

STATUTORY-BASIS FINANCIAL STATEMENTS

Financial Guaranty Insurance Company
September 30, 2011

Financial Guaranty Insurance Company

Statutory-Basis Financial Statements

September 30, 2011

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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)

	September 30, 2011	December 31, 2010
	<i>(Unaudited)</i>	
Admitted assets		
Fixed maturity securities, available for sale at amortized cost (fair value of \$1,085,403 in 2011 and \$577,259 in 2010)	\$ 1,018,809	\$ 541,754
Preferred stock (fair value of \$6,770 in 2011 and \$7,347 in 2010)	3,713	3,713
Other invested assets	24,167	26,301
Short-term investments, at cost, which approximates fair value	993,486	1,297,861
Cash and cash equivalents	1,753	14,360
Total cash and invested assets	<u>2,041,928</u>	<u>1,883,989</u>
Accrued investment income	13,180	7,351
Other assets	3,873	5,958
Receivable from parent and subsidiaries	574	1,625
Total admitted assets	<u>\$ 2,059,555</u>	<u>\$ 1,898,923</u>
Liabilities and capital and surplus		
Liabilities:		
Losses	\$ 5,071,499	\$ 3,497,355
Loss adjustment expenses	45,093	44,202
Reinsurance payable on paid losses	-	749
Unearned premiums	176,995	230,701
Provision for reinsurance	-	17,772
Contingency reserves	403,339	321,148
Accounts payable and accrued expenses	11,026	11,286
Payable for securities	28,839	-
Foreign income tax payable	894	933
Ceded balances payable	422	1,860
Total liabilities	<u>5,738,107</u>	<u>4,126,006</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	439,881
Unassigned deficit	(4,433,433)	(2,981,964)
Total capital and deficit	<u>(3,678,552)</u>	<u>(2,227,083)</u>
Total liabilities and capital and deficit	<u>\$ 2,059,555</u>	<u>\$ 1,898,923</u>

See accompanying notes.

Financial Guaranty Insurance Company

Statutory-Basis Statements of Operations
(Unaudited)

(Dollars in Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Premiums earned	\$ 18,467	\$ 23,298	\$ 111,776	\$ 75,014
Losses incurred	(940,833)	40,562	(1,482,300)	(403,534)
Loss adjustment expenses incurred	(6,998)	(39,842)	(19,319)	(45,389)
Other underwriting expenses incurred	(11,023)	(16,742)	(35,296)	(49,355)
Ceding commission income (expense)	261	501	(2,915)	1,635
Underwriting (loss) gain	(940,126)	7,777	(1,428,054)	(421,629)
Net investment income	10,606	8,380	26,414	37,455
Net realized (losses) gains capital, net of tax of \$0, for the three and nine months ended September 30, 2011 and 2010	(1,733)	659	(3,540)	52,325
Net investment gain	8,873	9,039	22,874	89,780
Other income	4,288	4,930	16,167	13,399
(Loss) gain after capital (losses) gains and before all other federal and foreign income taxes	(926,965)	21,746	(1,389,013)	(318,450)
Federal and foreign income tax expense (benefit)	109	(310)	402	(359)
Net (loss) gain	\$ (927,074)	\$ 22,055	\$ (1,389,415)	\$ (318,091)
Capital and Surplus				
Deficit as regards policyholders, beginning of period	\$ (2,728,031)	\$ (1,686,868)	\$ (2,227,083)	\$ (1,281,420)
Net (loss) gain	(927,074)	22,055	(1,389,415)	(318,091)
Changes in net unrealized capital gains (losses)	-	1,747	(16,314)	2,940
Change in net unrealized foreign exchange	(1,764)	4,001	1,862	(5,881)
Change in non admitted	93	(2,670)	16,817	11,357
Change in provision for reinsurance	2,604	1,800	17,772	3,173
Paid in surplus adjustments	-	-	-	329
Increase in contingency reserve	(24,380)	(40,410)	(82,191)	(112,752)
Change in deficit as regards policyholders	(950,521)	(13,477)	(1,451,469)	(418,925)
Deficit as regards policyholders as of statement date	\$ (3,678,552)	\$ (1,700,345)	\$ (3,678,552)	\$ (1,700,345)

See accompanying notes.

Financial Guaranty Insurance Company

Statutory-Basis Statements of Cash Flows
(Unaudited)

(Dollars in Thousands)

	Nine Months Ended	
	September 30,	
	2011	2010
Operations		
Premiums collected, net of reinsurance	\$ 58,123	\$ 62,253
Losses and loss adjustment expenses recoveries (paid)	73,416	(6,268)
Underwriting expenses paid	(38,996)	(53,773)
Ceding commission received	899	1,635
Net investment income received	21,641	47,202
Other income	16,575	13,399
Federal and foreign income tax (payments) refunds	(440)	27,985
Net cash provided by operations	131,218	92,433
Investment activities		
Proceeds from sales, maturities, or repayments of investments:		
Bonds and Stocks	55,091	771,909
Other invested assets	2,134	54,395
Total investment proceeds	57,225	826,304
Cost of investments acquired:		
Bonds	503,278	751
Other invested assets	3,198	175
Total investments acquired	506,476	926
Net cash (used) provided by investment activities	(449,251)	825,378
Financing and miscellaneous activities		
Other cash provided (applied):		
Capital and surplus paid in	-	329
Other cash provided (applied)	1,051	(1,001)
Total other cash provided (applied)	1,051	(672)
Net (decrease) increase in cash, cash equivalents and short-term investments	(316,982)	917,139
Cash, cash equivalents and short-term investments:		
Beginning of year	1,312,221	366,176
End of period	\$ 995,239	\$ 1,283,315

See accompanying notes.

