ASSURED GUARANTY LTD
Form 10-Q
August 03, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
ý QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2017
Or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition Period from to
Commission File No. 001-32141
ASSURED GUARANTY LTD.
(Exact name of registrant as specified in its charter)

Bermuda	98-0429991
(State or other jurisdiction of incorporation)	(I.R.S. employer identification no.)

30 Woodbourne Avenue
Hamilton HM 08
Bermuda
(Address of principal executive offices)
(441) 279-5700
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
The number of registrant's Common Shares ($0.01 par value) outstanding as of August 1, 2017 was 119,055,277 (includes 50,225 unvested restricted shares).

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Assured Guaranty Ltd.

Consolidated Balance Sheets (unaudited)

(dollars in millions except per share and share amounts)

	As of June 30, 2017	As of December 31, 2016
Assets		
Investment portfolio:		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost of $10,018 and $9,974)	$10,505	$ 10,233
Short-term investments, at fair value	678	590
Other invested assets	88	162
Total investment portfolio	11,271	10,985
Cash	200	118
Premiums receivable, net of commissions payable	916	576
Ceded unearned premium reserve	174	206
Deferred acquisition costs	107	106
Reinsurance recoverable on unpaid losses	78	80
Salvage and subrogation recoverable	403	365
Credit derivative assets	6	13
Deferred tax asset, net	391	497
Current income tax receivable	—	12
Financial guaranty variable interest entities’ assets, at fair value	757	876
Other assets	352	317
Total assets	$14,655	$ 14,151
Liabilities and shareholders’ equity		
Unearned premium reserve	$3,748	$ 3,511
Loss and loss adjustment expense reserve	1,268	1,127
Reinsurance balances payable, net	54	64
Long-term debt	1,294	1,306
Credit derivative liabilities	367	402
Current income tax payable	96	—
Financial guaranty variable interest entities’ liabilities with recourse, at fair value	689	807
Financial guaranty variable interest entities’ liabilities without recourse, at fair value	131	151
Other liabilities	258	279
Total liabilities	7,905	7,647
Commitments and contingencies (See Note 14)		
Common stock ($0.01 par value, 500,000,000 shares authorized; 119,668,859 and 127,988,230 shares issued and outstanding)	1	1
Additional paid-in capital	711	1,060
Retained earnings	5,722	5,289
Accumulated other comprehensive income, net of tax of $146 and $70	315	149
Deferred equity compensation	1	5

Total shareholders’ equity	6,750	6,504
Total liabilities and shareholders’ equity	$14,655	$ 14,151

The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statements of Operations (unaudited)

(dollars in millions except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues				
Net earned premiums	$162	$214	$326	$397
Net investment income	101	98	223	197
Net realized investment gains (losses):				
Other-than-temporary impairment losses	(2)	(8)	(3)	(28)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	5	(3)	13	(7)
Net impairment loss	(7)	(5)	(16)	(21)
Other net realized investment gains (losses)	22	15	63	18
Net realized investment gains (losses)	15	10	47	(3)
Net change in fair value of credit derivatives:				
Realized gains (losses) and other settlements	5	24	20	32
Net unrealized gains (losses)	(11)	39	28	(29)
Net change in fair value of credit derivatives	(6)	63	48	3
Fair value gains (losses) on committed capital securities	2	(11)	0	(27)
Fair value gains (losses) on financial guaranty variable interest entities	12	4	22	22
Bargain purchase gain and settlement of pre-existing relationships	—	—	58	—
Other income (loss)	22	18	111	52
Total revenues	308	396	835	641
Expenses				
Loss and loss adjustment expenses	72	102	131	192
Amortization of deferred acquisition costs	4	5	8	9
Interest expense	25	25	49	51
Other operating expenses	57	63	125	123
Total expenses	158	195	313	375
Income (loss) before income taxes	150	201	522	266
Provision (benefit) for income taxes				
Current	(5)	32	46	62
Deferred	2	23	6	(1)
Total provision (benefit) for income taxes	(3)	55	52	61
Net income (loss)	$153	$146	$470	$205
Earnings per share:				
Basic	$1.26	$1.09	$3.81	$1.52
Diluted	$1.24	$1.09	$3.76	$1.51
Dividends per share	$0.1425	$0.13	$0.285	$0.26

The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income (loss)	$153	$146	$470	$205
Unrealized holding gains (losses) arising during the period on:				
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $30, $31, $53 and $62	62	84	106	179
Investments with other-than-temporary impairment, net of tax provision (benefit) of $23, $(3), $51 and $(13)	46	(6)	96	(23)
Unrealized holding gains (losses) arising during the period, net of tax	108	78	202	156
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $5, $4, $26 and $0	9	5	48	(1)
Change in net unrealized gains (losses) on investments	99	73	154	157
Other, net of tax provision	10	(9)	12	(11)
Other comprehensive income (loss)	$109	$64	$166	$146
Comprehensive income (loss)	$262	$210	$636	$351

The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statement of Shareholders' Equity (unaudited)

For the Six Months Ended June 30, 2017

(dollars in millions, except share data)

	Common Shares Outstanding	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Deferred Equity Compensation	Total Shareholders' Equity
Balance at December 31, 2016	127,988,230	$ 1	$ 1,060	$ 5,289	$ 149	$ 5	$ 6,504
Net income	—	—	—	470	—	—	470
Dividends ($0.285 per share)	—	—	—	(36)	—	—	(36)
Common stock repurchases	(8,886,752)	0	(351)	—	—	—	(351)
Share-based compensation and other	567,381	0	2	—	—	(4)	(2)
Other comprehensive income	—	—	—	—	166	—	166
Other	—	—	—	(1)	—	—	(1)
Balance at June 30, 2017	119,668,859	$ 1	$ 711	$ 5,722	$ 315	$ 1	$ 6,750

The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Consolidated Statements of Cash Flows (unaudited)

(in millions)

	Six Months Ended June 30, 2017	2016
Net cash flows provided by (used in) operating activities	$ 198	$ (47)
Investing activities		
Fixed-maturity securities:		
Purchases	(1,143)	(510)
Sales	778	739
Maturities	462	645
Net sales (purchases) of short-term investments	20	(190)
Net proceeds from paydowns on financial guaranty variable interest entities’ assets	81	556
Acquisition of MBIA UK, net of cash acquired (see Note 2)	95	—
Other	68	(12)
Net cash flows provided by (used in) investing activities	361	1,228
Financing activities		
Dividends paid	(36)	(35)
Repurchases of common stock	(351)	(135)
Repurchases of common stock to pay withholding taxes	(12)	(2)
Net paydowns of financial guaranty variable interest entities’ liabilities	(86)	(531)
Repayment/ extinguishment of long-term debt	(6)	(1)
Proceeds from option exercises	3	1
Net cash flows provided by (used in) financing activities	(488)	(703)

Effect of foreign exchange rate changes	3			(3		)
Increase (decrease) in cash and restricted cash	74			475		
Cash and restricted cash at beginning of period (see Note 10)	127			166		
Cash and restricted cash at end of period (see Note 10)	$	201		$	641	
Supplemental cash flow information						
Cash paid (received) during the period for:						
Income taxes	$	(7	)	$	1	
Interest	$	45		$	48	

The accompanying notes are an integral part of these consolidated financial statements.

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Assured Guaranty Ltd.

Notes to Consolidated Financial Statements (unaudited)

June 30, 2017

1. Business and Basis of Presentation

Business

Assured Guaranty Ltd. (AGL and, together with its subsidiaries, Assured Guaranty or the Company) is a Bermuda-based holding company that provides, through its operating subsidiaries, credit protection products to the United States (U.S.) and international public finance (including infrastructure) and structured finance markets. The Company applies its credit underwriting judgment, risk management skills and capital markets experience primarily to offer financial guaranty insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. If an obligor defaults on a scheduled payment due on an obligation, including a scheduled principal or interest payment (debt service), the Company is required under its unconditional and irrevocable financial guaranty to pay the amount of the shortfall to the holder of the obligation. The Company markets its financial guaranty insurance directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. The Company guarantees obligations issued principally in the U.S. and the United Kingdom (U.K.), and also guarantees obligations issued in other countries and regions, including Australia and Western Europe. The Company also provides other forms of insurance that are in line with its risk profile and benefit from its underwriting experience.

