutory-basis statements of cash flow are presented in a specified format, which differs from the format prescribed under GAAP. Cash, cash equivalents, and short-term investments in the statements of cash flow represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

#### Comprehensive Income

Comprehensive income is not determined for statutory reporting purposes.

#### 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 for GAAP reporting. For statutory reporting purposes these assets are non-admitted.

#### Stock Compensation

Employees of the Company may receive stock-based compensation under a FGIC Corp. stock incentive plan that provides for stock-based compensation, including stock options, restricted stock awards, and restricted stock units. The compensation expense associated with the stock-based compensation is allocated to the Company by FGIC Corp. and is recorded as compensation expense and a capital contribution to the Company. This capital contribution does not result in a cash payment; however it is included in the Statement of Cash Flow consistent with the presentation in the Annual Statement.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

#### 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.

#### Reclassifications

Certain 2008 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2009 financial statement presentation.

#### New Accounting Pronouncements

The NAIC adopted Statement of Statutory Accounting Principles ("SSAP") No. 43 – Revised entitled *Loan-backed and Structured Securities*, effective September 30, 2009. SSAP No. 43R establishes principles for investments in loan-backed and structured securities and increased disclosures regarding other-than-temporarily impaired securities (see Note 7).

In December 2009, the NAIC adopted an amendment to SSAP No. 60 entitled *Financial Guaranty Insurance*. As a result of the amendment, the Company is required to provide additional disclosures regarding the accounting for premiums and loss reserve liabilities (see Note 6 and Note 11).

In December 2009, the NAIC also adopted SSAP 10R entitled *Income Taxes* with an effective date of year ended December 31, 2009. The revision increases the admissibility limits of deferred tax assets if certain thresholds are met and requires a valuation allowance if it is more likely than not that some or all of a gross deferred tax asset will not be realized.

#### Reconciliation of GAAP and SAP

The following is a reconciliation of net loss and stockholder's equity for the Company and its subsidiaries presented on a GAAP basis to the corresponding amounts for the Company prepared and reported using SAP prescribed or permitted by the NYID for the periods indicated below:

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 4. Significant Accounting Policies (continued)

	2009		2008	
	Net Loss	Stockholders' Deficit	Net Loss	Stockholders' Deficit
GAAP-basis amount:	\$ (893,802)	\$ (848,714)	\$ (1,105,490)	\$ (7,631)
Unrealized losses (gains) 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	<u>\$ (1,617,260)</u>	<u>\$ (1,281,420)</u>	<u>\$ (560,618)</u>	<u>\$ 505,534</u>

### 5. Financial Guaranty Contracts

In accordance with amendments to SSAP 60, Financial Guaranty Insurance, the Company is required to provide additional information affecting the present and future recognition and measurement of financial guarantee insurance contracts.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 5. Financial Guaranty Contracts (continued)

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

	<b>Year Ended December 31, 2009</b>
Beginning expected future premiums at December 31, 2008	\$ 1,121,134
Premium payments received	(117,453)
New business written	—
Adjustments for changes in expected premiums, including impact of terminations and FX movement	(15,397)
Ending expected future premiums at December 31, 2009	\$ 988,284

The following is a schedule of undiscounted premiums expected to be collected 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:

	<b>Undiscounted premium expected to be collected</b>
<b>Twelve months ended:</b>	
December 31, 2010	\$ 102,633
December 31, 2011	92,080
December 31, 2012	79,877
December 31, 2013	68,315
<b>Five years ended:</b>	
December 31, 2018	231,632
December 31, 2023	149,154
December 31, 2028	115,209
December 31, 2033	74,323
December 31, 2038	43,816
December 31, 2043	20,912
December 31, 2048	6,865
December 31, 2053	3,466

## Financial Guaranty Insurance Company

### Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

#### 5. Financial Guaranty Contracts (continued)

The following table presents the expected unearned premiums and the expected future premium earnings on non-installment policies 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:

	Unearned Premiums	Expected Future Premium Earnings		Total Expected Future Premium Earnings
		Upfront	Other Non - Installment	
<b>Year ended:</b>				
December 31, 2009	\$ 246,205	\$ -	\$ -	\$ -
<b>Twelve months ended:</b>				
December 31, 2010	228,537	8,057	9,612	17,669
December 31, 2011	214,693	7,972	5,872	13,844
December 31, 2012	201,524	8,080	5,089	13,169
December 31, 2013	188,961	7,737	4,825	12,563
<b>Five years ended:</b>				
December 31, 2018	140,482	30,464	18,015	48,479
December 31, 2023	96,922	32,025	11,535	43,560
December 31, 2028	67,692	21,111	8,119	29,230
December 31, 2033	38,016	24,187	5,489	29,676
December 31, 2038	14,195	19,630	4,190	23,820
December 31, 2043	4,857	6,418	2,921	9,339
December 31, 2048	1,871	730	2,256	2,985
December 31, 2053	621	-	1,251	1,251
December 31, 2058	-	-	621	621

As of December 31, 2009, unearned premiums amounted to \$489,235 on installment contracts which represents the remaining amount of premium that would have been recognized if all premiums had been received at inception.

