

STATUTORY-BASIS FINANCIAL STATEMENTS

Financial Guaranty Insurance Company  
June 30, 2010

Financial Guaranty Insurance Company

Statutory-Basis Financial Statements

June 30, 2010

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Statutory-Basis Financial Statements

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Financial Guaranty Insurance Company

Statutory-Basis Balance Sheets  
(Dollars in Thousands, except per share amounts)

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(Unaudited)</i>	
<b>Admitted assets</b>		
Fixed maturity securities, available for sale at amortized cost (fair value of \$629,875 in 2010 and \$1,309,393 in 2009)	\$ 583,455	\$ 1,235,501
Fixed maturity securities, available for sale at fair value (amortized cost of \$425 in 2010 and \$87,640 in 2009)	425	87,640
Preferred stock (fair value of \$8,091 in 2010 and \$6,853 in 2009)	3,713	3,713
Common stock	–	4,728
Other invested assets	22,934	25,672
Short-term investments, at cost, which approximates fair value	1,220,986	294,204
Cash and cash equivalents	26,400	71,972
Total cash and invested assets	<u>1,857,913</u>	<u>1,723,430</u>
Accrued investment income	6,999	17,575
Other assets	8,977	8,578
Receivable from parent and subsidiaries	1,018	2,757
Federal and foreign income tax receivable	–	26,997
Total admitted assets	<u>\$ 1,874,907</u>	<u>\$ 1,779,337</u>
<b>Liabilities and capital and surplus</b>		
Liabilities:		
Losses	\$ 3,039,072	\$ 2,597,687
Loss adjustment expenses	15,711	11,060
Unearned premiums	240,459	246,205
Provision for reinsurance	4,014	5,385
Contingency reserves	240,624	168,284
Accounts payable and accrued expenses	18,518	29,728
Federal and foreign income tax payable	1,074	114
Ceded balances payable	2,303	2,294
Total liabilities	<u>3,561,775</u>	<u>3,060,757</u>
Capital and surplus (deficit):		
Common stock, par value \$1,500 per share; 10,000 shares authorized, issued, and outstanding	15,000	15,000
Redeemable preferred stock, par value \$1,000 per share; 3,000 shares authorized, issued and outstanding	300,000	300,000
Paid-in surplus	439,881	439,551
Unassigned deficit	(2,441,749)	(2,035,971)
Total capital and deficit	<u>(1,686,868)</u>	<u>(1,281,420)</u>
Total liabilities and capital and deficit	<u>\$ 1,874,907</u>	<u>\$ 1,779,337</u>

See accompanying notes.

Financial Guaranty Insurance Company

Statutory-Basis Statements of Operations  
(Unaudited)

(Dollars in Thousands)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Premiums earned	\$ 24,220	\$ 31,928	\$ 51,716	\$ 66,293
Losses incurred	(86,428)	(653,607)	(444,096)	(957,389)
Loss adjustment expenses incurred	(2,224)	967	(5,547)	(3,254)
Other underwriting expenses incurred	(15,384)	(12,834)	(32,613)	(32,319)
Ceding commission income	466	(195)	1,134	513
Underwriting loss	(79,350)	(633,741)	(429,406)	(926,156)
Net investment income	12,999	19,921	29,075	40,755
Net realized capital gains (losses), net of tax of \$0, for the six and three months ended June 30, 2010 and 2009, respectively	46,283	(20,469)	51,666	(24,461)
Net investment gain (loss)	59,282	(548)	80,741	16,294
Other income	3,881	13,731	8,469	10,905
Loss after capital gains (losses) and before all other federal and foreign income taxes	(16,187)	(620,558)	(340,195)	(898,957)
Federal and foreign income tax expense	(126)	(8,076)	(49)	(5,844)
Net loss	\$ (16,061)	\$ (612,482)	\$ (340,146)	\$ (893,113)

See accompanying notes.

Financial Guaranty Insurance Company

Statutory-Basis Statements of Cash Flows  
(Unaudited)

(Dollars in Thousands)

	<b>Six months ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Operations</b>		
Premiums collected, net of reinsurance	\$ 44,700	\$ 55,615
Losses and loss adjustment expenses paid	(3,605)	(673,726)
Underwriting expenses paid	(38,253)	(73,022)
Ceding commission received	1,134	513
Net investment income received	40,272	59,360
Other income	8,470	5,821
Federal income tax refunds	28,006	4,938
Net cash provided by (used in) operations	<u>80,724</u>	<u>(620,501)</u>
<b>Investment activities</b>		
Proceeds from sales, maturities, or repayments of investments:		
Bonds and Stocks	750,622	725,367
Other invested assets	51,330	55,271
Total investment proceeds	<u>801,952</u>	<u>780,638</u>
Cost of investments acquired:		
Bonds	412	9,294
Other invested assets	9	-
Miscellaneous applications	-	79,612
Total investments acquired	<u>421</u>	<u>88,906</u>
Net cash provided by investment activities	<u>801,531</u>	<u>691,731</u>
<b>Financing and miscellaneous activities</b>		
Other cash provided (applied):		
Capital and surplus paid in	329	697
Other cash applied	(1,374)	1,548
Total other cash (used) provided	<u>(1,045)</u>	<u>2,245</u>
Net increase in cash, cash equivalents and short-term investments	<u>881,210</u>	<u>73,475</u>
Cash, cash equivalents and short-term investments:		
Beginning of year	366,176	422,522
End of period	<u>\$ 1,247,386</u>	<u>\$ 495,997</u>

See accompanying notes.

# Financial Guaranty Insurance Company

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

June 30, 2010  
(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.

At June 30, 2010 and December 31, 2009, PMI Mortgage Insurance Company (“PMI”), affiliates of the Blackstone Group L.P. (“Blackstone”), the Cypress Group L.L.C. (“Cypress”) and CIVC Partners L.P. (“CIVC”) owned approximately 42%, 23%, 23% and 7% of FGIC Corp.’s common stock, respectively. As of June 30, 2010 and December 31, 2009, an affiliate of General Electric Capital Corp. (“GE Capital”) owned 2,346 shares, or 100%, of FGIC Corp.’s senior participating mandatorily convertible modified preferred stock (the “Senior Preferred Shares”), with an aggregate liquidation preference of \$350,231, and approximately 5% of FGIC Corp.’s outstanding common stock.