In the past, the Company sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives, primarily credit default swaps (CDS). Contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company’s obligation to make loss payments are similar to those for financial guaranty insurance contracts. The Company’s credit derivative transactions are governed by International Swaps and Derivative Association, Inc. (ISDA) documentation. The Company has not entered into any new CDS in order to sell credit protection in the U.S. since the beginning of 2009, when regulatory guidelines were issued that limited the terms under which such protection could be sold. The capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act also contributed to the Company not entering into such new CDS in the U.S. since 2009. The Company actively pursues opportunities to terminate existing CDS, which terminations have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated variable interest entities (VIEs) for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These unaudited interim consolidated financial statements are as of June 30, 2017 and cover the three-month period ended June 30, 2017 (Second Quarter 2017), the three-month period ended June 30, 2016 (Second Quarter 2016), the six-month period ended June 30, 2017 (Six Months 2017) and the six-month period ended June 30, 2016 (Six Months 2016). Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The year-end balance sheet data was derived from audited financial statements, except Note 18, Subsidiary Information, which reflects transfers of businesses between entities within the consolidated group that occurred in the current reporting period consistently for all prior periods presented.

The unaudited interim consolidated financial statements include the accounts of AGL, its direct and indirect subsidiaries (collectively, the Subsidiaries), and its consolidated VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included in AGL’s Annual Report on Form 10-K for the year ended December 31, 2016, filed with the U.S. Securities and Exchange Commission (the SEC).

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The Company's principal insurance company subsidiaries are:

- Assured Guaranty Municipal Corp. (AGM), domiciled in New York;
- Municipal Assurance Corp. (MAC), domiciled in New York;
- Assured Guaranty Corp. (AGC), domiciled in Maryland;
- Assured Guaranty (Europe) plc (AGE), organized in the U.K.; and
- Assured Guaranty Re Ltd. (AG Re) and Assured Guaranty Re Overseas Ltd. (AGRO), domiciled in Bermuda.

The Company’s organizational structure includes various holding companies, two of which - Assured Guaranty U.S. Holdings Inc. (AGUS) and Assured Guaranty Municipal Holdings Inc. (AGMH) - have public debt outstanding. See Note 15, Long-Term Debt and Credit Facilities and Note 18, Subsidiary Information.

The Company is actively working to combine the operations of its European subsidiaries, AGE, Assured Guaranty (UK) plc (AGUK), Assured Guaranty (London) plc (AGLN) and CIFG Europe S.A. (CIFGE), through a multi-step transaction, which ultimately is expected to result in AGUK, AGLN and CIFGE transferring their insurance portfolios to and merging with and into AGE. As a preparatory step for the merger, AGE, AGUK and AGLN were re-registered as public limited companies on June 1, 2017. As a further preparatory step, AGUK, AGLN and CIFGE were sold by AGC to AGM and then contributed by AGM to AGE on June 26, 2017. Note 18, Subsidiary Information, presents the transfer of AGUK, AGLN and CIFGE from AGC to AGM consistently in all prior periods presented. While the Company and its European subsidiaries have received certain regulatory approvals, the combination is subject to further regulatory and court approvals. As a result, the Company cannot predict whether, or when, such combination will be completed.

Adopted Accounting Standards

Statement of Cash Flows

In November 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the Emerging Issues Task Force), which addresses the presentation of changes in restricted cash and restricted cash equivalents in the statement of cash flows with the objective of reducing the existing diversity in practice. Under the ASU, entities are required to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the ASU requires a reconciliation be presented either on the face of the statement of cash flows or in the notes to the financial statements showing the totals in the statement of cash flows to the related captions in the balance sheet. The ASU was adopted on January 1, 2017 and was applied retrospectively. The required reconciliation is shown in Note 10, Investments and Cash.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force), which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. This ASU did not have an effect on the Company’s consolidated statements of cash flows for the periods presented.

Share-Based Payments

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718) - Improvements to Employee Share-Based Payment, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee’s shares than it previously could for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The ASU was adopted January 1, 2017. This ASU did not have a material effect on the consolidated financial statements.

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Future Application of Accounting Standards

Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, Receivables-Nonrefundable Fees and Other Costs (Topic 310-20) - Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. This ASU has no effect on the accounting for purchased callable debt securities held at a discount. ASU 2017-08 is to be applied using a modified retrospective approach through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the effect that this ASU will have on its consolidated financial statements.

Income Taxes

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, which removes the current prohibition against immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. Under the ASU, the selling (transferring) entity is required to recognize a current income tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a deferred tax asset or deferred tax liability, as well as the related deferred tax benefit or expense, upon receipt of the asset. The ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, and early adoption is permitted. The ASU’s amendments are to be applied on a modified retrospective basis recognizing the effects in retained earnings as of the beginning of the year of adoption. The Company does not expect this ASU to have a material effect on its consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires lessees to present right-of-use assets and lease liabilities on the balance sheet. ASU 2016-02 is to be applied using a modified retrospective approach at the beginning of the earliest comparative period in the financial statements. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the effect that this ASU will have on its consolidated financial statements.

Financial Instruments

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU are intended to make targeted improvements to GAAP by addressing certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Under the ASU, certain equity securities will need to be accounted for at fair value with changes in fair value recognized through net income instead of other comprehensive income (OCI). Another amendment pertains to liabilities that an entity has elected to measure at fair value in accordance with the fair value option for financial instruments. For these liabilities, the portion of fair value change related to instrument specific credit risk will be separately presented in OCI as opposed to the income statement. The Company elected the fair value option to account for its consolidated FG VIEs. FG VIE financial liabilities with recourse are sensitive to changes in the Company’s implied credit worthiness and will be impacted by the ASU.

The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the fiscal year in which the guidance is adopted. Early adoption is permitted only for the amendment related to the change in presentation of financial liabilities that are fair valued using the fair value option. The Company does not expect that the amendment related to certain equity securities will have a material effect on its consolidated financial statements.

Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments in this ASU are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will use forward-looking information to better inform their credit loss estimates as a result of the ASU. While many of the loss

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estimation techniques applied today will still be permitted, the inputs to those techniques will change to reflect the full amount of expected credit losses. The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as credit quality and underwriting standards of an organization's portfolio.

In addition, the ASU amends the accounting for credit losses on available-for-sale securities and purchased financial assets with credit deterioration. The ASU also eliminates the concept of "other than temporary" from the impairment model for certain available-for-sale securities. Accordingly, the ASU states that an entity must use an allowance approach, must limit the allowance to an amount at which the security's fair value is less than its amortized cost basis, may not consider the length of time fair value has been less than amortized cost, and may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists. For purchased financial assets with credit deterioration, the ASU requires an entity's method for measuring credit losses to be consistent with its method for measuring expected losses for originated and purchased non-credit-deteriorated assets.

The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For debt securities classified as available-for-sale, entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted. The changes to the impairment model for available-for-sale securities and changes to purchased financial assets with credit deterioration are to be applied prospectively. Early adoption is permitted for fiscal years, and interim periods with those fiscal years, beginning after December 15, 2018. The Company is evaluating the effect that this ASU will have on its consolidated financial statements.

2. Acquisitions

MBIA UK Insurance Limited

On January 10, 2017 (the MBIA UK Acquisition Date), AGC completed its acquisition of MBIA UK Insurance Limited (MBIA UK), the U.K. operating subsidiary of MBIA Insurance Corporation (MBIA) (the MBIA UK Acquisition). As consideration for the outstanding shares of MBIA UK plus $23 million in cash, AGC exchanged all its holdings of notes issued in the Zohar II 2005-1 transaction (Zohar II Notes), which were insured by MBIA. AGC's Zohar II Notes had total outstanding principal of approximately $347 million and fair value of $334 million as of the MBIA UK Acquisition Date. The MBIA UK Acquisition added approximately $12 billion of net par insured on January 10, 2017.

MBIA UK was renamed Assured Guaranty (London) Ltd. and on June 1, 2017, was re-registered as a public limited company. Further, AGLN was sold by AGC to AGM and then contributed by AGM to AGE on June 26, 2017. Refer to Note 1, Business and Basis of Presentation for additional information on the Company's European subsidiaries combination.

