

REPORT ON EXAMINATION  
OF THE  
ASSURED GUARANTY MUNICIPAL CORP.  
AS OF  
DECEMBER 31, 2011

DATE OF REPORT

MAY 14, 2013

EXAMINER

IAN MARTIN

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

May 14, 2013

Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30849 dated May 8, 2012 attached hereto, I have made an examination into the condition and affairs of Assured Guaranty Municipal Corp. as of December 31, 2011, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Assured Guaranty Municipal Corp.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company's home office located at 31 West 52<sup>nd</sup> Street, New York, New York 10019.

## 1. SCOPE OF EXAMINATION

The Department has performed a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2007. This examination covered the four-year period from January 1, 2008 through December 31, 2011. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted in conjunction with the state of Maryland, which was the coordinating state of the Assured Guaranty Group. The examination was performed concurrently with the examinations of the following insurers: Assured Guaranty Corp. (“AGC”), Assured Guaranty Municipal Insurance Company (“AGMIC”), Assured Guaranty Mortgage Insurance Company (“AG Mortgage”) and Municipal and Infrastructure Assurance Corporation (now known as Municipal Assurance Corp. (“MAC”)).

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment and an evaluation based upon the Company’s Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

Significant subsequent events  
Company history

Corporate records  
Management and control  
Fidelity bonds and other insurance  
Pensions, stock ownership and insurance plans  
Territory and plan of operation  
Growth of Company  
Loss experience  
Reinsurance  
Accounts and records  
Statutory deposits  
Financial statements  
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

## **2. DESCRIPTION OF COMPANY**

The Company, formerly known as Financial Security Assurance, Inc., was incorporated under the laws of New York on March 16, 1984 and commenced operations on September 23, 1985. The Company was initially organized as a property and casualty insurance company. On August 2, 1989, the Company restated its Charter and amended its license to become a financial guaranty insurance corporation pursuant to the provisions of Article 69 of the New York Insurance Law.

Assured Guaranty Ltd. (“AGL”), a Bermuda-based holding company which is the ultimate holding company of Assured Guaranty Group, through a wholly-owned subsidiary, Assured Guaranty U.S. Holdings Inc., acquired Assured Guaranty Municipal Holdings Inc. (“AGMH”), formally known as Financial Security Assurance Holdings Ltd., and most of its subsidiaries, including the Company, from Dexia Holdings, Inc. AGMH owns 100% of the Company.

At December 31, 2011, Capital paid in was \$15,000,000 consisting of 330 shares of \$45,454.55 par value per share common stock.

Gross paid in and contributed surplus was \$776,884,430 and represented an increase by \$421,065,955 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
December 31, 2007	Beginning gross paid in and contributed surplus	\$355,818,475
2008	Surplus adjustments paid in	426,206,228
2008	Surplus adjustments transferred to capital (stock dividend)	(615,687)
2009	Surplus adjustments paid out	<u>(4,524,583)</u>
	Total Surplus Contributions (Distribution)	<u>421,065,958</u>
December 31, 2011	Ending gross paid in and contributed surplus	<u>\$776,884,433</u>

A. Management

Pursuant to the Company's Charter and By-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. The number of directors was revised effective January 9, 2013 to not less than seven nor more than thirteen. The number of directors required to be residents of New York State was revised effective January 9, 2013 from two to one. The revised Charter and By-laws reflecting the changes were filed with the Department.

The board met at least four times during each calendar year. At December 31, 2011, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Howard Wayne Albert Short Hills, NJ	Chief Risk Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company.
Robert Adam Bailenson Cold Spring Harbor, NY	Chief Financial Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
Richard James Bauerfeld Wilton, CT	Chief Surveillance Officer, Structured Finance Assured Guaranty Mortgage Insurance Company Assured Guaranty Municipal Corp.
Russell Brown Brewer II Darien, CT	Chief Surveillance Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company

Name and ResidencePrincipal Business Affiliation

Gon Ling Chow  
New York, NY

Deputy General Counsel, Corporate and Assistant  
Secretary,  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.

Deputy General Counsel, Corporate and Managing  
Director,  
Assured Guaranty Municipal Corp.