#### 6. Fair Value Measurements

Accounting Standards Codification (“ASC”) Topic 820 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 6. Fair Value Measurements (continued)

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 that were accounted for at fair value as of December 31, 2009 and 2008 by level within the ASC Topic 820 fair value hierarchy. As required by ASC Topic 820, financial assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	December 31, 2009			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Fixed maturity securities, available for sale	\$ -	\$ 87,640	\$ -	\$ 87,640
Common stock	-	4,728	-	4,728
Short-term investments	-	170,651	-	170,651
Total assets at fair value	\$ -	\$ 263,019	\$ -	\$ 263,019
	December 31, 2008			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Fixed maturity securities, available for sale	\$ -	\$ 223,284	\$ -	\$ 223,284
Preferred stock	-	7,894	-	7,894
Common stock	-	29,192	-	29,192
Short-term investments	-	6,212	-	6,212
Total assets at fair value	\$ -	\$ 266,582	\$ -	\$ 266,582

### Fixed maturity securities, preferred stock and common stock

Certain of the Company's fixed maturity securities are classified as available for sale and are recorded at lower of amortized cost or fair value as determined by the Securities Valuation Office. Short-term investments are classified at cost which approximates fair value. Unrealized gains and losses on these investments are recorded as a separate component of surplus.

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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 6. Fair Value Measurements (continued)

the valuation process include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and other reference data. Preferred and common stock are valued consistent with the fixed maturity securities.

### 7. Investments

Investments in bonds carried at amortized cost of \$3,768 and \$3,770 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 bonds, preferred stock, common stock and short-term investments are as follows:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
<b>December 31, 2009</b>				
Obligations of states and political subdivisions	\$ 1,057,051	\$ 57,738	\$ -	\$ 1,114,789
Asset- and mortgage-backed securities	171,213	11,228	-	182,441
U.S. Treasury securities and obligations of				
U.S. Government corporations and agencies	46,999	2,696	-	49,695
Debt securities issued by foreign governments	13,548	521	-	14,069
Corporate	34,330	1,709	-	36,039
Total bonds	<u>1,323,141</u>	<u>73,892</u>	<u>-</u>	<u>1,397,033</u>
Preferred stock	3,713	3,140	-	6,853
Common stock	4,728	-	-	4,728
Short-term investments	170,651	-	-	170,651
Total	<u>\$ 1,502,233</u>	<u>\$ 77,032</u>	<u>\$ -</u>	<u>\$ 1,579,265</u>
<b>December 31, 2008</b>				
Obligations of states and political subdivisions	\$ 2,045,922	\$ 40,725	\$ (49,538)	\$ 2,037,109
Asset- and mortgage-backed securities	237,774	4,409	(11,118)	231,065
U.S. Treasury securities and obligations of				
U.S. Government corporations and agencies	63,480	9,169	-	72,649
Debt securities issued by foreign governments	16,397	551	(3)	16,945
Corporate	47,754	474	(1,010)	47,218
Total bonds	<u>2,411,327</u>	<u>55,328</u>	<u>(61,669)</u>	<u>2,404,986</u>
Preferred stock	7,894	-	-	7,894
Common stock	29,192	-	-	29,192
Short-term investments	6,212	1	-	6,213
Total	<u>\$ 2,454,625</u>	<u>\$ 55,329</u>	<u>\$ (61,669)</u>	<u>\$ 2,448,285</u>

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **7. Investments (continued)**

The carrying values of the Company's investment in the equity of its subsidiaries were \$22,121 and \$17,105 at December 31, 2009 and 2008, respectively. Investment in the equity of its subsidiaries were non-admitted due to the Company's surplus deficit (see Note 4). Included in the change in net unrealized losses for the years ended December 31, 2009 and 2008 were \$2,783 and \$20,876, respectively, related to the change in carrying values of the Company's investments in its subsidiaries and affiliates.

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 basis. As a result, the Company recorded other-than-temporary impairment losses on its fixed income securities of \$55,834 and \$41,931 for the years ended December 31, 2009 and 2008, respectively. These losses are included in "Net realized capital losses net of tax" in the Statements of Operations and represent the difference between the amortized cost basis and its fair value at the balance sheet date. Net realized capital losses net of tax for the years ended December 31, 2009 and 2008 also includes \$5,023 and \$2,266, respectively, of a realized loss on cash equivalents related to an other-than-temporary impairment.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 7. Investments (continued)

In accordance with SSAP 43R, information related to other-than-temporarily impaired asset-and mortgage-backed securities is shown below.