On July 29, 2010, PMI sold 100% of its common stock in FGIC Corp. to Dubel & Associates, LLC (“Dubel”), an entity controlled by FGIC’s Chief Executive Officer, John S. Dubel. On August 2, 2010, Dubel transferred such FGIC Corp common stock to FGIC Corp. and directed FGIC Corp. to retire such common stock without Dubel receiving any compensation therefor. FGIC Corporation retired such common stock on August 3, 2010. As a result of these transactions, Blackstone, Cypress, CIVC and GE Capital own approximately 39.5%, 39.5%, 12% and 7.7% of FGIC Corp.’s common stock, respectively, as of August 3, 2010.

### 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 second quarter of 2010, 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 \$1,686,868 as of June 30, 2010. 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.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**2. Recent Developments (continued)**

(November 2008). As of June 30, 2010, FGIC's aggregate net liability under its insured exposures continued to exceed the aggregate risk limit prescribed by the Insurance Law and FGIC's insured exposure under individual policies continued to exceed the applicable single risk limits prescribed by the Insurance Law.

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

On November 20, 2009, FGIC filed with the New York Insurance Department (the "NYID") its Quarterly Statement for the period ending September 30, 2009, in which FGIC reported a policyholders' surplus deficit at September 30, 2009 of approximately \$866,000 and an impairment of its required minimum policyholders' surplus of approximately \$932,000.

On November 24, 2009, the NYID issued an order pursuant to Section 1310 of the Insurance Law requiring FGIC, effective that day, to suspend paying any and all claims and prohibiting FGIC from writing any new policies. Accordingly, FGIC immediately suspended all claims payments. FGIC had previously ceased writing any new policies in January 2008. Such NYID order (as modified by the Supplemental Order Pursuant to Insurance Law §1310 dated March 25, 2010) is referred to herein as the "NYID Order". 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. The NYID Order requires FGIC 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 June 15, 2010, or such subsequent date as the Superintendent deems appropriate. FGIC may only operate in the ordinary course of business and as necessary to effectuate its plan to eliminate FGIC's policyholders' surplus deficit. The NYID Order does not limit in any way the Superintendent's ability to seek rehabilitation or liquidation of FGIC prior to such date.

FGIC has since formulated a comprehensive restructuring plan to fulfill the requirements set forth in the NYID Order and with a view to remediate its RMBS, ABS CDO and other exposures, mitigate FGIC's potential existing exposure for claims based on mark-to-market termination payments with respect to certain credit default swap ("CDS") transactions insured by FGIC or FGIC UK Ltd., remove its capital impairment and return FGIC to compliance with the applicable minimum policyholders' surplus requirement. FGIC submitted an initial surplus restoration plan to the NYID on December 22, 2009 and subsequently submitted an amended and restated surplus restoration plan (as so amended and restated, the "Surplus Restoration Plan" or the "Plan"). The NYID acknowledged that FGIC will continue its efforts to

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**2. Recent Developments (continued)**

effectuate the amended and restated Surplus Restoration Plan and the transactions contemplated therein or attendant thereto on March 25, 2010.

The Surplus Restoration Plan includes the following three 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 the offer to exchange launched by Sharps SP I LLC on March 25, 2010 (as amended, amended and restated, modified, supplemented or extended from time to time, the "Offer") or through various other consensual remediation transactions; (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, through consensual transactions; and (iii) mitigating FGIC's existing exposure for claims based on mark-to-market termination payments under CDS insured by FGIC or FGIC UK Ltd., pursuant to consensual transactions with the counterparties to such CDS, including pursuant to the transactions contemplated by certain agreements with the counterparties to certain of such CDS and related transactions.

FGIC has reached definitive agreements or agreements in principle contemplating transactions which would mitigate, commute or terminate FGIC's exposure with respect to certain ABS CDOs and other obligations, each as contemplated in the Surplus Restoration Plan (the "Other Restructuring Transactions"). The Other Restructuring Transactions are conditioned upon, among other things, the successful closing of the Offer and, if applicable, completion of definitive documentation acceptable to the parties thereto.

The Other Restructuring Transactions, together with the transactions contemplated by the agreements with the CDS counterparties and related transactions referred to above, represent substantially all of the loss mitigation transactions currently contemplated under the Surplus Restoration Plan, other than the Offer. However, it is possible that FGIC could complete additional loss mitigation transactions.

Notwithstanding the foregoing, there can be no assurance that FGIC will successfully effectuate the Surplus Restoration Plan.

On August 3, 2010 (the "Petition Date"), FGIC Corp. filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code (the "Chapter 11 Case"). The Chapter 11 Case was assigned to the Honorable Stuart M. Bernstein, United States Bankruptcy Judge for the Southern District of New York ("Bankruptcy Court"). FGIC Corp. also filed with the Bankruptcy Court a Plan of Reorganization (the "Reorganization Plan"), along with a Disclosure Statement (the "Disclosure Statement"). The purpose of the Disclosure Statement was to provide creditors of FGIC Corp. with adequate information to make an informed judgment about the Reorganization Plan before voting on the Reorganization Plan. None of the subsidiaries or affiliates of FGIC Corp., including FGIC, are subject to the Chapter 11 Case.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**2. Recent Developments (continued)**

The effects of any bankruptcy proceeding are uncertain, but may include, among other consequences, a change of control of the Company, changes in the composition of the Board of Directors of FGIC Corp. and the FGIC Board, and management and policy changes at FGIC Corp. and FGIC. Any attempt by creditors of FGIC Corp. or others involved in the Chapter 11 Case to enforce a claim or judgment against FGIC or to interfere in FGIC's operations could result in the Superintendent seeking to commence rehabilitation or liquidation proceedings against FGIC. Any change of control at FGIC Corp. and correspondingly, FGIC, could create instability and general uncertainty regarding the strategic plan of FGIC as a whole, with resulting management and policy changes, including FGIC's use of net operating loss carryforwards, and increased scrutiny by the NYID and FGIC's stakeholders, which could lead the Superintendent to commence rehabilitation or liquidation proceedings. Further, under New York Insurance Law, any change of control of FGIC requires the Superintendent's prior approval.

**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 effectuation of the Offer 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. 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.