Stephen Donnarumma  
Brooklyn, NY

Chief Credit Officer,  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.  
Assured Guaranty Municipal Corp.  
Assured Guaranty Municipal Insurance Company

Dominic John Frederico  
Palm Beach Gardens, FL

Chairman, President and Chief Executive Officer,  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.  
Assured Guaranty Municipal Corp.  
Assured Guaranty Municipal Insurance Company

Philip Richard Kastellec  
New York, NY

Deputy General Counsel, Regulatory,  
Assured Guaranty Mortgage Insurance Company

Deputy General Counsel, Regulatory and Assistant  
Secretary,  
Assured Guaranty Municipal Corp.

James Michael Michener  
Smith's, Bermuda, FL-05

General Counsel and Secretary  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.  
Assured Guaranty Municipal Corp.  
Assured Guaranty Municipal Insurance Company

Robert Bruce Mills  
New Hope, PA

Chief Operating Officer,  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.  
Assured Guaranty Municipal Corp.  
Assured Guaranty Municipal Insurance Company

Donald Hal Paston  
Livingston, NJ

Treasurer,  
Assured Guaranty Mortgage Insurance Company  
Assured Guaranty Corp.  
Assured Guaranty Municipal Corp.  
Assured Guaranty Municipal Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Andrew Hoyt Pickering New York, NY	Senior Managing Director, Risk Management, Assured Guaranty Municipal Corp.
Bruce Elliot Stern Bronxville, NY	Executive Officer, Government and Corporate Affairs, Assured Guaranty Corp. Assured Guaranty Municipal Corp.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

Article II of the Company's By-laws calls for the annual meeting of the corporation's shareholders to be held on the first Tuesday in the month of April for the purpose of electing Directors and for the transaction of such other business as may come before the meeting. A review of the Company records revealed that for the year 2009, the Company held three shareholders' meetings. However, none of those meetings was held on the first Tuesday in the month of April as stipulated in the Company's by-laws. The shareholders' meetings were held in July, October and December. For the years 2010 and 2011, no record of minutes was noted among the records provided to us by the Company indicating that the Company held its annual shareholders' meeting as stipulated in its by-laws or of the holding of any other shareholders' meetings for both years.

It is recommended that the Company hold Annual shareholders' meetings in accordance with schedule specified in its By-laws and maintain minutes for those meetings.

As of December 31, 2011, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Dominic John Frederico	Chairman, President and Chief Executive Officer
James Michael Michener	Secretary and General Counsel
Donald Hal Paston	Treasurer
Howard Wayne Albert	Chief Risk Officer
Robert Adam Bailenson	Chief Financial Officer
Laura Ann Bieling	Controller
Russell Brown Brewer II	Chief Surveillance Officer
Stephen Donnarumma	Chief Credit Officer
Robert Bruce Mills	Chief Operating Officer
John Mahlon Ringler	Assistant Vice President, Regulatory Reporting
Benjamin Gad Rosenblum	Chief Actuary

B. Territory and Plan of Operation

As of December 31, 2011, the Company was licensed to write business in all fifty states, the District of Columbia, and Puerto Rico.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
16(C,D,E,F)	Surety
17(A)	Credit
25	Financial guaranty

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$66,400,000.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a percentage of Total Premium</u>
2008	\$285,509,561	\$787,593,581	36.25%
2009	\$135,421,026	\$270,757,195	50.02%
2010	\$137,506,469	\$445,045,713	30.90%
2011	\$120,157,373	\$314,883,660	38.16%

The Company provides financial guaranty for a broad range of financing, including municipal bonds and loans, asset backed securities collateralized by consumer or corporate receivables, collateralized debt obligations, international public sector project financings, credit default swaps, and other structured financial obligations that remain in force for many years. In August 2008, the Company announced that it would cease insuring structured finance obligations and instead participate exclusively in the global public finance financial guaranty business.

Financial guaranty insurance written by the Company generally provides an unconditional and irrevocable guaranty that protects the holder of financial obligation against non payment of principal and interest due. Upon a payment default on an insured obligation, the Company is generally required to pay principal, interest or other amounts due in accordance with the obligation's original payment schedule or may, at its option, pay such amounts on an accelerated basis.

The Company markets its credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities as well as to investors in such debt obligations. The Company guarantees debt obligations issued in many countries, although its principal focus is on the U.S., Europe and Australia.

### C. Reinsurance

Assumed reinsurance accounted for 7.68% of the Company's gross premium written at December 31, 2011. During the period covered by this examination, the Company's assumed reinsurance business has decreased since the last examination.