The MBIA UK Acquisition was accounted for under the acquisition method of accounting which requires that the assets and liabilities acquired be recorded at fair value. The Company exercised significant judgment to determine the fair value of the assets it acquired and liabilities it assumed in the MBIA UK Acquisition. The most significant of these determinations related to the valuation of MBIA UK's financial guaranty insurance contracts. On an aggregate basis, MBIA UK's contractual premiums for financial guaranty insurance contracts were less than the premiums a market participant of similar credit quality would demand to acquire those contracts on the MBIA UK Acquisition Date, particularly for below-investment-grade (BIG) transactions, resulting in a significant amount of the purchase price being allocated to these contracts. For information on the methodology used to measure the fair value of assets acquired and liabilities assumed in the MBIA UK Acquisition, please refer to Note 7, Fair Value Measurement.

The fair value of the Company's stand-ready obligation on the MBIA UK Acquisition Date is recorded in unearned premium reserve. After the MBIA UK Acquisition Date, loss reserves and loss and loss adjustment expenses (LAE) will be recorded when the expected losses for each contract exceeds the remaining unearned premium reserve, in accordance with the Company's accounting policy described in the Annual Report on Form 10-K. The expected losses acquired by the Company as part of the MBIA UK Acquisition are included in Note 5, Expected Losses to be Paid.

The excess of the fair value of net assets acquired over the consideration transferred was recorded as a bargain purchase gain in "bargain purchase gain and settlement of pre-existing relationships" in net income. In addition, the Company and MBIA UK had pre-existing reinsurance relationships, which were also effectively settled at fair value on the MBIA UK Acquisition Date. The gain on settlement of these pre-existing reinsurance relationships represents the net difference between the historical assumed balances that were recorded by the Company and the fair value of ceded balances acquired from MBIA UK. The Company believes the bargain purchase gain resulted from MBIA's strategy to address its insurance obligations with

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regards to the Zohar II Notes, the issuers of which MBIA did not expect would have sufficient funds to repay such notes in full on the scheduled maturity date of such notes in January 2017.

The following table shows the net effect of the MBIA UK Acquisition, including the effects of the settlement of pre-existing relationships.

	Fair Value of Net Assets Acquired, before Settlement of Pre-existing Relationships	Net effect of Settlement of Pre-existing Relationships	Net Effect of MBIA UK Acquisition
	(in millions)		
Purchase price (1)	$334	$ —	$ 334
Identifiable assets acquired:			
Investments	459	—	459
Cash	72	—	72
Premiums receivable, net of commissions payable	274	(4)	270
Other assets	16	(6)	10
Total assets	821	(10)	811
Liabilities assumed:			
Unearned premium reserves	389	(6)	383
Current tax payable	25	—	25
Other liabilities	4	(5)	(1)
Total liabilities	418	(11)	407
Net assets of MBIA UK	403	1	404
Cash acquired from MBIA Holdings	23	—	23
Deferred tax liability	(36)	—	(36)
Net asset effect of MBIA UK Acquisition	390	1	391
Bargain purchase gain and settlement of pre-existing relationships resulting from MBIA UK Acquisition, after-tax	56	1	57
Deferred tax	—	1	1
Bargain purchase gain and settlement of pre-existing relationships resulting from MBIA UK Acquisition, pre-tax	$56	$ 2	$ 58

(1) The purchase price of $334 million was allocated as follows: (1) $329 million for the purchase of net assets of $385 million, and (2) the settlement of pre-existing relationships between MBIA UK and Assured Guaranty at a fair value of $5 million.

Revenue and net income related to MBIA UK from the MBIA UK Acquisition Date through June 30, 2017 included in the consolidated statement of operations were approximately $149 million and $112 million, respectively, including the bargain purchase gain, settlement of pre-existing relationships, quarterly activity and realized gain on the disposition of AGC's Zohar II Notes. For Second Quarter 2017 and Six Months 2017, the Company recognized transaction expenses related to the MBIA UK Acquisition of $1 million and $7 million, respectively, comprising primarily legal and financial advisors fees.

Unaudited Pro Forma Results of Operations

The following unaudited pro forma information presents the combined results of operations of Assured Guaranty and MBIA UK as if the acquisition had been completed on January 1, 2016, as required under GAAP. The pro forma accounts include the estimated historical results of the Company and MBIA UK and pro forma adjustments primarily comprising the earning of the unearned premium reserve and the expected losses that would be recognized in net income for each prior period presented, as well as the accounting for bargain purchase gain, settlement of pre-existing relationships, the realized gain on the disposition of the Zohar II Notes and MBIA UK acquisition related expenses, all net of tax at the applicable statutory rate.

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The unaudited pro forma combined financial information is presented for illustrative purposes only and does not indicate the financial results of the combined company had the companies actually been combined as of January 1, 2016, nor is it indicative of the results of operations in future periods. The Company did not include any pro forma combined financial information for 2017 as substantially all of MBIA UK's results of operations for 2017 are included in Six Months 2017 consolidated statements of operations.

Unaudited Pro Forma Results of Operations

	Six Months 2016 (in millions, except per share amounts)
Pro forma revenues	$ 775
Pro forma net income	308
Pro forma earnings per share (EPS):	
Basic	2.28
Diluted	2.27

Please refer to Note 2, Acquisitions, in Part II, Item 8. “Financial Statements and Supplementary Data” of AGL’s Annual Report on Form 10-K for the year ended December 31, 2016 for additional information on other recent acquisitions.

3. Ratings

The financial strength ratings (or similar ratings) for the Company’s insurance companies, along with the date of the most recent rating action (or confirmation) by the rating agency, are shown in the table below. Ratings are subject to continuous rating agency review and revision or withdrawal at any time. In addition, the Company periodically assesses the value of each rating assigned to each of its companies, and as a result of such assessment may request that a rating agency add or drop a rating from certain of its companies.

	S&P Global Ratings, a division of Standard & Poor’s Financial Services LLC	Kroll Bond Rating Agency	Moody’s Investors Service, Inc.	A.M. Best Company, Inc.
AGM	AA (stable) (6/26/17)	AA+ (stable) (12/14/16)	A2 (stable) (8/8/16)	—
AGC	AA (stable) (6/26/17)	AA (stable) (9/20/16)	(1)	—
MAC	AA (stable) (6/26/17)	AA+ (stable) (7/14/17)	—	—
AG Re	AA (stable) (6/26/17)	—	—	—
AGRO	AA (stable) (6/26/17)	—	—	A+ (stable) (6/15/17)
AGE	AA (stable) (6/26/17)	—	A2 (stable) (8/8/16)	—
AGUK	AA (stable) (6/26/17)	—	(1)	—
AGLN	BB (positive) (1/12/17)	—	(2)	—
CIFGE	—	—	—	—

(1) AGC requested that Moody’s Investors Service, Inc. (Moody's) withdraw its financial strength ratings of AGC and AGUK in January 2017, but Moody's denied that request. Moody’s continues to rate AGC A3 (stable) and AGUK A3; Moody's put AGUK on review for upgrade on June 27, 2017, following its transfer to AGM.

(2) Assured Guaranty did not request that Moody's rate AGLN. Moody's continues to rate AGLN, and upgraded its rating to Baa2 (stable) on January 13, 2017, following its acquisition by AGC, and then to Baa1 on review for further upgrade on June 27, 2017, following its transfer to AGM.

There can be no assurance that any of the rating agencies will not take negative action on their financial strength ratings of AGL's insurance subsidiaries in the future.

For a discussion of the effects of rating actions on the Company, see Note 6, Contracts Accounted for as Insurance, and Note 13, Reinsurance and Other Monoline Exposures.

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4. Outstanding Exposure

The Company’s financial guaranty contracts are written in either insurance or credit derivative form, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that it views as investment grade at inception, although, as part of its loss mitigation strategy for existing troubled credits, it may underwrite new issuances that it views as BIG. The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, requires rigorous subordination or collateralization requirements. Reinsurance may be used in order to reduce net exposure to certain insured transactions.

Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. The Company also includes within public finance similar obligations issued by territorial and non-U.S. sovereign and sub-sovereign issuers and governmental authorities.

Structured finance obligations insured by the Company are generally issued by special purpose entities, including VIEs, and backed by pools of assets having an ascertainable cash flow or market value or other specialized financial obligations. Some of these VIEs are consolidated as described in Note 9, Consolidated Variable Interest Entities. Unless otherwise specified, the outstanding par and debt service amounts presented in this note include outstanding exposures on VIEs whether or not they are consolidated.