Financial Guaranty Insurance Company

Notes to Statutory-Basis Financial Statements (Unaudited)

September 30, 2011
(Dollars in Thousands)

1. Organization and Background

Financial Guaranty Insurance Company, 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 September 30, 2011 and December 31, 2010, affiliates of the Blackstone Group L.P., the Cypress Group L.L.C. and CIVC Partners L.P. owned approximately 39.5%, 39.5% and 12% of FGIC Corp.’s common stock, respectively. As of September 30, 2011 and December 31, 2010, an affiliate of General Electric Capital Corp. owned 2,346 shares, or 100%, of FGIC Corp.’s senior participating mandatorily convertible modified preferred stock, and approximately 7.7% of FGIC Corp.’s outstanding common stock.

2. Recent Developments

Since the fourth quarter of 2007, the Company has incurred significant losses on its policies relating to certain residential mortgage-backed securities (“RMBS”) and to certain collateralized debt obligations of asset-backed securities (“ABS CDOs”) backed primarily by subprime RMBS, which 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 \$3,678,552 as of September 30, 2011. Under the 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. Given such policyholders’ surplus deficit, (i) New York’s Superintendent of Financial Services could seek court appointment as rehabilitator or liquidator of FGIC at any time or (ii) in the exercise of its fiduciary duties, the FGIC Board of Directors (the “FGIC Board”) may request the Superintendent to seek, and in such event it is likely that the Superintendent would seek, such court appointment.

As of October 3, 2011, the functions and authority of (i) the New York State Insurance Department were transferred to the New York State Department of Financial Services and (ii) New York’s Superintendent of Insurance were transferred to New York’s Superintendent of Financial Services. References in these notes to (i) the “Department” shall refer to the New York State Insurance Department or the New York State Department of Financial Services and (ii) to the “Superintendent” shall refer to New York’s Superintendent of Insurance or New York’s Superintendent of Financial Services, in each case as the context shall require.

Financial Guaranty Insurance Company

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

September 30, 2011
(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. 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).

On November 24, 2009, the Department 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 Department order (as modified by the Supplemental Order Pursuant to Insurance Law §1310 dated March 25, 2010) is referred to herein as the “1310 Order”. The 1310 Order also directed FGIC to submit a plan to the Superintendent to eliminate the impairment of FGIC’s policyholders’ surplus by January 5, 2010. The 1310 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 1310 Order does not limit in any way the Superintendent’s ability to seek rehabilitation or liquidation of FGIC at any time.

FGIC formulated a comprehensive restructuring plan to fulfill the requirements set forth in the 1310 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 Department 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 Department acknowledged that FGIC would continue its efforts to effectuate the amended and restated Surplus Restoration Plan and the transactions contemplated therein or attendant thereto on March 25, 2010.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

2. Recent Developments (continued)

The Surplus Restoration Plan included 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 ("Sharps") 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 that had been contemplated by certain agreements with the counterparties to certain of such CDS and related transactions.

FGIC reached definitive agreements or agreements in principle with certain CDS counterparties or other policy beneficiaries to effectuate the loss mitigation transactions described in clauses (ii) and (iii) of the preceding paragraph (the "Other Restructuring Transactions"). However, the Other Restructuring Transactions were conditioned upon, among other things, the successful closing of the Offer.

On October 25, 2010, Sharps announced that it did not receive sufficient participation from eligible holders in the Offer to satisfy the conditions necessary to complete the Offer. The Offer was not extended beyond the October 22, 2010 expiration date. Consequently, the Offer terminated in accordance with its terms, and none of the eligible FGIC-insured securities tendered under the Offer were accepted. As a result, the conditions for successfully effectuating the Surplus Restoration Plan have not been satisfied. Furthermore, since the Offer did not successfully close, the agreements relating to the Other Restructuring Transactions either terminated in accordance with their terms or have conditions to closing that can not be satisfied.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

2. Recent Developments (continued)

Since September 2010, as a consequence of the inability to gain the necessary level of participation in the Offer, FGIC has been engaged in discussions with the Department and starting in November 2010, the steering committee for an advisory group of policyholders regarding potential alternative surplus restoration plans to restore FGIC's statutory surplus and to restructure FGIC in a manner that is fair and equitable to its policyholders and other creditors. Recent alternative surplus restoration plan discussions have focused on, among other things, restoring FGIC to statutory solvency through a rehabilitation proceeding, and FGIC has also been engaged in discussions with counsel for the New York Liquidation Bureau and the financial advisor retained by such counsel regarding such a potential plan since May 2011 and September 2011, respectively (such plan and any other alternative surplus restoration plan that may be developed are referred to collectively as the "Alternative Surplus Restoration Plan"). FGIC has also been engaged in discussions with CDS counterparties to negotiate new or amended agreements regarding certain Other Restructuring Transactions, which would be included in, and would be completed as part of and subject to the successful effectuation of, the Alternative Surplus Restoration Plan. The Alternative Surplus Restoration Plan, if successfully effectuated, would be expected to restore FGIC to statutory solvency and to provide for (i) FGIC's policy obligations to be modified in a manner that is fair and equitable to its policyholders, (ii) the moratorium on the payment of claims pursuant to the 1310 Order to be lifted and (iii) FGIC to execute a run-off of its business in which it will be obligated to pay its policy and other obligations as modified by, and strictly in the manner and priority provided for under, the Alternative Surplus Restoration Plan. See Note 3 for a description of the risks and uncertainties relating to the Alternative 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"). On September 7, 2010, an official committee of unsecured creditors was appointed. None of the subsidiaries or affiliates of FGIC Corp., including FGIC, are subject to the Chapter 11 Case.