As a result of uncertainties associated with the aforementioned factors and continuing risks such as those described below, management has concluded that there is substantial doubt about the ability of the Company to continue as a going concern. The Company's financial statements as of June 30, 2010 and December 31, 2009 and for the six months ended June 30, 2010 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: (i) the uncertainties associated with implementing and successfully achieving the goals of its Surplus Restoration Plan, by the date required in the NYID Order or otherwise, and successfully consummating the Offer and the other transactions described in the Surplus Restoration Plan, as well as the effect of the consummation of such Offer and such other transactions on FGIC's financial position, and (ii) the risk of rehabilitation or liquidation at any time by the Superintendent given FGIC's policyholders' surplus deficit. 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 June 30, 2010. Moreover, there can be no assurance that FGIC will successfully

Financial Guaranty Insurance Company

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

June 30, 2010  
(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)**

effectuate the Surplus Restoration Plan. Consummation of the Offer is subject to various conditions, including satisfactory mitigation of the risk of termination of CDS transactions guaranteed by FGIC or FGIC UK Ltd. as a result of events that have occurred prior to such consummation and the approval or non-objection by the NYID, among other conditions. There can be no assurance that the NYID will approve the completion of the Offer, the consummation of the transactions contemplated by certain agreements with the counterparties to certain FGIC or FGIC UK Ltd.-insured CDS transactions and related transactions described in the Surplus Restoration Plan intended to mitigate the CDS transaction termination risk or the consummation of certain other transactions intended to mitigate, commute or terminate FGIC's exposure with respect to certain ABS CDOs and other obligations, or that the other conditions to closing the Offer and the consummation of such transactions will be satisfied. 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 timing of the Company's recommencement of claims payments and payment in full of due and unpaid amounts under its policies, (b) the Company's future financial condition, (c) future intervention by the NYID or (d) future events, including those outside of the Company's control, or third party actions that may adversely impact the Company's ability to perform under its insurance policies in the future or otherwise affect FGIC's ability to conduct its business as contemplated by the Surplus Restoration Plan. 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 consummation, would cause FGIC to report policyholders' surplus below the \$66,400 minimum requirement under the Insurance Law. Based on these factors and the continuing risks and uncertainties summarized below, management has concluded that there is substantial doubt about FGIC's ability to continue as a going concern.

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

Financial Guaranty Insurance Company

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

June 30, 2010  
(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)**

- 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, which have led to erosion in the quality of assets and in the collection of cash flows from assets within structured securities that the Company has guaranteed and may worsen, spread to, or negatively impact 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. In addition, catastrophic events or terrorist acts could adversely affect the ability of public sector issuers to meet their obligations with respect to securities insured by the Company and the Company may incur material losses due to these exposures if the economic stress caused by these events is more severe than it currently foresees. 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 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 accurate 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 8 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 (Unaudited) (continued)

June 30, 2010  
(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. It would be an event of default under all of the CDS contracts insured by FGIC UK Ltd. if FGIC or FGIC UK Ltd., as applicable, should be placed into rehabilitation or liquidation. In addition, given FGIC's significant deficit in policyholders' surplus and significant anticipated near-term claim payments, the NYID has ordered FGIC to suspend paying claims under its policies. Some CDS contracts insured by FGIC (or, in limited cases, FGIC UK Ltd.) contain certain cross default event of default provisions, meaning that certain defaults by FGIC (or, in limited cases, FGIC UK Ltd.) relating to payments due on its debt or policies, including such failures or defaults caused by the NYID Order, may trigger an event of default under such CDS contracts. As such, the continued suspension of claim payments (or other delay in the recommencement of claims payments or payment in full of due and unpaid amounts under FGIC's policies) could result in the termination of, and the assertion of termination payments by counterparties under, FGIC- insured CDS contracts with respect to which FGIC fails to pay a policy claim and possibly certain other CDS contracts insured by FGIC (or, in limited cases, FGIC UK Ltd.). 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")). Consummation of the transactions contemplated by certain agreements with the counterparties to certain FGIC or FGIC UK Ltd.-insured CDS transactions and related transactions described in the Surplus Restoration Plan will mitigate existing exposure FGIC or FGIC UK Ltd. may have to pay claims based on mark-to-market termination payments with respect to such CDS transactions as a result of events that have occurred prior to such consummation including, without limitation, events relating to the NYID Order. If the transactions contemplated by such agreements with such counterparties and related transactions are not consummated, the aggregate amount of claims based on termination payments that may be asserted against FGIC would significantly exceed its available claims paying resources and liquidity funds and accordingly, would result in an increase in FGIC's policyholders' surplus deficit and have a material adverse effect on FGIC's financial position, results of operations and solvency.

- There can be no assurance when or if claim payments by the Company will recommence. Even upon the completion of its restructuring, FGIC does not anticipate that it will immediately recommence, nor does FGIC know when it may recommence, the payment of claims under its policies, and even upon such recommencement, FGIC does not know when due and unpaid amounts under its policies will be paid in full. Any continued suspension of FGIC's ability to make claim payments or other delay in its recommencement of claim payments or payment in full of due and unpaid amounts under its policies could have a number of material adverse consequences, including, but not limited to, (i) litigation for breach of contract and various other

Financial Guaranty Insurance Company

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

June 30, 2010  
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**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)**

causes of action, (ii) the loss of access and control rights under certain FGIC-insured transactions that FGIC has used to obtain additional information concerning its insured exposures and to direct or otherwise control remediation activities, (iii) subordination or withholding of certain premium and/or reimbursement payments, and (iv) the assertion of claims for mark-to-market termination payments by counterparties to FGIC or FGIC UK Ltd.-insured CDS contracts on which FGIC fails to pay a claim or under which an event of default otherwise occurs as a result of such suspension or other failure to pay claim payments, 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 or if there is other delay in its recommencement of claims payments or payment in full of due and unpaid amounts under its policies. FGIC has received notices from trustees on the underlying trusts in 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 June 30, 2010, FGIC is prohibited by the Insurance Law from paying dividends on its common stock or preferred stock. As a result of not paying dividends, the holders of FGIC's preferred stock could become entitled to add two additional directors to FGIC's Board. This event could create instability and general uncertainty regarding the strategic plan of FGIC as a whole, with resulting management and policy changes, and increased scrutiny by the NYID and FGIC's stakeholders, which could lead the Superintendent to commence rehabilitation or liquidation proceedings. This event also could cause FGIC to become deconsolidated from FGIC Corp for federal tax purposes. If FGIC becomes deconsolidated from FGIC Corp. prior to FGIC Corp.'s ownership change in bankruptcy, FGIC's NOLs would not be protected by the 382(l)(5) Exception and would be severely limited following FGIC Corp.'s ownership change. In addition, following any such deconsolidation, FGIC Corp. would no longer be permitted to utilize FGIC's NOLs to shelter FGIC Corp.'s income. See Note 7 for further information regarding FGIC's NOL limitations if FGIC or FGIC Corporation experiences an ownership change.
- The effects of FGIC Corp.'s Chapter 11 Case are uncertain, but may include, among other consequences, a change of control of FGIC, changes in the composition of the Board of Directors of FGIC Corp. and the FGIC Board, and management and policy changes at FGIC Corp. and FGIC. Any attempt by creditors of FGIC Corp. or others involved in the Chapter 11 Case to enforce a claim or judgment against FGIC or to interfere in FGIC's operations could result in the Superintendent seeking to commence rehabilitation or liquidation proceedings against FGIC. Any