Surveillance Categories

The Company segregates its insured portfolio into investment grade and BIG surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. BIG exposures include all exposures with internal credit ratings below BBB-. The Company’s internal credit ratings are based on internal assessments of the likelihood of default and loss severity in the event of default. Internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies, except that the Company's internal credit ratings focus on future performance rather than lifetime performance.

The Company monitors its investment grade credits to determine whether any need to be internally downgraded to BIG and refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company’s view of the credit’s quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. The Company’s credit ratings on assumed credits are based on the Company’s reviews of low-rated credits or credits in volatile sectors, unless such information is not available, in which case, the ceding company’s credit ratings of the transactions are used.

Credits identified as BIG are subjected to further review to determine the probability of a loss. See Note 5, Expected Loss to be Paid, for additional information. Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a future loss is expected and whether a claim has been paid. For surveillance purposes, the Company calculates present value using a discount rate of 4% or 5% depending on the insurance subsidiary. (Risk-free rates are used for calculating the expected loss for financial statement measurement purposes.)

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The Company expects “future losses” on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims in the future of that transaction than it will have reimbursed. The three BIG categories are:

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected.

- BIG Category 2: Below-investment-grade transactions for which future losses are expected but for which no claims (other than liquidity claims, which are claims that the Company expects to be reimbursed within one year) have yet been paid.

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- BIG Category 3: Below-investment-grade transactions for which future losses are expected and on which claims (other than liquidity claims) have been paid.

Components of Outstanding Exposure

Unless otherwise noted, ratings disclosed herein on the Company's insured portfolio reflect its internal ratings. The Company classifies those portions of risks benefiting from reimbursement obligations collateralized by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating.

The Company purchases securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses (loss mitigation securities). The Company excludes amounts attributable to loss mitigation securities (unless otherwise indicated) from par and debt service outstanding, which amounts are included in the investment portfolio, because it manages such securities as investments and not insurance exposure. As of June 30, 2017 and December 31, 2016, the Company excluded $2.0 billion and $2.1 billion, respectively, of net par related to loss mitigation securities (which are mostly BIG), and other loss mitigation strategies. The following table presents the gross and net debt service for financial guaranty contracts.

Financial Guaranty
Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
	(in millions)			
Public finance	$429,419	$ 425,849	$415,689	$ 409,447
Structured finance	21,000	29,151	20,356	28,088
Total financial guaranty	$450,419	$ 455,000	$436,045	$ 437,535

In addition to amounts shown in the tables above, the Company had outstanding commitments to provide guaranties of $14 million for structured finance and $461 million for public finance obligations as of June 30, 2017. The expiration dates for the public finance commitments range between July 1, 2017 and September 1, 2017, with $191 million expiring prior to the date of this filing. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

Financial Guaranty Portfolio by Internal Rating
As of June 30, 2017

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S		Structured Finance Non-U.S		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
	(dollars in millions)									
AAA	$1,709	0.7 %	$2,212	5.5 %	$4,364	27.9 %	$768	38.1 %	$9,053	3.1 %
AA	38,894	16.7	206	0.5	5,294	33.8	76	3.8	44,470	15.3
A	129,869	55.9	13,065	32.2	1,732	11.1	275	13.7	144,941	49.9
BBB	54,804	23.6	22,905	56.5	712	4.5	734	36.4	79,155	27.2

BIG	7,142	3.1	2,145	5.3	3,553	22.7	161	8.0	13,001	4.5
Total net par outstanding (1)	$232,418	100.0%	$40,533	100.0%	$15,655	100.0 %	$2,014	100.0 %	$290,620	100.0%

(1) The June 30, 2017 amounts include $12.7 billion of net par from the MBIA UK Acquisition.

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Financial Guaranty Portfolio by Internal Rating
As of December 31, 2016

Rating Category	Public Finance U.S. Net Par Outstanding	%	Public Finance Non-U.S. Net Par Outstanding	%	Structured Finance U.S Net Par Outstanding	%	Structured Finance Non-U.S Net Par Outstanding	%	Total Net Par Outstanding	%
	(dollars in millions)									
AAA	$2,066	0.8 %	$2,221	8.4 %	$9,757	44.2 %	$1,447	47.0 %	$15,491	5.2 %
AA	46,420	19.0	170	0.6	5,773	26.2	127	4.1	52,490	17.7
A	133,829	54.7	6,270	23.8	1,589	7.2	456	14.8	142,144	48.0
BBB	55,103	22.5	16,378	62.1	879	4.0	759	24.6	73,119	24.7
BIG	7,380	3.0	1,342	5.1	4,059	18.4	293	9.5	13,074	4.4
Total net par outstanding	$244,798	100.0%	$26,381	100.0%	$22,057	100.0 %	$3,082	100.0 %	$296,318	100.0%

Components of BIG Portfolio

Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of June 30, 2017

	BIG Net Par Outstanding BIG 1	BIG 2	BIG 3	Total BIG	Net Par Outstanding
			(in millions)		
Public finance:					
U.S. public finance	$2,392	$662	$ 4,088	$ 7,142	$ 232,418
Non-U.S. public finance	1,872	273	—	2,145	40,533
Public finance	4,264	935	4,088	9,287	272,951
Structured finance:					
U.S. Residential mortgage-backed securities (RMBS)	211	349	2,315	2,875	5,089
Triple-X life insurance transactions	—	—	126	126	2,053
Trust preferred securities (TruPS)	242	—	—	242	1,508
Other structured finance	208	189	74	471	9,019
Structured finance	661	538	2,515	3,714	17,669
Total	$4,925	$1,473	$ 6,603	$ 13,001	$ 290,620

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Components of BIG Net Par Outstanding
(Insurance and Credit Derivative Form)
As of December 31, 2016

	BIG Net Par Outstanding				Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding
			(in millions)		
Public finance:					
U.S. public finance	$2,402	$3,123	$ 1,855	$ 7,380	$ 244,798
Non-U.S. public finance	1,288	54	—	1,342	26,381
Public finance	3,690	3,177	1,855	8,722	271,179
Structured finance:					
U.S. RMBS	197	493	2,461	3,151	5,637
Triple-X life insurance transactions	—	—	126	126	2,057
TruPS	304	126	—	430	1,892
Other structured finance	304	263	78	645	15,553
Structured finance	$805	$882	$ 2,665	$ 4,352	$ 25,139
Total	$4,495	$4,059	$ 4,520	$ 13,074	$ 296,318

BIG Net Par Outstanding
and Number of Risks
As of June 30, 2017

	Net Par Outstanding			Number of Risks(2)		
Description	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$4,377	$ 548	$4,925	157	11	168
Category 2	1,412	61	1,473	60	3	63
Category 3	6,473	130	6,603	153	8	161
Total BIG	$12,262	$ 739	$13,001	370	22	392

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BIG Net Par Outstanding
and Number of Risks
As of December 31, 2016

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$3,861	$ 634	$4,495	165	10	175
Category 2	3,857	202	4,059	79	6	85
Category 3	4,383	137	4,520	148	9	157
Total BIG	$12,101	$ 973	$13,074	392	25	417

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(1) Includes net par outstanding for VIEs.

(2) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making debt service payments.

Exposure to Puerto Rico

The Company has insured exposure to general obligation bonds of the Commonwealth of Puerto Rico (Puerto Rico or the Commonwealth) and various obligations of its related authorities and public corporations aggregating $4.9 billion net par as of June 30, 2017, all of which are rated BIG. In recent years, Puerto Rico has experienced significant general fund budget deficits and a challenging economic environment. Beginning on January 1, 2016, a number of Puerto Rico credits have defaulted on bond payments, and the Company has now paid claims on several Puerto Rico credits as shown in the table "Puerto Rico Net Par Outstanding" below.

On November 30, 2015 and December 8, 2015, Governor García Padilla of Puerto Rico (the Former Governor) issued executive orders (Clawback Orders) directing the Puerto Rico Department of Treasury and the Puerto Rico Tourism Company to "claw back" certain taxes pledged to secure the payment of bonds issued by the Puerto Rico Highways and Transportation Authority (PRHTA), Puerto Rico Infrastructure Financing Authority (PRIFA), and Puerto Rico Convention Center District Authority (PRCCDA). The Puerto Rico credits insured by the Company subject to clawback are shown in the table “Puerto Rico Net Par Outstanding” below.