Security Description	December 31, 2008 Amortized Cost	December 31, 2009 Amortized Cost	December 31, 2009 Fair Value	Other-than- Temporary Impairment Loss Recognized
Banc of America Comm Mort Inc 2005-1 A4	\$ 3,407	\$ 3,237	\$ 3,473	\$ 198
Banc of America Comm Mort Inc 2005-3 A3A	3,006	2,767	2,984	279
Banc of America Commercial Series 2006-4 A4	4,951	–	–	1,085
CS First Boston Mortgage	5,003	–	–	403
Credit Suisse Mortgage Capital 2006-C5 A3	5,019	3,494	4,171	1,591
First Union National Bank Comm 2000-C1 A2	2,901	1,030	1,029	–
GMAC Commercial Mortgage 2005-C1 A5	2,458	–	–	257
GS Mortgage Securities Corp II 2005-GG4 A3	3,566	3,253	3,569	415
JP Morgan Chase Commercial Series 2007-CB18 A4	3,542	2,711	3,093	869
LB-UBS Commercial Mortgage Series 2007-C2 A3	1,958	1,432	1,684	548
LB UBS Commercial Mortgage 2005-C5 AM	3,863	2,606	3,154	1,325
LB UBS Commercial Mortgage 2002-C1 B	3,004	2,952	3,162	58
LB UBS Commercial Mortgage 2002-C1 E	2,303	2,093	2,238	249
JP Morgan Comml Mtg Finance 2000-C10 A2	2,735	642	642	1
Morgan Stanley Capital I 2005-HQ6 A2A	3,503	3,447	3,514	89
Morgan Stanley Dean Witter 2002-HQ B	5,533	5,519	5,914	6
Morgan Stanley Dean Witter 2002-HQ C	3,001	2,995	3,223	2
Wachovia Bank Commercial Mortg 2006-C27 A3	4,717	3,802	4,257	958
Wachovia Bank Commercial Mortg 2006-C29 A4	5,019	3,871	4,692	1,198
Total	<u>\$ 69,489</u>	<u>\$ 45,851</u>	<u>\$ 50,799</u>	<u>\$ 9,531</u>

The amortized cost and fair value of the investment portfolio at December 31, 2009, by contractual maturity date, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 7. Investments (continued)

	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in one year	\$ 36,352	\$ 36,593
Due after one through five years	230,852	244,456
Due after five years through ten years	279,557	295,745
Due after ten years	624,301	660,072
Asset- and mortgage-backed securities	171,213	182,441
<b>Total</b>	<b>\$ 1,342,275</b>	<b>\$ 1,419,307</b>

As of December 31, 2009, the Company did not have more than 5% of its investment portfolio concentrated in a single issuer or industry other than government agencies; however, the Company had the following investment concentrations by state.

	<b>Fair Value</b>
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
Subtotal	660,344
All other states	322,923
All other investments	595,998
<b>Total</b>	<b>\$ 1,579,265</b>

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 7. Investments (continued)

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

	Year Ended December 31	
	2009	2008
Income from bonds	\$ 81,871	\$ 136,672
Income from preferred stocks	846	848
Income from common stocks	–	861
Income from cash, cash equivalents and short-term investments	965	10,048
Total investment income	83,682	148,429
Investment expenses	(2,994)	(3,978)
Net investment income	\$ 80,688	\$ 144,451

In 2009 and 2008, proceeds from sales of investments in bonds carried at amortized cost were \$1,067,657, and \$1,281,374, respectively. For 2009 and 2008, gross realized gains of \$51,940 and \$41,607, respectively, and gross realized losses of \$2,393 and \$819, respectively, were realized on such sales.

### 8. 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 “Other underwriting expenses” incurred in the 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 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 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 Balance Sheet at December 31, 2009 and the corresponding expense was

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 8. Business Restructuring (continued)

recorded in “Other underwriting expenses” incurred in the 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 “Other underwriting expenses” incurred 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.

### 9. Federal Income Taxes

The Company files a consolidated U.S. federal income tax return with FGIC Corp. The method of allocation between FGIC Corp. and its subsidiaries is determined under a tax sharing agreement approved by FGIC Corp.’s and the Company’s Board of Directors and the New York State Insurance Department, and is based upon separate return calculations. Wholly owned subsidiaries of both the Company and FGIC Corp. are also parties to the tax sharing agreement.

The following is a reconciliation of current federal income taxes computed on loss before provision for federal and foreign income taxes at the statutory rate and the provision for current federal income taxes.

	Year Ended December 31	
	2009	2008
Income taxes computed on loss before provision for federal and foreign income taxes, at the statutory rate	\$ (576,878)	\$ (195,813)
Tax effect of:		
Tax-exempt interest	(19,301)	(34,330)
Deferred tax expense	563,540	227,012
Other, net	1,675	4,399
(Benefit) provision for federal and foreign income taxes	\$ (30,964)	\$ 1,269

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 9. Federal Income Taxes (continued)

The composition of total tax expense for the years ended December 31, 2009 and 2008 is as follows:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Current:		
Federal	\$ (31,348)	\$ 995
Foreign	384	667
	<u>(30,964)</u>	<u>1,662</u>
Federal income tax on net capital gains	–	(393)
Federal and foreign income tax (benefit) expense	<u>\$ (30,964)</u>	<u>\$ 1,269</u>

The changes in net deferred income taxes, inclusive of non-admitted assets, are comprised of the following:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Increase (decrease) in deferred tax assets	\$ 563,653	\$ 224,000
(Increase) decrease in deferred tax liabilities	(113)	3,013
Net change in deferred taxes	<u>\$ 563,540</u>	<u>\$ 227,013</u>

As of December 31, 2009, the Company had a domestic net operating loss carryforward of \$3,588,428 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.