On the Petition Date, FGIC Corp. 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. FGIC Corp. has not yet asked the Bankruptcy Court to approve the Disclosure Statement and, therefore, FGIC Corp. has not yet submitted the Reorganization Plan to its creditors for a vote. See Note 3 for a description of the risks and uncertainties for FGIC relating to the Chapter 11 Case.

Financial Guaranty Insurance Company

Notes to Statutory-Basis Financial Statements
(Unaudited)

September 30, 2011
(Dollars in Thousands)

2. Recent Developments (continued)

On June 30, 2011, FGIC and FGIC UK Ltd. entered into a Deed of Termination pursuant to which they mutually agreed to terminate the Reinsurance Agreement dated March 31, 2004 and the Excess of Loss Reinsurance Agreement dated March 31, 2004 under which FGIC had provided reinsurance on financial guarantees or policies written by FGIC UK Ltd., and to release each other from all present and future claims and liabilities under or in connection with such agreements. Pursuant to the Deed of Termination, FGIC was relieved of its reinsurance obligations in respect of approximately \$8.0 billion of par exposure and was permitted to retain 100% of all premiums (net of ceding commissions) previously paid to FGIC. As a result, FGIC recognized premiums of approximately \$51 million in June 2011, which amount is included in "Premiums Earned" in the Statement of Operations for the nine months ended September 30, 2011.

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

As of September 30, 2011, FGIC continues to report a deficit in policyholders' surplus and to be out of compliance with the \$66,400 minimum policyholders' surplus requirement under the Insurance Law (and in the absence of a successful effectuation of the Alternative Surplus Restoration Plan, FGIC will continue to report such a deficit and non-compliance). As a result, (i) the Superintendent could seek court appointment as rehabilitator or liquidator of FGIC at any time or (ii) in the exercise of its fiduciary duties, the FGIC Board may request the Superintendent to seek, and in such event it is likely that the Superintendent would seek, such court appointment. There can be no assurance that, in connection with any such appointment, the Superintendent would seek to effectuate the Alternative Surplus Restoration Plan. Any such appointment of the Superintendent as rehabilitator or liquidator of FGIC could have a material adverse impact on FGIC's business, results of operations and financial condition.

There can be no assurance that (i) an agreement will be reached on the terms of the Alternative Surplus Restoration Plan or the transactions that are intended to form part of the Alternative Surplus Restoration Plan, (ii) the Alternative Surplus Restoration Plan and the transactions contemplated thereby will receive all required regulatory and judicial approvals, or (iii) the transactions contemplated by the Alternative Surplus Restoration Plan will be consummated or the Alternative Surplus Restoration Plan will otherwise be successfully effectuated. Even if the Alternative Surplus Restoration Plan were to be successfully effectuated, there can be no assurances provided regarding the Company's future financial condition or possible future

Financial Guaranty Insurance Company

Notes to Statutory-Basis Financial Statements
(Unaudited)

September 30, 2011
(Dollars in Thousands)

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

intervention by the Department. 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 September 30, 2011 and December 31, 2010 and for the nine months ended September 30, 2011 and 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.

In addition, the Company continues to be materially exposed to certain other 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, 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, including 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 and timing of a loss on a guaranteed obligation and any related expected recoveries. 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 housing and mortgage market conditions. Small changes in assumptions underlying these

Financial Guaranty Insurance Company

Notes to Statutory-Basis Financial Statements
(Unaudited)

September 30, 2011
(Dollars in Thousands)

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

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 counterparties the right to require mark-to-market termination payments under the CDS, which payments are guaranteed by FGIC, following any payment default by FGIC under the policy guaranteeing the CDS or following the occurrence of certain events that are outside FGIC's control. Specifically, it would be an event of default under certain of the CDS contracts insured by FGIC if FGIC is insolvent within the meaning of the CDS contracts and under most of such CDS contracts if FGIC should be placed into rehabilitation or liquidation by the Superintendent. 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, 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 other policies may trigger an event of default under such CDS contracts. 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.). If FGIC were able to consummate the Other Restructuring Transactions as part of a successful effectuation of the Alternative Surplus Restoration Plan, this would mitigate existing exposure FGIC or FGIC UK Ltd. may have to pay claims based on mark-to-market termination payments with respect to the subject CDS contracts as a result of events that have occurred or may occur prior to such consummation, including, without limitation, events relating to the 1310 Order or, if applicable, a FGIC rehabilitation or liquidation proceeding. If such Other Restructuring 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,

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

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

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 if or when claim payments by FGIC will recommence or whether due and unpaid amounts under FGIC's policies will ever 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 in cash of due and unpaid amounts under its policies (as well as, among other things, any appointment of the Superintendent as rehabilitator or liquidator of FGIC) could have a number of material adverse consequences, including, but not limited to, (i) litigation for breach of contract and various other 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, 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 in cash of due and unpaid amounts under its policies. FGIC has received notices from trustees on the underlying trusts in certain transactions asserting 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 September 30, 2011, FGIC is prohibited by the Insurance Law from paying dividends on its common stock or preferred stock. Even if the Alternative Surplus Restoration Plan were to be successfully effectuated, FGIC would not be permitted to pay dividends or other distributions on its common stock or preferred stock.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

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

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 FGIC as a whole, with resulting management and policy changes, and increased scrutiny by the Department 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 anticipated ownership change in bankruptcy, FGIC's NOLs (as defined in Note 7 below) would not be protected by the 382(l)(5) exception and would be severely limited following such 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 Corp. 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 change of control at FGIC Corp. and correspondingly, FGIC, could create instability and general uncertainty regarding FGIC as a whole, with resulting management and policy changes, including FGIC's use of its NOLs, and increased scrutiny by the Department and FGIC's stakeholders, which could lead the Superintendent to commence rehabilitation or liquidation proceedings. Further, under the 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

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

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

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 nine months ended September 30, 2011, are not necessarily indicative of results that may be expected for the year ending December 31, 2011. These unaudited interim financial statements should be read in conjunction with the audited Statutory-Basis Financial Statements for the year ended December 31, 2010, including the accompanying notes.