On June 30, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) was signed into law by the President of the United States. PROMESA establishes a seven-member federal financial oversight board (Oversight Board) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. PROMESA provides a legal framework under which the debt of the Commonwealth and its related authorities and public corporations may be voluntarily restructured, and grants the Oversight Board the sole authority to file restructuring petitions in a federal court to restructure the debt of the Commonwealth and its related authorities and public corporations if voluntary negotiations fail, provided that any such restructuring must be in accordance with an Oversight Board approved fiscal plan that respects the liens and priorities provided under Puerto Rico law.

On January 2, 2017, Ricardo Antonio Rosselló Nevares (the Governor) took office, replacing the Former Governor. On January 29, 2017, the Governor signed the Puerto Rico Emergency and Fiscal Responsibility Act (Emergency Act) that, among other things, defined an emergency period that has since been extended to December 31, 2017, continued diversion of collateral away from bonds the Company insures, and defined the powers and duties of the Fiscal Agency and Financial Advisory Authority (FAFAA).

In mid-March 2017, the Oversight Board certified Puerto Rico's fiscal plan, dated March 13, 2017 (Fiscal Plan). The Fiscal Plan provides only approximately $7.9 billion for Commonwealth debt service over the next ten years, an amount less than scheduled debt service for such period. The Fiscal Plan itself acknowledges that there are a number of legal and contractual issues not addressed by the Fiscal Plan. On April 28, 2017, the Oversight Board approved fiscal plans for PREPA and PRHTA, and directed PRASA to amend its proposed plan in several ways. The Oversight Board approved the amended PRASA plan on June 30, 2017. The PRHTA plan assumes that PRHTA will not pay any debt service at least through 2026. The

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PRASA plan assumes it will pay only approximately 65% of its debt service through 2026. The Company does not believe the fiscal plans of PRHTA or PRASA in their current forms comply with certain mandatory requirements of PROMESA.

On May 3, 2017, the Oversight Board filed a petition with the Federal District Court of Puerto Rico for the Commonwealth under Title III of PROMESA. Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under chapter 9 of the federal bankruptcy code. On May 5, 2017, the Oversight Board certified a filing under Title III of PROMESA for the Puerto Rico Sales Tax Financing Corporation (COFINA). On May 21, 2017, the Board filed a petition under Title III of PROMESA for PRHTA. On July 2, 2017, after the rejection by the Oversight Board and termination by PREPA of the Restructuring Support Agreement (RSA) described below, the Oversight Board commenced proceedings for PREPA under Title III of PROMESA.
The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to obligations the Company insures are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters. Please see “Puerto Rico Recovery Litigation” below.

Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over any proceedings under PROMESA. Judge Swain has selected a team of five federal judges to act as mediators for as yet to be identified issues and disputes. It is currently anticipated that initial issues and disputes to be the subject of voluntary mediation will be selected during August 2017 and that any resulting mediation efforts will begin in September 2017.

The final shape, timing and validity of responses to Puerto Rico’s distress eventually enacted or implemented under the auspices of PROMESA and the Oversight Board or otherwise, and the final impact, after resolution of legal challenges, of any such responses on obligations insured by the Company, are uncertain.

The Company groups its Puerto Rico exposure into three categories:

- Constitutionally Guaranteed. The Company includes in this category public debt benefiting from Article VI of the Constitution of the Commonwealth, which expressly provides that interest and principal payments on the public debt are to be paid before other disbursements are made.

- Public Corporations – Certain Revenues Potentially Subject to Clawback. The Company includes in this category the debt of public corporations for which applicable law permits the Commonwealth to claw back, subject to certain conditions and for the payment of public debt, at least a portion of the revenues supporting the bonds the Company insures. As a constitutional condition to clawback, available Commonwealth revenues for any fiscal year must be insufficient to pay Commonwealth debt service before the payment of any appropriations for that year. The Company believes that this condition has not been satisfied to date, and accordingly that the Commonwealth has not to date been entitled to claw back revenues supporting debt insured by the Company. Prior to the enactment of PROMESA, the Company sued various Puerto Rico governmental officials in the United States District Court, District of Puerto Rico asserting that Puerto Rico's attempt to “claw back” pledged taxes is unconstitutional, and demanding declaratory and injunctive relief. Please see "Puerto Rico Recovery Litigation" below.

- Other Public Corporations. The Company includes in this category the debt of public corporations that are supported by revenues it does not believe are subject to clawback.

Constitutionally Guaranteed

General Obligation. As of June 30, 2017, the Company had $1,495 million insured net par outstanding of the general obligations of Puerto Rico, which are supported by the good faith, credit and taxing power of the Commonwealth. On July 1, 2016, despite the requirements of Article VI of its Constitution, the Commonwealth defaulted on most of the debt service payment due that day, and the Company made its first claim payments on these bonds, and has continued to make claim payments on these bonds. As noted above, the Oversight Board filed a petition under Title III of PROMESA with respect to the Commonwealth.

Puerto Rico Public Buildings Authority (PBA). As of June 30, 2017, the Company had $169 million insured net par outstanding of PBA bonds, which are supported by a pledge of the rents due under leases of government facilities to departments, agencies, instrumentalities and municipalities of the Commonwealth, and that benefit from a Commonwealth guaranty supported by a pledge of the Commonwealth's good faith, credit and taxing power. On July 1, 2016, despite the requirements of Article VI of its Constitution, the PBA defaulted on most of the debt service payment due that day, and the Company made its first claim payments on these bonds, and has continued to make claim payments on these bonds.

Public Corporations - Certain Revenues Potentially Subject to Clawback

PRHTA. As of June 30, 2017, the Company had $918 million insured net par outstanding of PRHTA (transportation revenue) bonds and $409 million insured net par of PRHTA (highways revenue) bonds. The transportation revenue bonds are secured by a subordinate gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to $120 million annually of taxes on crude oil, unfinished oil and derivative products. The highways revenue bonds are secured by a gross lien on gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The non-toll revenues consisting of excise taxes and fees collected by the Commonwealth on behalf of PRHTA and its bondholders that are statutorily allocated to PRHTA and its bondholders are potentially subject to clawback. Despite the presence of funds in relevant debt service accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company made its first claim payments on these bonds. As noted above, on April 28, 2017, the Oversight Board approved a fiscal plan for PRHTA that PRHTA will not pay any debt service at least through 2026. The Company does not believe the PRHTA fiscal plan in its current form complies with certain mandatory requirements of PROMESA.

PRCCDA. As of June 30, 2017, the Company had $152 million insured net par outstanding of PRCCDA bonds, which are secured by certain hotel tax revenues. These revenues are sensitive to the level of economic activity in the area and are potentially subject to clawback. There were sufficient funds in the PRCCDA bond accounts to make only partial payments on the July 1, 2017 PRCCDA bond payments guaranteed by the Company, and the Company made its first claim payments on these bonds.

PRIFA. As of June 30, 2017, the Company had $18 million insured net par outstanding of PRIFA bonds, which are secured primarily by the return to Puerto Rico of federal excise taxes paid on rum. These revenues are potentially subject to the clawback. The Company made its first claim payment on PRIFA bonds in January 2016, and has continued to make claim payments on PRIFA bonds.

Other Public Corporations

Puerto Rico Electric Power Authority (PREPA). As of June 30, 2017, the Company had $777 million insured net par outstanding of PREPA obligations, which are secured by a lien on the net revenues of the electric system.

On December 24, 2015, AGM and AGC entered into an RSA with PREPA, an ad hoc group of uninsured bondholders and a group of fuel-line lenders that would, subject to certain conditions, result in, among other things, modernization of the utility and a restructuring of current debt. Upon finalization of the contemplated restructuring transaction, insured PREPA revenue bonds (with no reduction to par or stated interest rate) would be supported by securitization bonds issued by a special purpose corporation and secured by a transition charge assessed on ratepayers.

In March 2017, the Governor indicated a desire to modify certain aspects of the RSA. On April 6, 2017, the Governor announced that an agreement in principle had been reached to supplement the RSA. As supplemented, the RSA called for AGM and AGC to provide surety insurance policies aggregating approximately $113 million ($14 million for AGC and $99 million for AGM) to support the securitization bonds contemplated by the RSA, to extend the maturity of all of the relending financing provided in 2016, and to provide $120 million of principal payment deferrals in 2018 through 2023. In addition, the RSA as supplemented provided for a consensual restructuring under Title VI of

PROMESA.