Financial Guaranty Insurance Company

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

June 30, 2010  
(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)**

change of control at FGIC Corp. and correspondingly, FGIC, could create instability and general uncertainty regarding the strategic plan of the company as a whole, with resulting management and policy changes, including FGIC's use of net operating loss carryforwards, and increased scrutiny by the NYID and FGIC's stakeholders, which could lead the Superintendent to commence rehabilitation or liquidation proceedings. Further, under New York Insurance Law, any change of control of FGIC requires the Superintendent's prior approval.

- 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. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources away from implementing loss mitigation efforts that are vital to FGIC's ability to continue as a going concern. See Note 9 for further information.

**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. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of results that may be expected for the year ending December 31, 2010. These unaudited interim financial statements should be read in conjunction with the audited Statutory-Basis Financial Statements for the year ended December 31, 2009, including the accompanying notes.

Certain 2009 amounts have been reclassified to conform to the 2010 presentation. Money market securities have been reclassified and are included in short-term investments at June 30, 2010 and December 31, 2009.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**5. Investments**

Investments in bonds carried at amortized cost of \$3,768 as of June 30, 2010 and December 31, 2009, 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>June 30, 2010</b>				
Obligations of states and political subdivisions	\$ 345,609	\$ 21,878	\$ –	\$ 367,487
Asset- and mortgage-backed securities	149,514	15,782	–	165,297
U.S. Treasury securities and obligations of				
U.S. Government corporations and agencies	46,840	5,975	–	52,815
Debt securities issued by foreign governments	11,933	391	–	12,324
Corporate	29,984	2,394	–	32,377
Total bonds	583,880	46,420	–	630,300
Preferred stock	3,713	4,378	–	8,091
Short-term investments	1,220,986	–	–	1,220,986
Total	\$ 1,808,579	\$ 50,798	\$ –	\$ 1,859,377
<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	1,323,141	73,892	–	1,397,033
Preferred stock	3,713	3,140	–	6,853
Common stock	4,728	–	–	4,728
Short-term investments	294,204	–	–	294,204
Total	\$ 1,625,786	\$ 77,032	\$ –	\$ 1,702,818

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**5. Investments (continued)**

The carrying values of the Company's investment in the equity of its subsidiaries were \$9,673 and \$22,122 at June 30, 2010 and December 31, 2009, respectively. Investment in the equity of its subsidiaries were non-admitted due to the Company's surplus deficit. Included in the change in net unrealized losses for the six months ended June 30, 2010 and 2009 were \$1,193 and \$197, respectively, related to the change in carrying values of the Company's investments in its subsidiaries and affiliates.

During 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 of \$0 and \$30,129 and \$9 and \$52,928 on its fixed income securities for the three and six months ended June 30, 2010 and 2009, respectively. These gains and losses are included in "Net realized capital gains or 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. There were no net realized capital gains or losses net of tax for the three months ended June 30, 2010 and 2009. Net unrealized capital gains or losses net of tax for the six months ended June 30, 2010 and 2009 also includes \$0 and \$5,023, respectively, of a realized loss related to an other-than-temporary impairment, and \$5,255 and \$0, respectively, of a realized capital gain on common stock.

The amortized cost and fair value of the investment portfolio at June 30, 2010, 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.

	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in one year	\$ 14,545	\$ 15,067
Due after one through five years	99,188	105,323
Due after five years through ten years	148,637	157,887
Due after ten years	175,709	194,817
Asset- and mortgage-backed securities	149,514	165,297
Total	<u>\$ 587,593</u>	<u>\$ 638,391</u>

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**5. Investments (continued)**

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

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2010	2009	2010	2009
Income from bonds	\$ 12,383	\$ 19,545	\$ 29,127	\$ 41,325
Income from preferred stocks	213	213	422	422
Income from cash, cash equivalents and short-term investments	637	199	773	680
Total investment income	13,233	19,957	30,322	42,427
Investment expenses	(458)	(800)	(1,247)	(1,672)
Net investment income	\$ 12,775	\$ 19,157	\$ 29,075	\$ 40,755

For the three months ended June 30, 2010 and 2009, proceeds from sales of investments in bonds carried at amortized cost were \$743,917, and \$240,938, respectively. For the six months ended June 30, 2010 and 2009, proceeds from sales of investments in bonds carried at amortized cost were \$748,071, and \$669,992, respectively. For the three months ended June 30, 2010 and 2009, gross realized gains of \$46,283 and \$13,433, respectively, and gross realized losses of \$0 and \$1,623, respectively, were realized on such sales. For the six months ended June 30, 2010 and 2009, gross realized gains of \$46,415 and \$30,158, respectively, and gross realized losses of \$0 and \$1,690, respectively, were realized on such sales.

**6. 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 did not incur additional expense during the six months ended June 30, 2010 and 2009, respectively, in relation to a further workforce reduction. For the six months ended June 30, 2010 and 2009, \$2,067 and \$8,417, respectively, of involuntary termination benefits were paid and the balance of \$1,700 and \$6,801, respectively, 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

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**6. Business Restructuring (continued)**

additional 25% of its leased office space. For the six months ended June 30, 2010 and 2009, the Company incurred additional expense of \$737 and \$3,398, respectively, as it increased the liability due to ceasing use of the additional space and adjustments to estimated net cash flows. In February 2010, the Company subleased approximately two-thirds of its unused office space for the remainder of its lease term. 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 June 30, 2010 and the corresponding expense was 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 the fourth quarter of 2008 related to the vacated office space. For the six months ended June 30, 2010 and 2009, the Company recorded a write-off of leasehold improvements of \$599 and \$497, respectively. The charges for the write-off of leasehold improvements were included in “Other underwriting expenses” incurred in the 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.