Certain reclassifications have been made to the corresponding period in prior year's Statement of Operations and Statement of Cash Flows to conform to the 2011 presentation.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

5. Investments

The amortized cost and fair value of admitted investments in bonds, preferred stock and short-term investments are as follows:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
September 30, 2011				
Obligations of states and political subdivisions	\$ 501,496	\$ 35,499	\$ —	\$ 536,995
Asset- and mortgage- backed securities	336,099	16,529	—	352,628
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	41,017	10,153	—	51,170
Debt securities issued by foreign governments	18,887	171	—	19,058
Corporate	121,310	4,242	—	125,552
Total bonds	1,018,809	66,594	—	1,085,403
Preferred stock	3,713	3,057	—	6,770
Short-term investments	993,486	15	(71)	993,430
Total	\$ 2,016,008	\$ 69,666	\$ (71)	\$ 2,085,603

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

5. Investments (continued)

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
December 31, 2010				
Obligations of states and political subdivisions	\$ 331,884	\$ 13,683	\$ —	\$ 345,567
Asset- and mortgage-backed securities	129,981	14,850	—	144,831
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	46,688	4,677	—	51,365
Debt securities issued by foreign governments	7,815	259	—	8,074
Corporate	25,386	2,036	—	27,422
Total bonds	541,754	35,505	—	577,259
Preferred stock	3,713	3,634	—	7,347
Short-term investments	1,297,861	4	—	1,297,865
Total	\$ 1,843,328	\$ 39,143	\$ —	\$ 1,882,471

The carrying values of the Company's investment in the equity of its subsidiaries were \$210 and \$16,089 at September 30, 2011 and December 31, 2010, respectively. Included in the change in net unrealized gains or losses for the nine months ended September 30, 2011 and 2010 were losses of \$16,314 and gains of \$2,940, respectively, related to the change in carrying values of the Company's investments in its subsidiaries. Investment in the equity of its subsidiaries was non-admitted due to the Company's surplus deficit.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

5. Investments (continued)

Prior to 2010, 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. The Company recorded other-than-temporary impairment losses of \$1,738 and \$3,545 on its fixed income securities for the three and nine months ended September 30, 2011, respectively. The Company recorded other-than-temporary impairment losses of \$167 and \$502 on its fixed income securities for the three and nine months ended September 30, 2010, respectively. These 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. Net realized capital gains or losses, net of tax, for the three and nine months ended September 30, 2010, includes \$602 and \$5,857, respectively, of a realized gain related to cash received on a cash equivalent previously impaired.

The amortized cost and fair value of the investment portfolio at September 30, 2011, 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.

	Amortized Cost	Fair Value
Due in one year	\$ 19,450	\$ 19,919
Due after one through five years	174,533	182,278
Due after five years through ten years	263,348	275,517
Due after ten years	225,379	255,061
Asset- and mortgage-backed securities	336,099	352,628
Total	<u>\$ 1,018,809</u>	<u>\$ 1,085,403</u>

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

5. Investments (continued)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Income from bonds	\$ 8,778	\$ 7,359	\$ 23,637	\$ 36,473
Income from preferred stocks	40	213	122	636
Income from cash, cash equivalents and short-term investments	2,269	1,130	4,023	1,916
Total investment income	11,087	8,702	27,782	39,025
Investment expenses	(481)	(322)	(1,368)	(1,570)
Net investment income	\$ 10,606	\$ 8,380	\$ 26,414	\$ 37,455

For both the three and nine months ended September 30, 2011, proceeds from sales of investment in bonds carried at amortized cost were \$10,492. For the three and nine months ended September 30, 2010, proceeds from sales of investments in bonds carried at amortized cost were \$1,796 and \$749,867, respectively. For both the three and nine months ended September 31, 2011, gross realized gains of \$6 and gross realized losses of \$0 were realized on such sales. For the three and nine months ended September 30, 2010, gross realized gains of \$234 and \$46,649, respectively, and gross realized losses of \$0 and \$0, respectively, were realized on such sales.

Investments in bonds carried at amortized cost of \$23,789 and \$23,334 as of September 30, 2011 and December 31, 2010, respectively, were on deposit with various regulatory authorities, as required by law.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

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 Company did not incur additional expense during the nine months ended September 30, 2011 and 2010, in relation to a further work force reduction. 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. For the nine months ended September 30, 2010 \$2,917 of involuntary termination benefits was paid. The Company paid all of the balance as of 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. 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 related to the remaining one-third of unused office space. The liability is recorded as a component of “Accounts payable and accrued expenses” on the Balance Sheet at September 30, 2011 and the corresponding expense is recorded in “Other underwriting expenses incurred” in the Statements of Operations. For the nine months ended September 30, 2011 and 2010, the Company incurred additional expense of \$666 and \$737, respectively, as it increased the liability due to adjustments to estimated net cash flows. 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 nine months ended September 30, 2010, the Company recorded a further write-off of leasehold improvements of \$899. The charges for the write-off of leasehold improvements were included in “Other underwriting expenses incurred” in the Statements of Operations.