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 was able to realize a \$25,334 tax benefit in 2009. The refund was received in January 2010. 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 is no AMT credit carryforward as the 2008 NOL carryback eliminated all prior years’ AMT. The amount of federal income taxes incurred and available for recoupment in the event of future losses is \$0.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 9. Federal Income Taxes (continued)

In accordance with SSAP 10(R), the Company evaluates its deferred income tax asset to determine if valuation allowances are required. SSAP 10(R) 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, collection of future installment premiums on 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 \$1,306,976 as of December 31, 2009. The Company will continue to analyze the need for a valuation allowance on a quarterly basis.

The following table presents the total of deferred tax assets and liabilities by tax character:

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
Deferred tax assets:		
Ordinary income	\$ 1,287,716	\$ 15,191
Capital gains	21,547	6,928
Gross deferred tax asset	<u>1,309,263</u>	745,610
Valuation allowance	(1,306,976)	–
Adjusted deferred tax asset	<u>2,287</u>	–
Nonadmitted adjusted deferred tax asset	–	(712,108)
Total admitted gross deferred tax asset	<u>2,287</u>	33,502
Deferred tax liabilities:		
Ordinary income	(558)	(439)
Capital gains	(1,729)	(352)
Total gross deferred tax liability	<u>(2,287)</u>	(1,000)
Net admitted deferred tax asset	<u>\$ –</u>	<u>\$ 32,502</u>

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 9. Federal 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 by tax component:

	<b>December 31</b>	
	<b>2009</b>	<b>2008</b>
Deferred tax assets:		
Premiums revenue recognition	\$ 14,684	\$ 15,191
Nonadmitted assets	5,786	6,928
Alternative minimum tax credit carryforward	–	8,816
Net operating loss carryforward	1,255,950	687,012
Impairment losses on investments	21,547	14,676
Deferred compensation	4,287	8,607
Other	7,009	4,380
Gross deferred tax asset	<u>1,309,263</u>	745,610
Valuation allowance	(1,306,976)	–
Adjusted deferred tax asset	<u>2,287</u>	–
Nonadmitted adjusted deferred tax asset	–	(712,108)
Total admitted gross deferred tax asset	<u>2,287</u>	33,502
Deferred tax liabilities:		
Foreign currency	(1,615)	(439)
Discount on bonds	(352)	(352)
Other	(320)	(209)
Total gross deferred tax liability	<u>(2,287)</u>	(1,000)
Net admitted deferred tax asset	<u>\$ –</u>	<u>\$ 32,502</u>

During the third quarter of 2008, the IRS commenced an examination of FGIC Corp.'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 FGIC Corp.'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.

### 10. 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 10. Reinsurance (continued)

typically will receive a ceding commission from the reinsurer. The ceding company is not relieved of its primary obligation to the policyholder in a reinsurance transaction.

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.

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 where 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 \$1,003 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 effects of reinsurance on premiums written and earned are as follows:

	Year Ended December 31			
	2009		2008	
	Written	Earned	Written	Earned
Direct premiums	\$ 86,253	\$ 178,388	\$ 114,858	\$ 494,628
Assumed premiums:				
Affiliates	22,548	25,832	30,942	37,954
Non-affiliates	754	1,071	(14,226)	3,354
Ceded premiums:				
Affiliates	(3,220)	(4,842)	1,471	(12,536)
Non-affiliates	(8,019)	(80,397)	(874,135)	(92,188)
Net premiums	<u>\$ 98,316</u>	<u>\$ 120,052</u>	<u>\$ (741,090)</u>	<u>\$ 431,212</u>

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 10. Reinsurance (continued)

On September 30, 2008, FGIC entered into a reinsurance agreement with MBIA Insurance Corporation (“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. 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 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 these policies.

FGIC assumed exposure of approximately \$848,300 in par amount as of December 31, 2008, from non affiliated 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. In March 2009, FGIC received a notice from one of the ceding companies pursuant to which the ceding company purports to terminate the related reinsurance agreement based on the downgrade of FGIC’s financial strength ratings by Moody’s and S&P. FGIC has reserved all its rights in respect of this notice and has notified the ceding company that it disputes the notice and the settlement amounts claimed.

The amounts deducted from unearned premiums for reinsurance ceded to other companies were \$949,318 and \$1,023,319 at December 31, 2009 and 2008, respectively. The amount of commissions that would be required to be returned by the Company if all reinsurance was canceled was \$197,938 and \$212,825 at December 31, 2009 and 2008, respectively. The amounts deducted from loss reserves for reinsurance ceded were \$105,990 and \$112,235 at December 31, 2009 and 2008, respectively. The amount of loss adjustment expenses for reinsurance ceded were \$286 and \$1,344 for December 31, 2009 and 2008.