The Oversight Board did not certify the RSA under Title VI of PROMESA as the Company believes is required by PROMESA, but rather, on July 2, 2017, commenced proceedings for PREPA under Title III of PROMESA. PREPA defaulted on its July 1, 2017 debt service payments, and the Company made its first claim payments on these bonds to bondholders as a result of these defaults. The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to the PREPA obligations it insures and the RSA are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters. Please see “Puerto Rico Recovery Litigation” below.

Puerto Rico Aqueduct and Sewer Authority (PRASA). As of June 30, 2017, the Company had $373 million of insured net par outstanding to PRASA bonds, which are secured by a lien on the gross revenues of the water and sewer system. On September 15, 2015, PRASA entered into a settlement with the U.S. Department of Justice and the U.S. Environmental

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Protection Agency that requires it to spend $1.6 billion to upgrade and improve its sewer system island-wide. There were sufficient funds in the PRASA bond accounts to make the July 1, 2016, January 1, 2017 and July 1, 2017 PRASA bond payments guaranteed by the Company, and those payments were made in full. As noted above, on April 28, 2017, the Oversight Board considered a fiscal plan for PRASA that assumes PRASA will pay only approximately 65% of its debt service through 2026, and approved the amended plan on June 30, 2017. Because PRASA has several categories of debt outstanding and the Company insures only PRASA debt with a senior lien on gross revenues of PRASA, it is unclear whether (or to what extent, if any) the payment of only 65% of debt service through 2026 would result in a reduction in PRASA payments of Company-insured debt. The Company does not believe the PRASA fiscal plan in its current form complies with certain mandatory requirements of PROMESA.

Municipal Finance Agency (MFA). As of June 30, 2017, the Company had $354 million net par outstanding of bonds issued by MFA secured by a lien on local property tax revenues. There were sufficient funds in the MFA bond accounts to make the July 1, 2016, January 1, 2017 and July 1, 2017 MFA bond payments guaranteed by the Company, and those payments were made in full.

COFINA. As of June 30, 2017, the Company had $271 million insured net par outstanding of junior COFINA bonds, which are secured primarily by a second lien on certain sales and use taxes. As noted above, the Oversight Board filed a petition on behalf of the Commonwealth under Title III of PROMESA. COFINA defaulted on its August 1, 2017 insured debt service payment, and the Company made its first claim payments on these bonds.

University of Puerto Rico (U of PR). As of June 30, 2017, the Company had $1 million insured net par outstanding of U of PR bonds, which are general obligations of the university and are secured by a subordinate lien on the proceeds, profits and other income of the University, subject to a senior pledge and lien for the benefit of outstanding university system revenue bonds. As of the date of this filing, all debt service payments on U of PR bonds insured by the Company have been made.

Puerto Rico Recovery Litigation

The Company believes that a number of the actions taken by the Commonwealth, the Oversight Board and others with respect to obligations it insures are illegal or unconstitutional or both, and has taken legal action, and may take additional legal action in the future, to enforce its rights with respect to these matters.

On January 7, 2016, AGM, AGC and Ambac Assurance Corporation (Ambac) commenced an action for declaratory judgment and injunctive relief in the U.S. District Court for the District of Puerto Rico (Federal District Court in Puerto Rico) to invalidate the executive orders issued by the Former Governor on November 30, 2015 and December 8, 2015 directing that the Secretary of the Treasury of the Commonwealth of Puerto Rico and the Puerto Rico Tourism Company claw back certain taxes and revenues pledged to secure the payment of bonds issued by the PRHTA, the PRCCDA and the PRIFA. The Commonwealth defendants filed a motion to dismiss the action for lack of subject matter jurisdiction, which the Court denied on October 4, 2016. On October 14, 2016, the Commonwealth defendants filed a notice of PROMESA automatic stay. While the automatic stay expired on May 1, 2017, on May 17, 2017, the Court stayed the action under PROMESA.

On May 3, 2017, AGM and AGC filed in the Federal District Court in Puerto Rico an adversary complaint seeking a judgment that the Commonwealth's Fiscal Plan violates various sections of PROMESA and the Contracts, Takings and Due Process Clauses of the U.S. Constitution, an injunction enjoining the Commonwealth and Oversight Board from presenting or proceeding with confirmation of any plan of adjustment based on the Fiscal Plan, and a stay on the confirmation of any plan of adjustment based on the Fiscal Plan pending development of a fiscal plan that complies with PROMESA and the U.S. Constitution.

On May 16, 2017, The Bank of New York Mellon, as trustee for the bonds issued by COFINA, filed an adversary complaint for interpleader and declaratory relief with the Federal District Court in Puerto Rico to resolve competing and conflicting demands made by various groups of COFINA bondholders, insurers of certain COFINA Bonds and COFINA, regarding funds held by the trustee for certain COFINA bond debt service payments scheduled to occur on and after June 1, 2017. On May 19, 2017, an order to show cause was entered permitting AGC and AGM to intervene in this matter.

On June 3, 2017, AGC and AGM filed an adversary complaint in Federal District Court in Puerto Rico seeking (i) a judgment declaring that the application of pledged special revenues to the payment of the PRHTA Bonds is not subject to the PROMESA Title III automatic stay and that the Commonwealth has violated the special revenue protections provided to the PRHTA Bonds under the Bankruptcy Code; (ii) an injunction enjoining the Commonwealth from taking or causing to be taken any action that would further violate the special revenue protections provided to the PRHTA Bonds under the Bankruptcy Code;

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and (iii) an injunction ordering the Commonwealth to remit the pledged special revenues securing the PRHTA Bonds in accordance with the terms of the special revenue provisions set forth in the Bankruptcy Code.

On June 26, 2017, AGM and AGC filed a complaint in Federal District Court in Puerto Rico seeking (i) a declaratory judgment that the PREPA RSA is a “Preexisting Voluntary Agreement” under Section 104 of PROMESA and the Oversight Board’s failure to certify the PREPA RSA is an unlawful application of Section 601 of PROMESA; (ii) an injunction enjoining the Oversight Board from unlawfully applying Section 601 of PROMESA and ordering it to certify the PREPA RSA; and (iii) a writ of mandamus requiring the Oversight Board to comply with its duties under PROMESA and certify the PREPA RSA.

On July 18, 2017, AGM and AGC filed a motion for relief from the automatic stay in the PREPA Title III bankruptcy proceeding and a form of complaint seeking the appointment of a receiver for PREPA.

All Puerto Rico exposures are internally rated BIG. The following tables show the Company’s insured exposure to general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations.

Puerto Rico
Gross Par and Gross Debt Service Outstanding

	Gross Par Outstanding		Gross Debt Service Outstanding	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
	(in millions)			
Exposure to Puerto Rico	$5,435	$ 5,435	$8,901	$ 9,038

Puerto Rico
Net Par Outstanding (1)

	As of June 30, 2017	As of December 31, 2016
	(in millions)	
Commonwealth Constitutionally Guaranteed		
Commonwealth of Puerto Rico - General Obligation Bonds (2) (3)	$1,495	$ 1,476
PBA (2)	169	169
Public Corporations - Certain Revenues Potentially Subject to Clawback		
PRHTA (Transportation revenue) (2) (3)	918	918
PRHTA (Highways revenue) (2) (3)	409	350
PRCCDA (2)	152	152
PRIFA (2)	18	18
Other Public Corporations		
PREPA (2) (3)	777	724
PRASA	373	373
MFA	354	334
COFINA (2) (3)	271	271
U of PR	1	1

Total net exposure to Puerto Rico	$4,937	$ 4,786

(1) The June 30, 2017 amounts include $150 million related to the commutation of previously ceded business. See Note 13, Reinsurance and Other Monoline Exposures, for more information.

(2) As of the date of this filing, the Company has paid claims on these credits.

(3) As of the date of this filing, the Oversight Board has certified a filing under Title III of PROMESA for these credits.

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The following table shows the scheduled amortization of the insured general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations. The Company guarantees payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. In the event that obligors default on their obligations, the Company would only be required to pay the shortfall between the principal and interest due in any given period and the amount paid by the obligors.