**7. 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.

	<b>Six Months Ended</b>	
	<b>June 30</b>	
	<b>2010</b>	<b>2009</b>
Income taxes computed on loss before provision for federal and foreign income taxes, at the statutory rate	\$ (119,069)	\$ (314,579)
Tax effect of:		
Tax-exempt interest	(6,575)	(9,696)
Change in valuation allowance	126,656	323,737
Other, net	(1,061)	(5,306)
Provision for federal and foreign income taxes	<u>\$ (49)</u>	<u>\$ (5,844)</u>

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**7. Federal Income Taxes (continued)**

The composition of total tax expense for the six months ended June 30, 2010 and 2009 is as follows:

	<b>Six Months Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Current:		
Federal	\$       —	\$ (6,068)
Foreign	(49)	224
	(49)	(5,844)
Federal income tax on net capital gains	—	—
Federal and foreign income tax expense	<u>\$       (49)</u>	<u>\$     (5,844)</u>

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

	<b>Six Months Ended June 30</b>	
	<b>2010</b>	<b>2009</b>
Increase in net deferred income tax assets	\$       —	\$ 323,737
Increase in deferred tax liabilities	—	—
Change in net deferred income taxes	<u>\$       —</u>	<u>\$ 323,737</u>

As of June 30, 2010, the Company had a domestic net operating loss carryforward of \$3,943,108 for tax purposes, which will be available to offset future taxable income. If not used, the carryforward will start expiring in 2027 through 2029 depending on the originating year.

FGIC's ability to utilize these losses could be limited; however, if an "ownership change" under Section 382 of the Internal Revenue Code ("Section 382") were to occur. Section 382 limits the ability of a corporation that experiences an ownership change to utilize its net operating loss carryforwards ("NOLs") and certain built-in losses after the ownership change. An ownership change is generally any change in ownership of more than 50 percentage points of a corporation's stock over a rolling 3-year period. Generally under Section 382, upon an ownership change, the amount of taxable income that a corporation can offset by its "pre-change losses" (which include its NOLs) is restricted to an annual amount equal to the equity value of the corporation prior to the ownership change multiplied by the long-term tax-exempt rate.

Notwithstanding Section 382's restriction on a corporation's use of NOLs, Section 382 provides significant relief to a corporation if an ownership change occurs in the context of a Chapter 11 case.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**7. Federal Income Taxes (continued)**

Specifically, section 382(l)(5) of the Code provides that a corporation under the jurisdiction of a court in a Chapter 11 case is not subject to the general limitations imposed by Section 382 if historic stockholders and/or the corporation's "qualified creditors" own at least 50% of the total value and voting power of the corporation's stock after the ownership change occurs (the "Section 382(l)(5) Exception").

FGIC anticipates that it will experience an ownership change when its parent FGIC Corp. emerges from bankruptcy. This ownership change will occur because it is expected that the existing equity in FGIC Corp. will be eliminated and creditors of FGIC Corp. will acquire its equity, thereby changing the ultimate beneficial owners of FGIC. While FGIC expects that it will qualify for the Section 382(l)(5) Exception, this result is not certain because certain factors are beyond FGIC's control and because the legal application of the Section 382(l)(5) Exception to a situation where the parent is in a Chapter 11 case and the subsidiary, which generated most of the NOLs, is not in a Chapter 11 case is somewhat ambiguous.

Should FGIC experience an ownership change for purposes of Section 382 and not qualify for the Section 382(l)(5) Exception, FGIC's ability to utilize its NOLs will be subject to an annual limitation in the future, which could have a material adverse impact on FGIC's Surplus Restoration Plan, result in a material increase in FGIC's U.S. federal income tax liability and materially reduce cash available.

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 June 30, 2010, 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  
(Unaudited) (continued)

June 30, 2010  
(Dollars in thousands)

**7. Federal Income Taxes (continued)**

In accordance with SSAP 10R, the Company evaluates its deferred income tax asset to determine if valuation allowances are required. SSAP 10R 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 \$1,433,632 as of June 30, 2010. 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>June 30, 2010</b>	December 31, 2009
Deferred tax assets:		
Ordinary income	<b>\$ 1,412,762</b>	\$ 1,287,716
Capital gains	<b>21,543</b>	21,547
Gross deferred tax asset	<b>1,434,305</b>	1,309,263
Valuation allowance	<b>(1,433,632)</b>	(1,306,976)
Adjusted deferred tax asset	<b>673</b>	2,287
Nonadmitted adjusted deferred tax asset	–	–
Total admitted gross deferred tax asset	<b>673</b>	2,287
Deferred tax liabilities:		
Ordinary income	<b>(1)</b>	(558)
Capital gains	<b>(672)</b>	(1,729)
Total gross deferred tax liability	<b>(673)</b>	(2,287)
Net admitted deferred tax asset	<b>\$ –</b>	\$ –

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**7. Federal Income Taxes (continued)**

The tax effects of temporary differences that give rise to significant portions of the net deferred tax asset at June 30, 2010 and December 31, 2009 are presented below by tax component:

	<b>June 30, 2010</b>	December 31, 2009
Deferred tax assets:		
Premiums revenue recognition	\$ 16,048	\$ 14,684
Nonadmitted assets	5,466	5,786
Net operating loss carryforward	1,380,088	1,255,950
Impairment losses on investments	21,543	21,547
Deferred compensation	2,476	4,287
Other	8,684	7,009
Gross deferred tax asset	<u>1,434,305</u>	<u>1,309,263</u>
Valuation allowance	(1,433,632)	(1,306,976)
Adjusted deferred tax asset	<u>673</u>	<u>2,287</u>
Nonadmitted adjusted deferred tax asset	—	—
Total admitted gross deferred tax asset	<u>673</u>	<u>2,287</u>
Deferred tax liabilities:		
Foreign currency	—	(1,615)
Discount on bonds	(352)	(352)
Other	(321)	(320)
Total gross deferred tax liability	<u>(673)</u>	<u>(2,287)</u>
Net admitted deferred tax asset	<u>\$ —</u>	<u>\$ —</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.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**8. Loss and Loss Adjustment Expense Reserves**