#### Amended and Restated Quota Share and Stop Loss Reinsurance Agreement

The majority of the Company's assumed business derives from the Amended and Restated Quota Share and Stop Loss Reinsurance Agreement ("Quota Share and Stop Loss Agreement") with its affiliate, Assured Guaranty (Europe) Ltd. ("AG Europe"), formerly Financial Security Assurance (U.K.) Ltd., which was amended and restated effective on May 16, 2010. This agreement covers business written on or after April 27, 1994. The business assumed from AG Europe is retroceded by the Company to its two subsidiaries under the Pooling Agreement discussed further herein.

Under the quota share portion of the Quota Share and Stop Loss Agreement, the Company assumes a proportionate share of the liabilities under each policy, contract or binder of insurance or reinsurance written by AG Europe. The proportionate share of liabilities to be assumed by the Company is determined on April 1 of each year and is in proportion to the surplus to policyholders and contingency reserves (together, "Statutory Capital" of the Company including its subsidiaries under the Pooling Agreement) relative to the aggregate Statutory Capital of the Company (including such subsidiaries) and AG Europe. Under the May 16, 2010 amendment and restatement, business written by AG Europe on or after July 1, 2009 that consists of municipal, utility, project finance,

infrastructure or similar risks and is not insured pursuant to a co-guaranty structure with the Company or an affiliate of AG Europe. Since 2009, no qualified business had been written and ceded under the quota share coverage.

Under the stop loss portion of the Quota Share and Stop Loss Agreement, the Company is responsible for 100% of losses and loss adjustment and other expenses incurred above net earned premiums plus amounts deducted from AG Europe's equalization reserves (the reserves required pursuant to the United Kingdom Insurance Companies Act 1982) during the calendar year, subject to annual limit pursuant to the Agreement. The Company received premiums of 12.5% of AG Europe's annual net earned premiums each year under the stop loss agreement. Under the May 16, 2010 amendment and restatement, the stop loss cover applies only to business written after July 1, 2009 that consists of municipal, utility, project finance, infrastructure or similar risks and is not insured pursuant to a co-guaranty structure with the Company or an affiliate of AG Europe.

This Quota Share and Stop Loss Agreement was non-disapproved by the Department on October 18, 2010.

#### Stop Loss Reinsurance Agreement

Effective November 3, 1998, the Company also provides stop loss reinsurance coverage to its affiliate, Assured Guaranty (Bermuda) Ltd. ("AG Bermuda"), formerly Financial Security Assurance International Ltd., with similar terms to the stop loss agreement with AG Europe. The Company received premiums under the stop loss agreement of 12.5% of AG Bermuda's annual net earned premiums each year.

This agreement was non-disapproved by the Department on October 30, 1998.

#### Amended & Restated Quota Share Reinsurance Pooling Agreement ("Pooling Agreement")

Effective July 1, 1986, the Company is a party to a quota share reinsurance pooling agreement between itself and two of its subsidiaries, AGMIC, formerly FSA Insurance Company, and AG Bermuda. The agreement was amended and restated as of October 1, 1996 and again as of December 31, 2009. Pursuant to the agreement, the companies share in the net retained risks insured by each of the companies, after cessions to other reinsurers, on a pro-rata basis in proportion to each company's relative Statutory Capital as reported in the most recently filed statutory statements at the time the

business is written. At December 31, 2011, the pooling percentages were approximately 64.79% for the Company, 30.29% for AGMIC and 4.92% for AG Bermuda. The latest amended and restated pooling agreement was non-disapproved by the Department on March 1, 2010.

### Ceded

#### Whole Account Quota Share Reinsurance Agreement

Effective October 1, 2010, the Company is a party to a Whole Account Quota Share Agreement with its affiliate, Assured Guaranty Re Ltd. (“AG Re”). Pursuant to this agreement, the Company is required to cede to AG Re on a quota share basis at least fifteen percent (15%) and not more than eighty-five percent (85%) of each policy the Company writes. The exact percentage ceded is determined at the Company’s option. Since the agreement’s inception, the Company has elected to cede to AG Re forty percent (40%) of each policy that it has issued. This agreement was non-disapproved by the Department on December 6, 2010.

#### Ceding Companies Allocation Agreement

Effective November 1, 2011, the Company entered into a ceding companies’ allocation agreement with its affiliate, AGC. Pursuant to the agreement, premiums, expenses, losses and recoveries will be allocated in a fair and reasonable manner between the Company and AGC for reinsurance agreements that the Company and AGC had jointly or separately entered with various other reinsurers. This agreement was non-disapproved by the Department on December 15, 2011.