Amortization Schedule of Puerto Rico Net Par Outstanding
and Net Debt Service Outstanding
As of June 30, 2017

	Scheduled Net Par Amortization	Scheduled Net Debt Service Amortization
	(in millions)	
2017 (July 1 - September 30)	$214	$ 336
2017 (October 1 - December 31)	0	2
Subtotal 2017	214	338
2018	188	429
2019	210	440
2020	270	490
2021	129	336
2022-2026	900	1,819
2027-2031	942	1,609
2032-2036	1,249	1,669
2037-2041	417	588
2042-2047	418	492
Total	$4,937	$ 8,210

Exposure to the Selected European Countries

The European countries where the Company has exposure and believes heightened uncertainties exist are: Hungary, Italy, Portugal, Spain and Turkey (collectively, the Selected European Countries). The Company’s direct economic exposure to the Selected European Countries, based on par, is shown in the following table, net of ceded reinsurance.

Net Direct Economic Exposure to Selected European Countries(1)
As of June 30, 2017

	Hungary	Italy	Portugal	Spain	Turkey	Total
	(in millions)					
Sub-sovereign exposure(2)	$218	$965	$ 74	$370	$ —	$1,627
Non-sovereign exposure(3)	122	415	—	—	201	738
Total	$340	$1,380	$ 74	$370	$ 201	$2,365
Total BIG (See Note 5)	$265	$—	$ 74	$370	$ —	$709

(1) While exposures are shown in U.S. dollars, the obligations are in various currencies, primarily euros.

(2)

Sub-sovereign exposure in Selected European Countries includes transactions backed by receivables from, or supported by, sub-sovereigns, which are governmental or government-backed entities other than the ultimate governing body of the country.

(3) Non-sovereign exposure in Selected European Countries includes debt of regulated utilities, RMBS and diversified payment rights (DPR) securitizations.

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When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. The Company may also have direct exposures to the Selected European Countries in business assumed from unaffiliated monoline insurance companies, in which case the Company depends upon geographic information provided by the primary insurer.

The Company's $201 million net insured par exposure in Turkey is to DPR securitizations sponsored by a major Turkish bank. These DPR securitizations were established outside of Turkey and involve payment orders in U.S. dollars, pounds sterling and euros from persons outside of Turkey to beneficiaries in Turkey who are customers of the sponsoring bank. The sponsoring bank's correspondent banks have agreed to remit all such payments to a trustee-controlled account outside Turkey, where debt service payments for the DPR securitization are given priority over payments to the sponsoring bank.

The Company has excluded from the exposure tables above its indirect economic exposure to the Selected European Countries through policies it provides on pooled corporate and commercial receivables transactions. The Company calculates indirect exposure to a country by multiplying the par amount of a transaction insured by the Company times the percent of the relevant collateral pool reported as having a nexus to the country. On that basis, the Company has calculated exposure of $50 million to Selected European Countries in transactions with $1.1 billion of net par outstanding.

Non-Financial Guaranty Insurance

The Company provided capital relief triple-X excess of loss life reinsurance on approximately $506 million of exposure as of June 30, 2017 and $390 million as of December 31, 2016. The triple-X excess of loss life reinsurance exposure is expected to increase to approximately $1.3 billion prior to September 30, 2036.

In addition, the Company started providing reinsurance on aircraft residual value insurance (RVI) policies in the first quarter of 2017 and had net exposure of $127 million to such reinsurance as of June 30, 2017. The Company had an outstanding commitment to provide reinsurance on aircraft RVI policies of approximately $46 million as of June 30, 2017 that will expire in the third quarter of 2017. The commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty’s request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

The capital relief triple-X excess of loss life reinsurance and aircraft residual value reinsurance are all rated investment grade internally. This non-financial guaranty exposure has a similar risk profile to the Company's other structured finance investment grade exposure written in financial guaranty form.

The Company also had provided legacy mortgage guaranty reinsurance related to loans originated in Ireland on debt service of approximately $39 million as of June 30, 2017, and $36 million as of December 31, 2016. As of the date of this filing, the Company no longer has any exposure to legacy mortgage guaranty reinsurance.

5. Expected Loss to be Paid

Loss Estimation Process

This note provides information regarding expected claim payments to be made under all contracts in the insured portfolio, regardless of the accounting model. The Company’s loss reserve committees estimate expected loss to be paid for all contracts by reviewing analyses that consider various scenarios with corresponding probabilities assigned to them. Depending upon the nature of the risk, the Company’s view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments and sector-driven loss severity assumptions or judgmental assessments. In the case of its assumed business, the Company may conduct its own analysis as just described or, depending on the Company’s view of the potential size of any loss and the information available to the Company, the Company may use loss estimates provided by ceding insurers. The Company monitors the performance of its transactions with expected losses and each quarter the Company’s loss reserve committees review and refresh their loss projection assumptions and scenarios and the probabilities they assign to those scenarios based on actual developments during the quarter and their view of future performance.

The financial guaranties issued by the Company insure the credit performance of the guaranteed obligations over an extended period of time, in some cases over 30 years, and in most circumstances, the Company has no right to cancel such financial guaranties. As a result, the Company's estimate of ultimate losses on a policy is subject to significant uncertainty over the life of the insured transaction. Credit performance can be adversely affected by economic, fiscal and financial market variability over the long life of most contracts.

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The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management, using both internal and external data sources with regard to frequency, severity of loss, economic projections, governmental actions, negotiations and other factors that affect credit performance. These estimates, assumptions and judgments, and the factors on which they are based, may change materially over a reporting period, and as a result the Company’s loss estimates may change materially over that same period.

The Company does not use traditional actuarial approaches to determine its estimates of expected losses. Actual losses will ultimately depend on future events or transaction performance and may be influenced by many interrelated factors that are difficult to predict. As a result, the Company's current projections of probable and estimable losses may be subject to considerable volatility and may not reflect the Company's ultimate claims paid. For information on the Company's loss estimation process, please refer to Note 5, Expected Loss to be Paid, of Part II, Item 8, Financial Statements and Supplementary Data in AGL's Annual Report on Form 10-K for the year ended December 31, 2016.

The following tables present a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives or financial guaranty (FG) VIEs, by sector, after the expected recoveries/ (payables) for breaches of representations and warranties (R&W) and other expected recoveries. The Company used risk-free rates for U.S. dollar denominated obligations that ranged from 0.0% to 2.83% with a weighted average of 2.32% as of June 30, 2017 and 0.0% to 3.23% with a weighted average of 2.73% as of December 31, 2016.

Net Expected Loss to be Paid
Roll Forward

	Second Quarter		Six Months	
	2017	2016	2017	2016
	(in millions)			
Net expected loss to be paid, beginning of period	$1,244	$1,337	$1,198	$1,391
Net expected loss to be paid on the MBIA UK portfolio as of January 10, 2017	—	—	21	—
Economic loss development (benefit) due to:				
Accretion of discount	8	6	16	15
Changes in discount rates	23	45	34	108
Changes in timing and assumptions	16	(29)	44	(42)
Total economic loss development (benefit)	47	22	94	81
Net (paid) recovered losses	6	(33)	(16)	(146)
Net expected loss to be paid, end of period	$1,297	$1,326	$1,297	$1,326

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Net Expected Loss to be Paid
Roll Forward by Sector
Second Quarter 2017

	Net Expected Loss to be Paid (Recovered) as of March 31, 2017	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2017 (2)
	(in millions)			
Public finance:				
U.S. public finance	$970	$ 78	$ (4)	$ 1,044
Non-U.S. public finance	41	1	0	42
Public finance	1,011	79	(4)	1,086
Structured finance:				
U.S. RMBS	197	(29)	14	182
Triple-X life insurance transactions	1	(2)	(3)	(4)
Other structured finance	35	(1)	(1)	33
Structured finance	233	(32)	10	211
Total	$1,244	$ 47	$ 6	$ 1,297

Net Expected Loss to be Paid
Roll Forward by Sector
Second Quarter 2016

	Net Expected Loss to be Paid (Recovered) as of March 31, 2016	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2016
	(in millions)			
Public finance:				
U.S. public finance	$864	$ 111	$ (12)	$ 963
Non-U.S. public finance	39	(2)	—	37
Public finance	903	109	(12)	1,000
Structured finance:				
U.S. RMBS	293	(81)	(20)	192
Triple-X life insurance transactions	102	(2)	0	100
Other structured finance	39	(4)	(1)	34
Structured finance	434	(87)	(21)	326
Total	$1,337	$ 22	$ (33)	$ 1,326