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

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Net balance at beginning of period	\$ 2,608,747	\$ 2,083,426
Incurred related to:		
Current year	7,920	454,592
Prior years	441,723	1,350,934
Total incurred	<u>449,643</u>	<u>1,805,526</u>
Paid related to:		
Current year	-	(115,337)
Prior years	(3,607)	(1,164,868)
Total paid	<u>(3,606)</u>	<u>(1,280,205)</u>
Net balance at end of period	<u>\$ 3,054,783</u>	<u>\$ 2,608,747</u>

Reserves for incurred losses and LAE attributable to the insured bond portfolio have increased to \$3,054,783 at June 30, 2010 from \$2,608,747 at December 31, 2009. The net loss and loss adjustment expense activity was mainly attributable to incurred losses for financial guaranty obligations covering RMBS partially offset by a reduction in reserves associated with certain CDS transactions referencing ABS CDOs, which were among the CDS transactions with Société Générale that were terminated by FGIC Credit Products LLC as described in Note 9. Reserves at June 30, 2010 relate predominantly to RMBS transactions net of anticipated recoveries on claims previously paid.

As of June 30, 2010, the Company has received, but as a result of the NYID Order, has not paid \$865,039 in claims which is included in "Losses" on the Balance Sheet.

The Company recorded an incurred loss, net of reinsurance, of \$809 and \$1,219 on its guarantees of sewer revenue warrants issued by Jefferson County, Alabama ("Jefferson County guarantees") for the three and six months ended June 30, 2010 respectively. The Company recorded an incurred loss, net of reinsurance, of \$54,774 and \$54,857 on its Jefferson County guarantees for the three and six months ended June 30, 2009 respectively. For the three and six months ended June 30, 2010, the Company paid claims, net of reinsurance, of \$0 on the Jefferson County guarantees. For the three and six months ended June 30, 2009, the Company paid claims, net of reinsurance, of \$24,014 and \$72,047 on the Jefferson County guarantees. At June 30, 2010 and December 31, 2009 loss reserves, net of reinsurance, was \$32,241 and \$30,175, 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

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**8. Loss and Loss Adjustment Expense Reserves (continued)**

differences between estimated and actual results may be material. At December 31, 2009, the net principal outstanding on the Jefferson County guarantees was \$1,174,290.

The Company incurred loss adjustment expenses, net of reinsurance, of \$41 and \$212 on the Jefferson County guarantees for the three and six months ended June 30, 2010, respectively. The Company incurred loss adjustment expenses, net of reinsurance, of (\$1,036) and \$665 on the Jefferson County guarantees for the three and six months ended June 30, 2009, respectively. For the three and six months ended June 30, 2010, the Company paid loss adjustment expenses, net of reinsurance, of \$27 and \$217 on the Jefferson County guarantees. For the three and six months ended June 30, 2009, the Company paid loss adjustment expenses, net of reinsurance, of \$1,273 and \$2,197 on the Jefferson County guarantees. At June 30, 2010 and June 30, 2009, the liability for loss adjustment expenses, net of reinsurance, was \$847 and \$852, 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 June 30, 2010 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 June 30, 2010, 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. The Company's loss and loss adjustment expense reserves at June 30, 2010 reflect the impact of settlements reached prior to the issuance date of the financial statements; however it does not reflect the potential impact, if any, of additional ongoing commutation, settlement and restructuring efforts by the Company. 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  
(Unaudited) (continued)

June 30, 2010  
(Dollars in thousands)

**8. Loss and Loss Adjustment Expense Reserves (continued)**

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

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

**Risk Category 1 – Performing Credits**

Transactions are performing with no expectation of loss. Financial strength of the transaction would enable it to withstand volatility in performance without risk of non-payment on timely debt service. Transactions are 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 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.

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**8. Loss and Loss Adjustment Expense Reserves (continued)**

The following table is a breakdown, as of June 30, 2010, of the Company's portfolio of insured financial obligations by risk category 4.

	<u>Risk Category 4</u>
Number of policies	139
Remaining weighted-average contract period (in years)	26
Insured contractual payments outstanding:	
Principal	\$ 17,429,820
Interest	3,784,976
Total	<u>\$ 21,214,796</u>
Gross loss reserves	\$ 7,336,943
Less:	
Gross projected recoveries	(1,914,649)
Discount, net	(2,051,168)
Gross loss reserves, net of discount	<u>\$ 3,371,126</u>
Unearned premiums	<u>\$ 15,189</u>
Reinsurance recoverable on paid losses reported in the balance sheet	<u>\$ 737</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 \$2,460 and \$5,878 for the three and six months ended June 30, 2010, respectively. Loss adjustment expenses incurred, excluding reinsurance, were (\$1,253) and \$2,985 for the three and six months ended June 30, 2009, respectively. These expenses are incurred for loss mitigation activity. The liability for loss adjustment expenses, excluding reinsurance, was \$12,818 and \$11,352 at June 30, 2010 and December 31, 2009, respectively, for the claim mitigation activity. The liability for loss adjustment expenses, net of reinsurance, was \$12,553 and \$11,067 at June 30, 2010 and December 31, 2009, respectively, for the claim mitigation activity.

## Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

#### **8. Loss and Loss Adjustment Expense Reserves (continued)**

“Other Invested Assets” includes FGIC insured securities in the amount of \$22,630 and \$25,375 as of June 30, 2010 and December 31, 2009, 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.

#### **9. Legal Proceedings**

FGIC and several other bond insurers have been named as defendants in three lawsuits filed by the following groups of California municipalities and entities: (i) County of Alameda; City and County of San Francisco; City of Los Angeles; Los Angeles Department of Water and Power; Los Angeles World Airports; City of Oakland; City of Richmond; Redwood City; East Bay Municipal Utility District; City of Sacramento; Sacramento Suburban Water District; Sacramento Municipal Utility District; City of San Jose; County of San Mateo; City of Stockton; County of Tulare; and The Regents of the University of California (the “Alameda Complaint”); (ii) Contra Costa County; City of Riverside; The Redevelopment Agency of the City of Riverside; and The Public Financing Authority of the City of Riverside (the “Contra Costa Complaint”) and (iii) The Jewish Community Center of San Francisco; County of San Mateo; The Redevelopment Agency of San Jose; Sacramento Suburban Water District; and East Bay Municipal Utility District (the “JCCSF Complaint”). The plaintiffs make similar allegations, including (i) that FGIC and the other bond insurer defendants colluded with the credit rating agencies (Moody’s Investors Service, Standard & Poor’s Ratings Services and Fitch Ratings, Inc. (the “Rating Agencies”)) to perpetuate a “dual rating system” used by the Rating Agencies, pursuant to which they 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 bond insurer 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. The Contra Costa Complaint and the JCCSF Complaint name the Rating Agencies as defendants as well; the Alameda Complaint does not. These cases have been coordinated as the *Ambac Bond Insurance Cases* in San Francisco Superior Court. FGIC has also received a “proposed” amended complaint that would add FGIC as a defendant to an action previously brought by The Olympic Club against other bond insurers and the Rating Agencies (the “Proposed Olympic Club Complaint”). The Proposed Olympic Club Complaint raises similar allegations concerning collusion to perpetuate the dual rating system.