#### Facultative Reinsurance Agreement

Effective August 16, 2005, the Company entered into a facultative reinsurance agreement with its affiliate, AG Bermuda. Under this agreement, the Company cedes 100% of losses within the first loss layer reinsurance of a particular policy subject to a limit of AG Bermuda’s liability per the agreement terms. In addition, AG Bermuda assumes on a quota share basis its allocable share (10%) of the Company’s exposure under the policy in excess of the first loss layer. This quota share reinsurance is in addition to AG Bermuda’s quota share reinsurance of the policy under the Pooling agreement. This agreement was non-disapproved by the Department on December 7, 2005.

Effective May 1, 2003, the Company put in place a Master Facultative Reinsurance Agreement with AG Re, whereby the Company cedes to the reinsurer a share of a risk(s) insured by the Company as specified and agreed to by the parties in a reinsurance memorandum. During the examination period, the Company placed five memoranda that were subject to the terms of the Master Facultative Reinsurance Agreement. These memoranda were filed with the Department.

Due to the impact of the financial crisis affecting the financial guaranty industry from the beginning of 2008, the Company did not renew its annual ceded reinsurance program with unaffiliated third parties for municipal, non-municipal and project finance transactions for any calendar year after 2008. The Company also did not renew its annual automatic facultative agreements with various unaffiliated third parties for any calendar year after 2008. Thus, all new business written in calendar year 2009 through the end of the examination period was reinsured solely with affiliated companies, except for a facultative cession of a single policy to Radian Asset Assurance Inc. (“Radian”) pursuant to a reinsurance commitment made by Radian prior to 2009.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114, respectively. An examination review of the Company's reinsurance trust agreements and relative amendments to such agreements revealed that the amendments to two of the trust agreements lacked some of the required provisions set forth in Regulation 114 of the Department. The description of the trust agreements and related recommendations are mentioned in Item D below, captioned “Holding Company System.”

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk

as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

During the period covered by this examination, the Company commuted various reinsurance agreements where it is was a ceding/assuming reinsurer.

D. Holding Company System

The Company is a member of the Assured Guaranty Group. The Company is a wholly-owned subsidiary of AGMH, a New York domiciled holding company. AGMH is an indirect subsidiary of AGL, a Bermuda based publicly traded holding company (NYSE: AGO) with worldwide operations.

A review of the Holding Company Registration Statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2011:



At December 31, 2011, in addition to the reinsurance agreements mentioned in Item 2C, the Company was party to the following agreements with other members of its holding company system:

#### Tax Allocation Agreement

Effective July 1, 2009, the Company entered into a tax allocation agreement with other members of the Assured Guaranty Group. Under the terms of the agreement, the Company filed a consolidated federal income tax return with its indirect parent, Assured Guaranty US Holding Inc. and its subsidiaries. The agreement was filed and non-disapproved by the Department on June 24, 2009. The Company amended the agreement on June 1, 2012 to add MAC as a party. However, the Company did not file the amendment with the Department pursuant to Circular Letter 33 (1979). The Company subsequently filed the amendment with the Department on February 7, 2013.

#### Service Agreements

Effective January 1, 2010, the Company with other affiliates in the Assured Guaranty Group entered into a service agreement with AGC, an affiliated company domiciled in Maryland. Pursuant to the agreement, AGC provides a staff of professional insurance and financial services executives, administrative and clerical personnel and payroll services to the participating companies in the Assured Guaranty Group. The Company provides office space and equipment to the participating companies in the Assured Guaranty Group. The agreement and a subsequent amendment were filed with the Department pursuant to Section 1505 of the New York Insurance Law and non-disapproved by the Department on June 22, 2011 and July 6, 2012, respectively.

Effective January 1, 2006, the Company entered into a service agreement with FSA Services (Americas) Inc. Under this agreement, the Company obtains support services in countries in the Americas, including Mexico, to conduct its business. The agreement was non-disapproved by the Department on December 29, 2005.

Effective October 1, 2002, the Company entered into a service agreement with FSA Services (Japan) Inc. Under this agreement, the Company obtains support services in Japan to conduct its business related to Japan. This agreement was non-disapproved by the Department on May 15, 2002.

### Net Worth Maintenance Agreements

Effective April 27, 1994, the Company entered into a net worth maintenance agreement with Financial Security Assurance UK Ltd., currently known as AG Europe. On May 16, 2011, the Company amended the net worth maintenance agreement. Under the amended agreement, the Company agrees to maintain AG Europe's qualifying capital resources at 110% of the minimum capital required of AG Europe under United Kingdom law and regulation, subject to certain limits. The agreement was non-disapproved by the Department on October 18, 2010.