Amounts incurred in connection with developing and seeking to effectuate the Surplus Restoration Plan and the Alternative Surplus Restoration Plan have been and will continue to be expensed as incurred.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

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 FGIC is determined under a tax sharing agreement approved by FGIC Corp.'s and FGIC's Board and the Department, and is based upon separate return calculations.

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.

	Nine Months Ended September 30,	
	2011	2010
Income tax benefits computed on loss before provision for federal and foreign income taxes, at the statutory rate	\$(486,154)	\$ (111,458)
Tax effect of:		
Tax-exempt interest	(4,271)	(7,856)
Change in valuation allowance	490,198	120,508
Other, net	629	(1,553)
Expense (benefit) provision for federal and foreign income taxes	\$ 402	\$ (359)

The composition of total tax expense (benefit) for the nine months ended September 30, 2011 and 2010 is as follows:

	Nine Months Ended September 30,	
	2011	2010
Current:		
Federal	\$ (556)	\$ (401)
Foreign	958	42
Federal and foreign income tax expense (benefit)	\$ 402	\$ (359)

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

7. Federal Income Taxes (continued)

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

	Nine Months Ended	
	September 30,	
	2011	2010
Increase in net deferred income tax assets	\$ —	\$ —
(Increase) in deferred tax liabilities	—	—
Change in net deferred income taxes	<u>\$ —</u>	<u>\$ —</u>

As of September 30, 2011, the Company had a domestic net operating loss (“NOL”) carryforward of \$5,475,660 for federal income tax purposes, which will be available (subject to the limitations discussed below) to offset future taxable income. If not used, the NOL will start expiring in 2027 through 2031 depending on the originating year.

FGIC’s ability to utilize its NOLs will be limited 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 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 immediately prior to the ownership change multiplied by the long-term tax-exempt rate.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

7. Federal Income Taxes (continued)

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. 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"). However, 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. Further, 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 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 the equity of reorganized FGIC Corp., thereby changing the ultimate beneficial owners of FGIC. While FGIC Corp. and FGIC expect that they will qualify for the Section 382(l)(5) Exception, this result is not certain because certain factors are beyond FGIC's control. 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 result in a material increase in FGIC's U.S. federal income tax liability and materially reduce cash available.

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)

September 30, 2011
(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 \$2,085,853 as of September 30, 2011. 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:

	September 30, 2011	December 31, 2010
Deferred tax assets:		
Ordinary income	\$ 2,074,922	\$ 1,583,078
Capital losses	13,018	14,176
Gross deferred tax asset	2,087,940	1,597,254
Valuation allowance	(2,085,853)	(1,595,852)
Adjusted deferred tax asset	2,087	1,402
Nonadmitted adjusted deferred tax asset	–	–
Total admitted gross deferred tax asset	2,087	1,402
Deferred tax liabilities:		
Ordinary income	(987)	(499)
Capital gains	(1,100)	(903)
Total gross deferred tax liability	(2,087)	(1,402)
Net admitted deferred tax asset	\$ –	\$ –

Financial Guaranty Insurance Company

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

September 30, 2011
(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 September 30, 2011 and December 31, 2010 are presented below by tax component:

	September 30, 2011	December 31, 2010
Deferred tax assets:		
Premiums revenue recognition	\$ 14,963	\$ 15,995
Net operating loss carryforward	1,916,481	1,554,006
Impairment losses on investments	12,632	13,893
Losses – salvage and subrogation recoverable	125,816	–
Other	18,048	13,360
Gross deferred tax asset	<u>2,087,940</u>	<u>1,597,254</u>
Valuation allowance	(2,085,853)	(1,595,852)
Adjusted deferred tax asset	<u>2,087</u>	<u>1,402</u>
Nonadmitted adjusted deferred tax asset	–	–
Total admitted gross deferred tax asset	<u>2,087</u>	<u>1,402</u>
Deferred tax liabilities:		
Foreign currency	985	(787)
Other	1,102	(615)
Total gross deferred tax liability	<u>2,087</u>	<u>(1,402)</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, 2007 and 2008. The examinations (tax years 2005 – 2008) were completed in the first quarter of 2011. Upon completion of the audit, \$556 previously accrued for potential interest payments was released.

Financial Guaranty Insurance Company

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

September 30, 2011
(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:

	September 30, 2011	December 31, 2010
Net balance at beginning of period	\$ 3,541,557	\$ 2,608,747
Incurred related to:		
Current year	117,829	(3,080)
Prior years	1,383,790	946,202
Total incurred	<u>1,501,619</u>	<u>943,122</u>
Recovery/(Paid) related to:		
Current year	-	-
Prior years	73,416	(10,312)
Total recovery/(paid)	<u>73,416</u>	<u>(10,312)</u>
Net balance at end of period	<u>\$ 5,116,592</u>	<u>\$ 3,541,557</u>

Reserves for incurred losses and LAE attributable to the insured bond portfolio have increased to \$5,116,592 at September 30, 2011 from \$3,541,557 at December 31, 2010. The increase in net loss was mainly attributable to a change in the interest rate assumptions used to project future interest liabilities and receipts with respect to the CDOs, together with a decrease in the statutory discount rate. Losses and loss adjustment expense reserves were discounted at 2.63% and 3.45% at September 30, 2011 and December, 31 2010, respectively. Losses and loss adjustment expense reserves at September 30, 2011, relate predominantly to RMBS and CDO transactions net of anticipated recoveries.