FGIC, MBIA, Inc. and Ambac Financial Group, Inc. have been named as defendants in a lawsuit filed by the City of Phoenix, Arizona, in the federal court for the District of Arizona. The complaint asserts causes of action based principally on the defendants’ alleged violations of Arizona insurance law prohibiting unfair discrimination in the rate or amount of premium charged.

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*

## Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

#### 9. Legal Proceedings (continued)

and *City Council of Baltimore v. Wachovia Bank N.A. et al.*, and *Central Bucks School District v. Wachovia Bank, N.A. et al.*, on behalf of all state, local and municipal government entities that purchased municipal guaranteed investment contracts (“GICs”) or derivative products from FGIC or the other defendants in the period from January 1, 1992 through December 31, 2006. The complaints were filed in federal court and allege, *inter alia*, various violations of federal antitrust laws by FGIC and other defendants in connection with the offering and sale of municipal GICs and derivative products (the “Lead Cases”). FGIC was also named as a defendant, along with a number of other financial institutions and parties which also have been named as defendants, in four other similar actions filed in federal court, *City of Oakland, California v. AIG Financial Products Corp. et al.*, *City of Fresno, California v. AIG Financial Products Corp. et al.*, *County of Alameda, California v. AIG Financial Products Corp. et al.*, and *Fresno County Financing Authority v. AIG Financial Products Corp. et al.* (the “AIG Actions”). The Judicial Panel on Multidistrict Litigation issued an order transferring the Lead Cases and the AIG Actions to the Southern District of New York under the caption *In re Municipal Derivatives Antitrust Litigation* for coordinated or consolidated pretrial proceedings. FGIC entered into tolling agreements with the plaintiffs in the Lead Cases in February 2009 and the AIG Actions in April 2009, pursuant to which FGIC was dismissed without prejudice as a defendant in the Lead Cases and the AIG Actions, respectively. The West Virginia Attorney General, which had previously filed a lawsuit in connection with its investigation of bidding practices in the market for municipal GICs and derivative products, amended its complaint in June 2010 to add FGIC and other parties as defendants. The complaint had previously been consolidated with the Lead Cases and the AIG Actions referred to above for coordinated or consolidated pretrial proceedings in the U.S. District Court for the Southern District of New York.

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 purportedly 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 most recent amended complaint alleges, among other things, that the bond insurers have failed to make payments on outstanding debt as contracted and were

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

June 30, 2010  
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**9. Legal Proceedings (continued)**

undercapitalized, contributing to the debt owed by class members. The plaintiffs seek rescission of the bonds and a declaration “that payments pursuant to all contracts for insurance and reinsurance be honored and payment thereunder be used for the use and benefit of the rate payers to the Jefferson County sewer system.” FGIC’s motion to dismiss the complaint for lack of standing 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. 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. In June 2009, the federal district court judge abstained from appointing a receiver and indicated that such matters should be heard in state court. In March 2010, by agreement of the parties, the court dismissed the remaining claims made by FGIC and the counterclaims against FGIC, without prejudice.

On January 13, 2010, FGIC Credit Products LLC (“Credit Products”) terminated CDS transactions with respect to more than \$3.5 billion in notional amount of reference obligations which were outstanding under the ISDA Master Agreement dated July 14, 2005 (the “SG Master Agreement”) between Credit Products and Société Générale on account of Société Générale’s failure to pay certain amounts as required by the terms of such CDS transactions. At that time Credit Products had honored all obligations that it was required to honor, and owed no amounts to Société Générale, pursuant to the terms of the transaction. On January 20, 2010, Société Générale filed a complaint against FGIC and Credit Products in the federal court for the Southern District of New York, alleging breach of contract and requesting a declaratory judgment finding that Credit Products’ termination of such CDS transactions was ineffective. On February 4, 2010, Société Générale filed an amended complaint, adding the allegation that FGIC, as credit support provider for Credit Products, had repudiated its obligations under the related insurance policies, resulting in an “Insurer Default” under the SG Master Agreement, which would permit Société Générale to receive a settlement amount based on market values of the CDS transactions. On February 22, 2010, Société Générale filed a second amended complaint, adding allegations that FGIC is liable to Société Générale for the causes of action brought against Credit Products because FGIC is Credit Products’ “alter ego”, or alternatively that FGIC had tortiously interfered with the SG Master Agreement and related CDS transactions. On March 17, 2010, FGIC and Credit Products filed a motion to dismiss all of Société Générale’s claims. On April 9, 2010, Société Générale filed its opposition to such motion to dismiss. On April 23, 2010, FGIC and Credit Products filed their reply to Société Générale’s opposition. On February 4, 2010, Société Générale also gave FGIC and Credit Products notice of its purported designation of an early termination date, which purportedly would require a mark-to-market termination payment from Credit Products, in respect of such CDS transactions, which Société Générale alleges were in effect at such time (but which FGIC and Credit Products claim have been terminated due to the default by Société Générale). On March 2, 2010, Société Générale gave FGIC and Credit Products notice of its early termination payment calculation, which purportedly would require a mark-to-market termination payment from Credit Products in the aggregate amount of approximately \$1.477 billion with respect to such

Financial Guaranty Insurance Company

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

June 30, 2010  
(Dollars in thousands)

**9. Legal Proceedings (continued)**

disputed CDS transactions. Credit Products has notified Société Générale that no “Insurer Default” has occurred and that Société Générale is not entitled to designate an early termination date. By Notices of Nonpayment dated March 5, 2010, Société Générale submitted to FGIC claims under the various FGIC policies in the aggregate amount of approximately \$1.477 billion based on Credit Products’ purported nonpayment of the disputed mark-to-market termination payments. FGIC has notified Société Générale that at no time has FGIC repudiated or disavowed its obligations under its policies, that Société Générale’s purported termination of the CDS transactions on the basis of a supposed repudiation by FGIC was ineffective, that no amounts are due to Société Générale under the CDS transactions, and as a result Société Générale’s claims under the FGIC policies are improper. As a result of the termination of such CDS transactions by Credit Products as described above, FGIC significantly reduced its related loss reserves as of June 30, 2010 but, as required by statutory accounting practices applicable to insurance disputes and related litigation, has not eliminated such reserves.