Amounts payable or recoverable for reinsurance on paid or unpaid losses are not subject to periodic or maximum limits.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 11. Losses and Loss Adjustment Expenses

Activity in the reserve for losses and loss adjustment expenses (LAE) is summarized as follows:

	<b>Year Ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Net balance at beginning of period	\$ 2,083,426	\$ 1,953,311
Incurred related to:		
Current year	454,592	1,070,111
Prior years	1,350,934	75,950
Total incurred	<u>1,805,526</u>	<u>1,146,061</u>
Paid related to:		
Current year	(115,337)	(55,340)
Prior years	(1,164,868)	(960,606)
Total paid	<u>(1,280,205)</u>	<u>(1,015,946)</u>
Net balance at end of period	<u>\$ 2,608,747</u>	<u>\$ 2,083,426</u>

Reserves for incurred losses and LAE attributable to the insured bond portfolio have increased to \$2,608,747 at December 31, 2009 from \$2,083,426 at December 31, 2008. The net loss and loss adjustment expense activity for the year ended December 31, 2009 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 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 \$74,817 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 \$30,175 and \$51,420,

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 11. Losses and Loss Adjustment Expenses (continued)

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'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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### **11. Losses and Loss Adjustment Expenses (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.

#### **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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 11. Loss and Loss Adjustment Expense Reserves (continued)

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 category 4.

	<b>Risk Category 4</b>
Number of policies	151
Remaining weighted-average contract period (in years)	27
Insured contractual payments outstanding:	
Principal	\$ 20,217,904
Interest	3,717,982
Total	<u>23,935,886</u>
Gross loss reserves	6,954,065
Less:	
Gross projected recoveries	(2,070,596)
Discount, net	(1,975,283)
Gross loss reserves, net of discount	<u>2,908,186</u>
Unearned premiums	<u>17,094</u>
Reinsurance recoverable on paid losses reported in the balance sheet	<u>\$ 857</u>

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 \$18,549 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 11. Loss and Loss Adjustment Expense Reserves (continued)

“Other Invested Assets – FGIC insured securities” on the Balance Sheet of \$25,375 and \$3,576 as of December 31, 2009 and December 31, 2008, respectively, reflects the lower of amortized cost or fair value of FGIC insured securities purchased adjusted for the estimated value associated with FGIC’s credit enhancement 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.

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, FGIC UK Limited paid \$200,000 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.

In connection with the settlement with Calyon, FGIC also entered into an intra-group settlement agreement with FGIC UK Limited to settle FGIC’s potential reinsurance obligation with FGIC UK Limited related to the Commitment Agreement for \$130,000 and all loss adjustment expenses incurred by FGIC or FGIC UK Limited related to Havenrock II. The intra-group settlement agreement also called for the termination of the net worth maintenance agreement between FGIC and FGIC UK Limited (see Note 12).

### 12. Related Party Transactions

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 engaged

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 12. Related Party Transactions (continued)

Blackstone Advisory to provide loss mitigation and remediation services related to the debt obligations of a certain local government entity, which 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 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 and 2008, ceded premiums written were \$891 and \$1,138, respectively, and ceding commission income was \$40 and \$48, respectively, with PMI Mortgage. Accounts payable due to PMI Mortgage was \$(3) and \$46 at December 31, 2009 and 2008 respectively. Loss reserves ceded to PMI Mortgage were \$8,049 and \$52,802 at December 31, 2009 and 2008, 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.

FGIC, in the normal course of operations, has entered into reinsurance transactions with RAM Reinsurance Company Limited ("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 and 2008, ceded premiums written for these transactions were \$2,328 and \$3,209, respectively, and ceding commission income was \$684 and \$943, respectively. Accounts payable to RAM Re were \$621 and \$401 at December 31, 2009 and 2008, respectively. See Note 17 for reinsurance recoverable from RAM Re.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 12. Related Party Transactions (continued)

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 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 and 2008, gross premiums written of \$175 and \$1,281 and premiums earned of \$386 and \$1,262, respectively, relating to these transactions are reflected in the Statutory-Basis Statements of Operations.

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

The Company is a party to a reinsurance agreement with FGIC UK Limited whereby the Company provides quota share reinsurance of 90% of all financial guarantee policies written by FGIC UK Limited. No new policies were written under this agreement during 2008. During 2009 and 2008, assumed premiums written and earned under the reinsurance agreement were \$6,861 and \$10,001 and \$9,625 and \$16,408, respectively. The Company's par exposure under the reinsurance agreement was \$6,885,356 and \$9,284,019 at December 31, 2009 and 2008, respectively. During 2009 and 2008, the Company recorded \$0 reserves for loss and loss adjustment expenses.

The Company also provides FGIC UK Limited with excess of loss coverage. Premiums assumed under the excess of loss reinsurance provision were \$0 during 2009 and 2008. No losses were paid under this agreement during 2009 and 2008.

On August 25, 2008, the net worth maintenance agreement with the Company and FGIC UK Limited was terminated.

Under New York Insurance Law, any contribution by the Company to FGIC UK Limited cannot exceed 35% of the Company's surplus to policy holders or 50% of its statutory surplus over and above its liabilities and capital (statutory earned surplus, at the time of such contribution), without the prior approval of the NYID. At December 31, 2009 and 2008, the Company's aggregate investment in FGIC

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 12. Related Party Transactions (continued)

UK Limited exceeded such amounts. As a result, the Company is required to obtain NYID approval prior to making additional capital contributions to FGIC UK Limited.

The Company made a contribution of \$25,000 to FGIC UK Limited during 2008, with prior approval from the NYID.

During 2009, FGIC Credit Products Limited, a wholly owned subsidiary of the Company, paid a dividend of \$1,544 to FGIC.