As of September 30, 2011, the Company has received, but as a result of the 1310 Order, has not paid \$1,764,819 in claims which is included in "Losses" on the Balance Sheet.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

8. Loss and Loss Adjustment Expense Reserves (continued)

The Company recorded an incurred loss, net of reinsurance, of \$47,651 and \$51,795 on its guarantees of sewer revenue warrants issued by Jefferson County, Alabama (“Jefferson County guarantees”) for the three and nine months ended September 30, 2011, respectively. At September 30, 2011 and December 31, 2010, the loss reserve, net of reinsurance, was \$86,132 and \$34,578, respectively. The estimated incurred losses were necessarily based upon estimates and subjective judgments about the outcomes of future events, including the County’s Chapter 9 bankruptcy filing on November 9, 2011. The incurred losses will be adjusted as additional information becomes available and differences between estimated and actual results may be material. At September 30, 2011, the net principal outstanding on the Jefferson County guarantees was \$1,171,129.

FGIC’s liability in RMBS, ABS and other 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 September 30, 2011, 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 September 30, 2011, 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 reserve reflect the impact of transactions closed prior to the issuance date of the financial statements; however it does not reflect the potential impact, if any, of additional ongoing commutation,

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

8. Loss and Loss Adjustment Expense Reserves (continued)

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.

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.

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

8. Loss and Loss Adjustment Expense Reserves (continued)

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.

The following table is a breakdown, as of September 30, 2011, of the Company's portfolio of insured financial obligations in risk category 4.

	Risk Category 4
Number of policies	151
Remaining weighted-average contract period (in years)	26
Insured contractual payments outstanding:	
Principal	\$ 16,126,755
Interest	3,188,276
Total	\$ 19,315,031
Gross loss reserves	\$ 8,940,477
Less:	
Gross projected recoveries	(1,396,396)
Discount, net	(2,043,349)
Gross loss reserves, net of discount	\$ 5,500,732
Unearned premiums	\$ 14,525
Reinsurance recoverable on paid losses reported in the balance sheet	\$ 91

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

8. Loss and Loss Adjustment Expense Reserves (continued)

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

Loss adjustment expenses incurred, excluding reinsurance, were \$(43,325) and \$(29,876) for the three and nine months ended September 30, 2011, respectively. Loss adjustment expenses incurred, excluding reinsurance, were \$40,484 and \$46,362 for the three and nine months ended September 30, 2010, respectively. The loss adjustment expenses for the nine months ended September 30, 2011 and 2010 relate primarily to projected litigation on certain RMBS transactions (see Note 9). The incurred expenses for the quarter were offset by settlement recoveries. The liability for loss adjustment expenses, net of reinsurance, was \$45,093 and \$44,202 at September 30, 2011 and December 31, 2010, respectively.

"Other Invested Assets" includes FGIC insured securities in the amount of \$23,845 and \$25,990 at September 30, 2011 and December 31, 2010, respectively and is reflected at 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

Starting in July 2008, FGIC and various other bond insurers (and/or their affiliates) have been named as defendants in a series of individual and/or consolidated complaints filed by the following California governmental and non-profit entities: (i) County of Alameda; City and County of San Francisco; City of Los Angeles; Los Angeles Department of Water and Power; The 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; City of Stockton; The Redevelopment Agency of the City of Stockton; The Public Financing Authority of the City of Stockton; County of Tulare; The Regents of the University of California; and The Redevelopment Agency of the City of San Jose (claims currently alleged in the Second Amended Consolidated Complaint filed

Financial Guaranty Insurance Company

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

September 30, 2011
(Dollars in Thousands)

9. Legal Proceedings (continued)

August 23, 2011, in *County of Alameda et al. v. Ambac Financial Group, Inc., et al.* (the “Alameda Complaint”)); (ii) Contra Costa County; City of Riverside; The Redevelopment Agency of the City of Riverside; The Public Financing Authority of the City of Riverside; County of San Mateo; and The Jewish Community Center of San Francisco (“JCCSF”) (claims currently alleged in the Third Amended Consolidated Complaint filed October 21, 2011, in *Contra Costa County, et al. v. Ambac Financial Group, Inc., et al.* (the “Contra Costa Complaint”)) and (iii) The Olympic Club (claims currently alleged in the Fourth Amended Complaint filed October 21, 2011, in *The Olympic Club v. Ambac Financial Group, Inc., et al.* (the “Olympic Club Complaint”)). Plaintiffs JCCSF, County of San Mateo, The Redevelopment Agency of San Jose, Sacramento Suburban Water District and East Bay Municipal Utility District are also plaintiffs in *The Jewish Community Center of San Francisco, et al. v. Ambac Financial Group, Inc., et al.* (the “JCCSF Complaint”), though their claims are now alleged in the Alameda or Contra Costa Complaints as well. The Contra Costa Complaint, the JCCSF Complaint and the Olympic Club Complaint name the Rating Agencies (as defined below) as defendants as well; the Alameda Complaint does not. The Contra Costa Complaint, the Alameda Complaint and the JCCSF Complaint have been deemed part of a California state court coordination proceeding titled the *Ambac Bond Insurance Cases* in San Francisco Superior Court. The Olympic Club Complaint is not formally part of the coordination proceeding but is functionally coordinated with the *Ambac Bond Insurance Cases*.