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Net Expected Loss to be Paid
Roll Forward by Sector
Six Months 2017

	Net Expected Loss to be Paid (Recovered) as of December 31, 2016	Net Expected Loss to be Paid on MBIA UK as of January 10, 2017	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2017 (2)
	(in millions)				
Public finance:					
U.S. public finance	$871	$ —	$ 202	$ (29)	$ 1,044
Non-U.S. public finance	33	13	(4)	0	42
Public finance	904	13	198	(29)	1,086
Structured finance:					
U.S. RMBS	206	—	(51)	27	182
Triple-X life insurance transactions	54	—	(55)	(3)	(4)
Other structured finance	34	8	2	(11)	33
Structured finance	294	8	(104)	13	211
Total	$1,198	$ 21	$ 94	$ (16)	$ 1,297

Net Expected Loss to be Paid
Roll Forward by Sector
Six Months 2016

	Net Expected Loss to be Paid (Recovered) as of December 31, 2015	Economic Loss Development / (Benefit)	(Paid) Recovered Losses (1)	Net Expected Loss to be Paid (Recovered) as of June 30, 2016
	(in millions)			
Public finance:				
U.S. public finance	$771	$ 209	$ (17)	$ 963
Non-U.S. public finance	38	(1)	—	37
Public finance	809	208	(17)	1,000
Structured finance:				
U.S. RMBS	409	(112)	(105)	192
Triple-X life insurance transactions	99	2	(1)	100
Other structured finance	74	(17)	(23)	34
Structured finance	582	(127)	(129)	326
Total	$1,391	$ 81	$ (146)	$ 1,326

(1)

Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets. The Company paid $7 million and $7 million in LAE for Second Quarter 2017 and 2016, respectively and $9 million and $9 million in LAE for Six Months 2017 and 2016, respectively.

(2) Includes expected LAE to be paid of $18 million as of June 30, 2017 and $12 million as of December 31, 2016.

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The following table presents the present value of net expected loss to be paid and the net economic loss development for all contracts by accounting model.

Net Expected Loss to be Paid (Recovered) and
Net Economic Loss Development (Benefit)
By Accounting Model

	Net Expected Loss to be Paid (Recovered)		Net Economic Loss Development (Benefit)			
	As of June 30, 2017	As of December 31, 2016	Second Quarter 2017	Second Quarter 2016	Six Months 2017	Six Months 2016
	(in millions)					
Financial guaranty insurance	$1,203	$ 1,083	$55	$ 40	$ 121	$ 101
FG VIEs (1) and other	98	105	0	(7)	(4)	(3)
Credit derivatives (2)	(4)	10	(8)	(11)	(23)	(17)
Total	$1,297	$ 1,198	$47	$ 22	$ 94	$ 81

(1) Refer to Note 9, Consolidated Variable Interest Entities.

(2) Refer to Note 8, Contracts Accounted for as Credit Derivatives.

Selected U.S. Public Finance Transactions

The Company insures general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating $4.9 billion net par as of June 30, 2017, all of which are BIG. For additional information regarding the Company's exposure to general obligations of Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations, please refer to "Exposure to Puerto Rico" in Note 4, Outstanding Exposure.

On February 25, 2015, a plan of adjustment resolving the bankruptcy filing of the City of Stockton, California under chapter 9 of the U.S. Bankruptcy Code became effective. As of June 30, 2017, the Company’s net par subject to the plan consists of $113 million of pension obligation bonds. As part of the plan settlement, the City will repay the pension obligation bonds from certain fixed payments and certain variable payments contingent on the City's revenue growth.

The Company projects that its total net expected loss across its troubled U.S. public finance credits as of June 30, 2017 including those mentioned above, which incorporated the likelihood of the various outcomes, will be $1.0 billion, compared with a net expected loss of $871 million as of December 31, 2016. Economic loss development in Second Quarter 2017 was $78 million and economic loss development for Six Months 2017 was $202 million, which was primarily attributable to Puerto Rico exposures.

Selected Non - U.S. Public Finance Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish and Portuguese issuers where a Spanish and Portuguese sovereign default may cause the sub-sovereigns also to default. The Company's exposure net of reinsurance to these Spanish and Portuguese credits is $370 million and $74 million, respectively. The Company rates all of these exposures BIG due to the financial condition of Spain and Portugal and their dependence on the sovereign. The Company's Hungary exposure is to infrastructure bonds dependent on payments from Hungarian governmental entities. The Company's exposure, net of reinsurance, to these Hungarian credits is $219 million, all of which is rated BIG.

As part of the MBIA UK Acquisition, the Company now also insures an obligation backed by the availability and toll revenues of a major arterial road into a city in the U.K. with $219 million of net par outstanding as of June 30, 2017. This transaction has been underperforming due to lower traffic volume and higher costs compared with expectations at underwriting.

These transactions, together with other non-U.S. public finance insured obligations, had expected loss to be paid of $42 million as of June 30, 2017, compared with $33 million as of December 31, 2016. The MBIA UK Acquisition added $13 million of net expected loss as of January 2017. The economic loss development during Second Quarter 2017 was

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approximately $1 million. The economic benefit of approximately $4 million during Six Months 2017 was due mainly to the improved internal outlook of certain European sovereigns and sub-sovereign entities.

Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS and any expected R&W recoveries to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates.

Second Quarter 2017 U.S. RMBS Loss Projections

Based on its observation during the period of the performance of its insured transactions (including delinquencies, liquidation rates and loss severities) as well as the residential property market and economy in general, the Company chose to make the changes to the assumptions it uses to project RMBS losses shown in the tables of assumptions in the sections below.

U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are or in the past twelve months have been two or more payments behind, have been modified, are in foreclosure, or have been foreclosed upon). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various non-performing categories. The Company arrived at its liquidation rates based on data purchased from a third party provider and assumptions about how delays in the foreclosure process and loan modifications may ultimately affect the rate at which loans are liquidated. Each quarter the Company reviews the most recent twelve months of this data and (if necessary) adjusts its liquidation rates based on its observations. The following table shows liquidation assumptions for various non-performing categories.

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First Lien Liquidation Rates

	June 30, 2017	March 31, 2017	December 31, 2016
Delinquent/Modified in the Previous 12 Months			
Alt A and Prime	20%	25%	25%
Option ARM	20	25	25
Subprime	20	25	25
30 – 59 Days Delinquent			
Alt A and Prime	30	30	35
Option ARM	35	35	35
Subprime	40	40	40
60 – 89 Days Delinquent			
Alt A and Prime	40	45	45
Option ARM	45	45	50
Subprime	45	50	50
90+ Days Delinquent			
Alt A and Prime	50	55	55
Option ARM	55	55	55
Subprime	55	55	55
Bankruptcy			
Alt A and Prime	45	45	45
Option ARM	50	50	50
Subprime	40	40	40
Foreclosure			
Alt A and Prime	60	65	65
Option ARM	65	65	65
Subprime	65	65	65
Real Estate Owned			
All	100	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans (including current loans modified or delinquent within the last 12 months), it projects defaults on presently current loans by applying a conditional default rate (CDR) trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming, recently nonperforming and modified loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (i.e., the CDR plateau), which, if applied for each of the next 36 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the most heavily weighted scenario (the base case), after the initial 36-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for 36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. In the base case, the Company assumes the final CDR will be reached 6 years after the initial 36-month CDR plateau period. Under the Company's methodology, defaults projected to occur in the first 36 months represent defaults that can be attributed to loans that were modified or delinquent in the last 12 months or that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 36 month period represent defaults attributable to borrowers that are currently performing or are projected to reperform.

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historically high levels, and the Company is assuming in the base case that these high levels

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generally will continue for another 18 months. The Company determines its initial loss severity based on actual recent experience. Each quarter the Company reviews available data and (if necessary) adjusts its severities based on its observations. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning after the initial 18 month period, declining to 40% in the base case over 2.5 years.

The following table shows the range as well as the average, weighted by outstanding net insured par, for key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS(1)