FGIC Credit Products, LLC, a wholly owned subsidiary of the Company, issued CDSs to certain buyers of credit protection. In connection with the issuance of CDSs by 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 CDSs. The Company recorded premiums written and earned of \$15,687 and \$16,207 during 2009 and \$20,941 and \$21,906 during 2008, respectively, related to these insurance agreements. No CDS contracts were issued during 2009 or 2008. The total par outstanding on these CDS was \$20,468,354 and \$26,691,394 at December 31, 2009 and 2008, respectively.

The Company shares office facilities and personnel with its affiliates. Such shared costs and expenses are allocated to affiliates based on time and usage studies, and those allocations vary depending on the assumptions underlying those studies. The Company allocated overhead costs of \$322 and \$355 to FGIC Corp. for the years ended December 31, 2009 and 2008, respectively. The Company allocated overhead costs of \$2,525 and \$3,757 to its wholly-owned subsidiaries in 2009 and 2008, respectively.

### 13. 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 and \$380 to the plan on behalf of employees for the years ended December 31, 2009 and 2008, respectively.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 13. Compensation Plans (continued)

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, and \$1,692 to the Plan on behalf of employees for the years ended December 31, 2009 and 2008, respectively.

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. During 2009 and 2008, FGIC Corp did not grant any stock based compensation.

Inter-company employee stock compensation transactions between FGIC Corp. and the Company are recorded at fair value. Specifically, restricted stock units grants are recorded based on fair value at grant date and employee stock options are recorded based on fair value using the Black-Scholes-Merton option pricing model. During 2009 and 2008, FGIC Corp. made capital contributions of \$1,049 and \$1,510, respectively, to the Company related to employee stock compensation transactions.

### 14. 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 and 2008, and (b) dividends may not exceed the lesser of 10% of its surplus or 100% of adjusted net investment income, as defined by 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.

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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 15. Revolving Credit Facility

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 Facility”). 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.

### 16. 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 16. Preferred Trust Securities (continued)

to the trusts in exchange for an aggregate gross purchase price of \$300,000 in cash. For the years ended December 31, 2009 and 2008, the fees incurred related to these put options were \$0 and \$6,509, respectively.

### 17. Financial Instruments

#### (a) Fair Value of Financial Instruments

The following methods and assumptions were used by the Company in estimating 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.

*Bonds and Preferred Stock:* Fair values for bonds and preferred stock are based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Fair value disclosure for bonds and preferred stock is included in the statutory-basis balance sheets and in Note 6 and Note 7.

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

*Common Stock:* Investments in wholly-owned subsidiaries are accounted for based on the underlying equity adjusted to a statutory basis, with changes in equity recorded directly to unassigned surplus. Fair values for common stock other than investment in wholly owned subsidiaries are based on unit prices published by the SVO, or in the absence of SVO published unit prices or when amortized cost is used by the SVO as unit price, quoted market prices by other third party organizations, where available.

*Cash and Cash Equivalents, Accrued Investment Income, Other Assets, Federal Income Taxes Payable, Accounts Payable and Accrued Expenses, Payable for Securities Purchased and Ceded Balances Payable:* The carrying amounts of these items approximate their fair values.

*Premium Receivable:* Premium Receivable represents the present value of premiums expected to be collected on installment contracts over the contract period discounted at 5%. Premiums receivable for future installments are not recorded for statutory purposes.

*Unearned Premiums:* The carrying value of the Company's unearned premiums is represented by the unearned premium reserve on upfront policies net of prepaid reinsurance premiums. The fair value is equal to the carrying value of unearned premiums plus premiums receivable.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 17. Financial Instruments (continued)

*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 average rate of return on the Company's admitted assets. Fair value is determined using a credit valuation adjustment calculated using an internally developed model (see Note 6).

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	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 195,525	\$ 195,525	\$ 416,310	\$ 416,310
Short-term investments	170,651	170,651	6,212	6,213
Bonds	1,323,141	1,397,033	2,411,327	2,404,986
Preferred stock	3,713	6,853	7,894	7,894
Common stock	4,728	4,728	46,297	46,297
Premiums receivable	–	485,500	–	598,313
Financial liabilities:				
Unearned premiums	246,205	731,705	267,940	886,349
Loss and loss adjustment expense reserves, net	2,608,747	453,967	2,083,426	652,112

### 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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 17. 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	5.9%	\$ 4,411,983	\$ -
Leases	1,934,446	2.6	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	4.5	3,294,799	75,700
Transportation	537,949	0.7	62,949	475,000
Higher Education	226,700	0.3	226,700	-
Project Finance	4,585,113	6.1	4,243,505	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	19,599,015	26.1	18,511,227	1,087,788
Structured Finance				
Auto ABS	1,851,067	2.5	1,851,067	-
ABS CDO	16,678,071	22.2	2,284,978	14,393,093
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	2.2	1,562,706	61,639
Pooled Aircraft/Aircraft Engines	3,385,373	4.5	2,206,588	1,178,785
Receivables	867,067	1.2	867,067	-
RMBS	19,999,692	26.6	19,827,927	171,765
Royalties/Intellectual Property	1,908,002	2.5	1,194,000	714,002
Student Loan	1,021,849	1.4	446,901	574,948
Total Structured Finance	48,656,012	64.8	31,312,733	17,343,278
International				
Airports	146,425	0.2	146,425	-
Corporate Obligation	300,776	0.4	208,992	91,784
Sovereign	158,724	0.2	158,724	-
Sub-Sovereign	738,683	1.0	738,683	-
Utility	4,668,872	6.2	2,810,564	1,858,308
Toll Road	859,447	1.1	772,253	87,195
Total International	6,872,928	9.1	4,835,640	2,037,287
<b>Total</b>	<b>\$ 75,127,955</b>	<b>100.0%</b>	<b>\$ 54,659,601</b>	<b>\$ 20,468,354</b>