In these actions, the plaintiffs make similar allegations that FGIC and the other bond insurer defendants (i) colluded with the credit rating agencies (Moody’s Investors Service, Inc., 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, in violation of the Cartwright Act (California’s antitrust statute) and (ii) engaged in unfair business practices in connection with the alleged Cartwright Act violations. In addition, plaintiffs whose bonds were insured by a bond insurer defendant also allege against such bond insurer with respect to such bond issues (a) breach of contract under the California Insurance Code for failure to disclose the extent of its exposure to RMBS and collateralized debt obligations (“CDOs”), and (b) the fraudulent failure to disclose the extent of its exposure to RMBS and CDOs, including whether it met capital adequacy requirements set by the Rating Agencies. The four plaintiffs whose bonds were insured by FGIC have brought such claims against FGIC. In July 2011, following a hearing, the defendants’ demurrers were sustained as to certain claims but they were overruled as to the claims described in clauses (i), (ii) and (a) above, and the plaintiffs were allowed to re-plead the claims described in clause (b) above. FGIC and the other bond insurer defendants filed demurrers to these re-pled claims, which were heard and overruled on October 20, 2011.

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

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(Dollars in Thousands)

9. Legal Proceedings (continued)

In *City of Phoenix v. Ambac Financial Group, Inc., et al.* (United States District Court, District of Arizona, filed on or about March 11, 2010), FGIC, MBIA Insurance Corporation, and Ambac Assurance Corporation are named as defendants in a lawsuit in which the plaintiff 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 filed an answer to the complaint in May 2010 and discovery is proceeding.

FGIC was named as a defendant, along with a number of other financial institutions and parties, in five purported class actions, *Hinds County, Mississippi v. Wachovia Bank N.A. et al.*, *Fairfax County, Virginia et al. v. Wachovia Bank N.A. et al.*, *Washington County, Tennessee v. Bank of America, N.A. et al.*, *Mayor and City Council of Baltimore v. Wachovia Bank N.A. et al.*, and *Central Bucks School District v. Wachovia Bank, N.A. et al.*, on behalf of all state, local and municipal government entities that purchased municipal guaranteed investment contracts ("GICs") or derivative products from FGIC or the other defendants in the period from January 1, 1992 through December 31, 2006. The complaints were filed in federal court and allege, *inter alia*, various violations of federal antitrust laws by FGIC and other defendants in connection with the offering and sale of municipal GICs and derivative products (the "Lead Cases"). FGIC was also named as a defendant, along with a number of other financial institutions and parties which also have been named as defendants, in four other similar actions filed in federal court, *City of Oakland, California v. AIG Financial Products Corp. et al.*, *City of Fresno, California v. AIG Financial Products Corp. et al.*, *County of Alameda, California v. AIG Financial Products Corp. et al.*, and *Fresno County Financing Authority v. AIG Financial Products Corp. et al.* (the "AIG Actions"). The Judicial Panel on Multidistrict Litigation issued an order transferring the Lead Cases and the AIG Actions to the Southern District of New York under the caption *In re Municipal Derivatives Antitrust Litigation* (MDL Docket No. 1950) 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. The West Virginia Attorney General (the "WVAG"), 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 August 2010, FGIC filed its motion to dismiss the complaint. In October 2010, the WVAG filed its opposition motion and FGIC filed its reply. On April 29, 2011, the court dismissed the WVAG's complaint against FGIC with prejudice.

Financial Guaranty Insurance Company

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

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9. Legal Proceedings (continued)

In addition, FGIC was named as a defendant, along with a number of other financial institutions and parties, in lawsuits filed in California state court by the Cities of Los Angeles, Stockton and San Diego, California and the Counties of San Mateo and Contra Costa, California (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.

In *Wilson v. JP Morgan Chase & Co., et al.* (Circuit Court of Jefferson County, Alabama, filed on or about June 17, 2008), FGIC and a number of other defendants were 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, refinanced certain fixed-rate debt with a combination of variable rate and auction rate securities that were hedged by interest rate swaps. These transactions, the complaint alleges, were purportedly done to facilitate the payment of fees to several bond brokers and financial advisors that in turn were paid to certain County officials. With respect to the bond insurers, including FGIC, the most recent amended complaint alleges, *inter alia*, that the bond insurers were undercapitalized and failed to make payments to certain bondholders in the wake of the County’s default on the bonds. 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 and the other defendants’ motions to dismiss the complaint for lack of standing were denied in January 2011. On February 24, 2011, FGIC and the other defendants filed petitions with the Alabama Supreme Court for a writ of mandamus to reverse that ruling.

In *The Bank of New York Mellon, et al. v. Jefferson County, Alabama, et al.* (United States District Court for the Northern District of Alabama, filed on or about September 17, 2008), 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

Financial Guaranty Insurance Company

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

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9. Legal Proceedings (continued)

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 U.S. District Court for the Southern District of New York (*Société Générale v. Financial Guaranty Insurance Co., et al.*, 10 Civ. 0472 (NRB)), 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 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

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

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9. Legal Proceedings (continued)

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 December 31, 2010 but, as required by statutory accounting practices applicable to insurance disputes and related litigation, has not eliminated such reserves.

On July 7, 2011, Société Générale, Credit Products and FGIC entered into a Settlement and Commutation Agreement (the "Settlement Agreement") in connection with the litigation described above. The Settlement Agreement provides for, among other things, the settlement of such litigation, the termination of the subject CDS transactions and the related FGIC policies and the mutual release of FGIC, Credit Products and Société Générale from all related claims and liability in consideration of a cash commutation payment by FGIC to Société Générale, subject in each case to, among other conditions, approval by the Department or applicable judicial approval of such settlement, termination and release. If these conditions are not satisfied prior to May 31, 2012, Société Générale will have the option to terminate the Settlement Agreement. On July 11, 2011, based on a joint stipulation filed by the parties, the court dismissed the above litigation without prejudice to the parties' ability to refile the action should the Settlement Agreement be terminated.