FGIC has been named as a defendant in an action brought by the Los Angeles County Museum of Art, in which plaintiff alleges, inter alia, that it incurred increased interest costs in respect of its FGIC-insured auction rate 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.

FGIC has been named in a lawsuit filed in January 2009 by the Louisiana Stadium and Exposition District (“LSED”) alleging, among other things, fraud, misrepresentation and breach of contract concerning FGIC’s failure to disclose the risks associated with exposure to the subprime market and failure to disclose the risk of a downgrade of FGIC’s ratings in connection with LSED’s issuance of auction rate securities. In May 2010, the court granted FGIC’s motion to dismiss all causes of action brought by LSED. LSED has appealed that decision.

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 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. FGIC is seeking to settle the dispute as part of the other loss remediation transactions contemplated by the Surplus Restoration Plan.

A reinsurer has filed for arbitration to resolve certain disputes relating to certain reinsurance agreements with FGIC, including those (i) challenging certain risks ceded by FGIC to the reinsurer and (ii) seeking to rescind or reform those cessions, and to restructure certain loss mitigation transactions undertaken by FGIC.

Countrywide Home Loans, Inc. (together with its predecessors and successors in interest, “Countrywide”) and certain of its affiliates filed a petition in the New York Supreme Court on March 24, 2010 pursuant to

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

June 30, 2010  
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**9. Legal Proceedings (continued)**

Article 78 of the New York Civil Practice Law and Rules, naming both the NYID and FGIC as respondents, in which Countrywide requests the court, among other things, to declare null and void, and annul, the NYID Order and order FGIC to immediately re-commence payment of claims alleging, among other things, that the NYID does not have authority to issue any such order. The NYID and FGIC are required to file their responses to the petition by October 29, 2010.

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 18 other states removing FGIC from these investigations.

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

In addition, FGIC is involved from time to time in various routine legal proceedings.

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. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources away from implementing loss mitigation efforts that are vital to FGIC's ability to continue as a going concern.

In addition to the lawsuits described above, FGIC has asserted, and from time to time may assert, claims in legal or arbitration proceedings against third parties to recover losses already incurred by FGIC or to mitigate future losses that FGIC may incur. The amount of losses that FGIC may recover or mitigate as a

Financial Guaranty Insurance Company

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

June 30, 2010  
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**9. Legal Proceedings (continued)**

result of these proceedings is uncertain, although, in the event of favorable outcomes or settlements, such amount could be material to FGIC's results of operations, financial position, profitability or cash flows.

FGIC and FGIC UK Ltd. filed a complaint against IKB Deutsche Industriebank AG ("IKB") and others in December 2009 in the commercial court in London, England seeking to recover damages caused to FGIC and FGIC UK Ltd. through a fraudulent scheme devised and perpetrated by IKB, which induced FGIC UK Ltd. to enter into a commitment agreement to provide financial guarantees to Havenrock II Limited, a special purpose vehicle created by IKB covering up to \$1.875 billion of losses on a \$2.5 billion reference portfolio of ABS. Previously, FGIC filed suit in the New York Supreme Court, seeking recovery of damages and rescission of the commitment agreement, and IKB filed a suit in Dusseldorf, Germany seeking a declaratory judgment; both of those suits were subsequently withdrawn in favor of the current action in London.

Radian Assurance Inc. ("Radian") has filed suit against Deutsche Bank National Trust Company ("DBNTC") and others, including FGIC and Indymac Bank F.S.B. ("IMB"), in the United States District Court for the Eastern District of Pennsylvania (the "EDPA Court"), seeking the rescission of a mortgage pool insurance policy (the "Pool Policy") that was issued by Radian in favor of DBNTC as trustee of Home Equity Mortgage Loan Asset-Backed Trust, Series INDS 2006-2B (as well as other pool policies as to which FGIC has no interest, which were issued by Radian in other IMB securitizations). The FDIC was appointed as receiver for IMB and conservator for Indymac Federal Bank, F.S.B. and, as receiver and conservator, was substituted for IMB as a party in the above-mentioned action. In March 2009, FGIC filed a request for arbitration against Radian, seeking to have Radian make payments under the Pool Policy. The EDPA Court generally stayed further action in the litigation pending the resolution of the arbitration, and Radian then asserted its rescission of the policy claim in the arbitration. Should FGIC prevail in arbitration and any further proceedings in the EDPA Court, FGIC could recover damages of as much as approximately \$29 million plus interest. The arbitration hearing is scheduled to begin in November 2010.

In December 2009, FGIC filed a suit in the New York Supreme Court against Countrywide alleging fraud and negligent misrepresentation by Countrywide and its affiliates in the origination of several RMBS transactions that closed in 2006 and 2007, and breach of contract in connection with Countrywide's failure to repurchase certain mortgage loans as provided by the operational agreements for those RMBS transactions, as well as a number of other RMBS transactions that closed in the period from 2004 to 2005 (the "Countrywide Litigation"). FGIC's complaint in the Countrywide Litigation alleges damages to FGIC in excess of \$1 billion. In February 2010, Countrywide filed a motion to dismiss certain of FGIC's claims in its initial complaint. On April 30, 2010, FGIC filed an amended complaint adding Countrywide Financial Corp., Countrywide Securities Corporation, Countrywide Bank, FSB, and Bank of America Corporation as defendants.

On June 15, 2010, Countrywide's motion to dismiss was generally denied by the court, but granted with respect to FGIC's claims based on negligent misrepresentation and the breach of the covenant of good

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

June 30, 2010  
*(Dollars in thousands)*

**9. Legal Proceedings (continued)**

faith. On August 6, 2010, Countrywide filed a notice of appeal with respect to that portion of the court's order denying Countrywide's motion to dismiss certain FGIC claims.