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.

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 17. Financial Instruments (continued)

	Number of policies outstanding	Net Par Outstanding	% of total
Alt-A (1 <sup>st</sup> 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 <sup>st</sup> lien)	89	5,283,134	26.4
Prime (1 <sup>st</sup> lien)	10	374,916	1.9
<b>Total</b>	<b>215</b>	<b>\$ 19,999,692</b>	<b>100.0%</b>

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 \$16,678,071, 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)	11	3,201,877	19.0
<b>Total</b>	<b>64</b>	<b>\$ 16,876,577</b>	<b>100.0%</b>

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 17. Financial Instruments (continued)

As of December 31, 2009, the composition of par outstanding ceded to reinsurers was as follows:

Reinsurer	Reinsurer Rating (S&P/Moody's)	Ceded Principal Outstanding	Ceded UPR	Reinsurance recoverable on paid and unpaid losses
National	A/Baa1	\$ 177,142,431	\$ 829,483	\$ -
AG Re	AA/A1	2,798,857	-	17,402
RAM Re	BB/Ba3	1,608,816	33,313	33,839
Radian Asset Assurance Inc.	BB-/Ba1	1,375,171	18,242	22,279
Assured Guaranty Corp.	AAA/Aa3	545,748	16,902	24,246
Swiss Reinsurance Company	A+/A1	602,492	7,043	-
Assured Guaranty Municipal Corp.	AAA/Aa3	550,800	38,304	-
Syncora Guarantee Inc.	Ca/R	230,468	2,151	-
PMI Mortgage	B+/Ba3	186,630	-	8,051
AMBAC Assurance Corp.	CC/Caa2	181,808	310	-
American Reinsurance Company	AA-/Aa3	58,585	103	-
Other		68,511	3,467	312
Total		<u>\$ 185,350,317</u>	<u>\$ 949,318</u>	<u>\$ 106,129</u>

### 18. Commitments and Contingencies

The Company leases office space under lease agreements that are accounted for as operating leases. Rent expense under the operating leases for the years ended December 31, 2009 and 2008 was \$3,033 and \$6,115, 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 8). Future lease payments associated with the remaining U.S. occupied space are as follows as of December 31, 2009:

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 18. Commitments and Contingencies (continued)

	<u>Amount</u>
Year ending December 31:	
2010	\$ 5,704
2011	5,681
2012	5,778
2013	5,838
2014	6,038
2015 and thereafter	<u>33,651</u>
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 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 18. Commitments and Contingencies (continued)

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 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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
(Dollars in thousands)

### 18. Commitments and Contingencies (continued)

SG. On February 4, 2010, SG filed an amended complaint, 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.

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

# Financial Guaranty Insurance Company

## Notes to Statutory-Basis Financial Statements (continued)

December 31, 2009  
*(Dollars in thousands)*

### **18. Commitments and Contingencies (continued)**

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.

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.

## Other Financial Information

## Report of Independent Auditors on Other Financial Information

The Board of Directors and Stockholder of  
Financial Guaranty Insurance Company

Our audits were conducted for the purpose of forming an opinion on the statutory-basis financial statements taken as a whole. The accompanying supplemental investment and reinsurance disclosures are presented to comply with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and is not a required part of the statutory-basis financial statements. Such information has been subjected to the auditing procedures applied in our audit of the statutory-basis financial statements and, in our opinion, is fairly stated in all material respects in relation to the statutory-basis financial statements taken as a whole.

This report is intended solely for the information and use of the company and state insurance departments to whose jurisdiction the company is subject and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst & Young LLP*

New York, New York  
February 17, 2010

**Financial Guaranty Insurance Company**  
**Supplemental Investment Risks Interrogatories Schedule**  
*(Dollars in Thousands)*

1. The Company's total admitted assets as reported on page two of its Annual Statement for 2009 is \$1,779,337.
2. Following are the Company's ten largest exposures as of December 31, 2009 to a single issuer/borrower/investment, by investment category, excluding (i) U.S. government and U.S. Government agency securities and those U.S. Government money market funds listed in the Appendix to the NAIC Securities Valuation Office (SVO) Practices and Procedures Manual as exempt and (ii) property occupied by the Company:

<b>Description of Exposure</b>	<b>Amount as of December 31, 2009</b>	<b>Percentage of Total Admitted Assets</b>
a. Michigan Municipal Board Authority	\$ 32,171	1.82%
b. Chicago III Board of Education	27,227	1.54
c. Salt River Project - Arizona	17,754	1.00
d. Massachusetts Bay Transportation Authority	17,049	0.96
e. Wisconsin State	16,757	0.95
f. Philadelphia PA Gas Works	16,718	0.94
g. Harris County - Texas	15,738	0.89
h. Massachusetts State	15,641	0.88
i. Texas State Transportation	15,379	0.87
j. Fannie Mae	15,088	0.85

3. The Company's total admitted assets held in bonds and preferred stocks by NAIC rating as of December 31, 2009 were:

	<b>Rating</b>	<b>Amount</b>	<b>Percentage of Total Admitted Assets</b>
Bonds	NAIC-1	\$ 1,251,337	70.05%
Bonds	NAIC-2	70,047	3.96
Bonds	NAIC-4	1,751	0.10
Preferred stock	P/PSF-1	3,713	0.21

Financial Guaranty Insurance Company  
Supplemental Investment Risks Interrogatories Schedule (continued)  
*(Dollars in Thousands)*

4. Assets held for investment in foreign investments are less than 2.5% of the Company's total admitted assets.
5. Assets held in Canadian investments are less than 2.5% of the Company's total admitted assets.
6. The Company has no assets held for investment with contractual sales restrictions.
7. Assets held in equity interests are less than 2.5% of the Company's total admitted assets.
8. The Company has no assets held in nonaffiliated, privately placed equities.
9. The Company has no assets held in general partnership interests.
10. The Company has no mortgage loans.
11. The Company has no assets held in investments in real estate.
12. The Company has no assets subject to securities lending, repurchase agreements, reverse repurchase agreements, dollar repurchase agreements or dollar reverse repurchase agreements.
13. The Company has no investments in warrants.
14. The Company has no potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for collars, swaps, and forwards.
15. The Company has no potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for futures contracts.

**Financial Guaranty Insurance Company**  
**Summary Investment Schedule**  
*(Dollars in Thousands)*

<b>Investment Categories</b>	<b>Gross Investment Holdings as of December 31, 2009*</b>		<b>Admitted Assets as Reported in the Annual Statement for 2009</b>	
Bonds:				
U.S. Treasury Securities	\$ 16,331	0.9%	\$ 16,331	0.9%
U.S. government agency and corporate obligations:				
U.S. Government Sponsored Agencies	30,667	1.8	30,667	1.8
Foreign government (including Canada, excluding mortgage-backed securities)	13,553	0.8	13,553	0.8
Securities issued by states, territories and possessions, and political subdivisions in the U.S.:				
U.S. States and territories general obligations	152,950	8.9	152,950	8.9
Political subdivisions of U.S. states, territories and possessions general obligations	115,684	6.7	115,684	6.7
Revenue and assessment obligations	788,414	45.7	788,414	45.7
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities issued or guaranteed by FNMA and FHLMC	115,783	6.7	115,783	6.7
CMOs or REMICs:				
Issued by FNMA, FHLMC, or GNMA				
All other mortgage-backed securities	55,429	3.2	55,429	3.2
Other debt and other fixed income securities:				
Unaffiliated domestic securities	32,530	1.9	32,530	1.9
Unaffiliated foreign securities	1,800	0.1	1,800	0.1
Preferred stocks:				
Unaffiliated	3,713	0.2	3,713	0.2
Other equity securities:				
Affiliated	4,728	0.3	4,728	0.3
Receivables for securities	-	0.0	-	0.0
Cash, cash equivalents, and short-term investments	366,176	21.3	366,176	21.3
Other invested assets	25,672	1.5	25,672	1.5
<b>Total invested assets</b>	<b>\$ 1,723,430</b>	<b>100.0%</b>	<b>\$ 1,723,430</b>	<b>100.0%</b>

\*Gross investment holdings as valued in compliance with NAIC Accounting Practices and Procedures Manual.

Financial Guaranty Insurance Company  
Supplemental Reinsurance Interrogatories Schedule  
December 31, 2009

1. The Company has not reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions).
  
2. The Company has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:
  - (a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
  - (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
  - (c) Aggregate stop loss reinsurance coverage;
  - (d) An unconditional or unilateral right by either party to commute the reinsurance contract except for such provisions which are only triggered by a decline in the credit status of the other party;
  - (e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
  - (f) A payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Financial Guaranty Insurance Company  
Supplemental Reinsurance Interrogatories Schedule (continued)  
December 31, 2009

3. The Company has not, during the period covered by the Annual Statement, ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:
- (a) the written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
  - (b) twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.

Financial Guaranty Insurance Company  
Supplemental Reinsurance Interrogatories Schedule (continued)  
December 31, 2009

4. Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, Property and Casualty Reinsurance, the Company has not ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the Annual Statement, and either:
- (a) accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
  - (b) accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

Financial Guaranty Insurance Company  
Note to Other Financial Information

**Note – Basis of Presentation**

The accompanying schedules present selected statutory-basis financial data as of December 31, 2009 and for the year then ended for purposes of complying with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and agrees to or is included in the amounts reported in the Company's 2009 Statutory Annual Statement as filed with the State of New York Insurance Department.