In *Museum Associates, dba Los Angeles County Museum of Art v. Financial Guaranty Insurance Co.* (United States District Court for the Central District of California, filed on or about November 4, 2008), 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. The case has been stayed voluntarily by the parties until February 15, 2012 with the court's approval.

In *Louisiana Stadium and Exposition District v. Financial Guaranty Insurance Co. (In re Merrill Lynch Auction Rate Securities Litigation)*, No. 09 MD 2030 (LAP) (S.D.N.Y.) (originally filed in the United States District Court for the Eastern District of Louisiana and in the Civil District Court for the Parish of Orleans, Louisiana on February 22, 2009 and February 29, 2009, respectively, and then removed and transferred to the S.D.N.Y. as part of a multidistrict

Financial Guaranty Insurance Company

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

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9. Legal Proceedings (continued)

litigation) and now pending on appeal as *Louisiana Stadium & Exposition District v. Financial Guaranty Insurance Co.*, No. 10-2030-cv (2d Cir.), plaintiff alleges, inter alia, fraud, misrepresentation and breach of contract concerning FGIC's failure to disclose the risks associated with its exposure to the subprime mortgage market and failure to disclose the risk of a downgrade of FGIC's ratings in connection with plaintiff's issuance of auction rate securities. In May 2010, the court granted with prejudice FGIC's motion to dismiss all causes of action. The plaintiff has appealed that decision, which appeal has been briefed and argued.

In April 2009, a monoline insurance company (the "Ceding Company") from which FGIC has assumed certain risks under a facultative reinsurance agreement 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 million 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 million 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. The arbitration panel remains in place, but the parties have informally agreed to a stay of the proceedings.

In *Countrywide Home Loans, Inc., et al. v. Financial Guaranty Insurance Co., et al.* (N.Y. Supreme Court, Index No. 103872/2010, filed on March 24, 2010), Countrywide Home Loans, Inc. (together with its predecessors and successors in interest, "Countrywide") and certain of its affiliates filed a petition pursuant to Article 78 of the New York Civil Practice Law and Rules, naming the Department, the Superintendent and FGIC as respondents, seeking (i) to declare null and void the 1310 Order and (ii) to order FGIC to immediately re-commence payment of claims. In *Countrywide Home Loans, Inc., et al. v. Financial Guaranty Insurance Co.* (N.Y. Supreme Court, Index No. 600757/10, filed on March 24, 2010), Countrywide sued FGIC for breach of contract and breach of the duty of good faith and fair dealing. On July 25, 2011, FGIC, Countrywide and the Department filed with the court a stipulation removing the Article 78 proceeding from the court's calendar, with leave to make application to the court to restore the case to its calendar. No filings by FGIC or the Department will be due unless the case is restored to the calendar.

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

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9. Legal Proceedings (continued)

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. By letter dated November 3, 2011, the Connecticut Attorney General informed FGIC that it had concluded its investigation into municipal bond rating practices. 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 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.

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9. Legal Proceedings (continued)

In *Financial Guaranty Insurance Co. v. IKB Deutsche Industriebank AG* (2009 Folio 1532, filed on or about December 14, 2009), FGIC and FGIC UK Ltd. filed a complaint against IKB Deutsche Industriebank AG (“IKB”) and others in the High Court of Justice, Queen’s Bench Division, Commercial Court, in London, England (the “London Action”), seeking to recover damages caused to FGIC and FGIC UK through a fraudulent scheme devised and perpetrated by IKB, which induced FGIC UK 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. Discovery and related matters are proceeding. In September 2011, a settlement agreement was signed and effectuated by FGIC, FGIC UK Ltd., IKB and others, pursuant to which, among other things, the London Action was dismissed.

In *Financial Guaranty Insurance Co. v. Countrywide Home Loans, Inc.* (N.Y. Supreme Court, Index No. 650736/2009, filed on December 11, 2009) (the “Countrywide Litigation”), FGIC sued 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. 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 (“BAC”) 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 faith. On August 6, 2010, Countrywide filed with the Appellate Division, First Department of the New York Supreme Court a notice of appeal with respect to that portion of the court’s order denying Countrywide’s motion to dismiss certain FGIC claims. On August 13, 2010, FGIC filed with the Appellate Division a cross-appeal with respect to that portion of the court’s order dismissing FGIC’s claims based on negligent misrepresentation and the breach of the covenant of good faith. On October 20, 2011, FGIC and Countrywide jointly filed a stipulation withdrawing the appeal and the cross-appeal.

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9. Legal Proceedings (continued)

On June 3, 2011, BAC filed a motion for the severance of FGIC's successor liability claim against BAC from FGIC's other claims in this case, and the consolidation of the successor liability claim with similar claims that currently form parts of three other cases brought by bond insurance companies against Countrywide and BAC. On October 31, 2011, the court denied BAC's motion insofar as it applied to discovery, but held in abeyance the motion insofar as it applies to trial of the successor liability claim, until final submission of summary judgment motions on the successor liability claim in FGIC's or any of the other bond insurance companies' cases. On November 3, 2011, BAC filed a notice of appeal of the court's decision to the Appellate Division of the N.Y. Supreme Court. On November 7, 2011, BAC moved for, and the Appellate Division granted, a temporary stay of discovery on the successor liability claim.