On September 23, 1997, the Company amended a net worth maintenance agreement originally dated April 27, 1994. The amendment replaced Financial Security Assurance of Maryland Inc. as a party to the agreement with AGMIC. The Company agrees to maintain AGMIC's policyholders' surplus of \$66,400,000 as determined under the laws of the State of New York or such greater amount subject to certain limits. The Company did not make any contributions pursuant to this agreement as of December 31, 2011. This agreement was non-disapproved by the Department on April 11, 1997.

On November 3, 1998, the Company entered into a net worth maintenance agreement with its subsidiary AG Bermuda. Under this agreement, the Company agrees to cause AG Bermuda to maintain the minimum shareholders' equity required under the laws of Bermuda, subject to certain limits. This agreement was non-disapproved by the Department on October 30, 1998.

### Trust Agreements

Effective March 21, 2011, the Company entered into a trust agreement with its affiliate, AG Bermuda and The Bank of New York Mellon as the trustee. The agreement was entered into in order to secure payments in connections with reinsurance agreements between the Company and AG Bermuda. An exception was noted and explained hereafter.

Effective December 23, 2004, the Company entered into a trust agreement with AGMIC and The Bank of New York as the trustee. This agreement was entered in order for the Company to take reinsurance credit for business ceded to AGMIC as required by California laws since AGMIC is an unlicensed reinsurer in California. The Agreement was non-disapproved by the Department on December 20, 2004.

Effective January 1, 1995, the Company entered into a trust agreement with Capital Mortgage Reinsurance Company (Bermuda) Ltd., as grantor, and the Chase Manhattan Bank N.A., as trustee. Capital Mortgage Reinsurance Company (Bermuda) Ltd. later became Assured Guaranty Re Overseas Ltd. (“AGRO”). On March 16, 2006 and August 28, 2008, the Company amended the trust agreement. The first amendment to the trust agreement was to reflect the Company’s name change while the second amendment was to reflect a change in the trustee from the Chase Manhattan Bank N.A. to the Bank of New York Mellon (“BONY”). On July 1, 2009, the Company became affiliated with AGRO. Neither the trust agreement nor the amendments to the trust agreements were subject to Section 1505 of the New York Insurance Law since they were executed prior to the date of which the Company and ARGO became affiliated. An exception was noted and explained hereafter.

Effective September 30, 2003, the Company entered into a trust agreement with ACE Capital Re International Ltd., as grantor, and State Street Bank and Trust, as trustee. ACE Capital Re International Ltd. later became AG Re. On March 21, 2006 and August 28, 2008, the Company amended the trust agreement. The first amendment to the trust agreement was to reflect the Company’s name change while the second amendment was to remove State Street Bank as trustee and to appoint the BONY as the new trustee. On July 1, 2009, the Company became affiliated with AG Re. Neither the trust agreement nor the amendments to the trust agreements were subject to Section 1505 of the New York Insurance Law since they were executed prior to the date of which the Company and AG Re became affiliated.

#### Regulation 114 Exceptions

Sections (d)(1) and (d)(2), and (f)(5) of Regulation 114 of the Department state as follows:

(d) The trust agreement must be clean and unconditional, in that:

- 1) the trust agreement must stipulate that the beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee;
- 2) no other statement or document need be presented in order to withdraw assets, except the beneficiary may be required to acknowledge receipt of withdrawn assets.

(f) The trust agreement must provide for the trustee to:

- 5) upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the beneficiary and deliver physical custody of such assets to such beneficiary.

A review of the second amendment to the trust agreement among the Company, AGRO, and BONY, revealed that trust agreement lacked the required provision set forth in Sections (d)(1), (d)(2), and (f)(5) of Regulation 114 of the Department. A review of the second amendment to the trust agreement among the Company, AG Bermuda, and BONY also revealed that the trust agreement lacked the required provision set forth in Section (f)(5) of Regulation 114 of the Department. Additionally, the Company did not file the trust agreement among itself, AG Bermuda and BONY with the Department pursuant to Section 1505 of the New York Insurance Law.

Upon notification from the examiners of the missing provisions, the Company submitted the draft agreements containing the required provisions to the Department on May 8, 2013. The Department review is currently pending.

#### Agreements for Cooperative and Joint use of Personnel, Property and Services

The Company has in effect as of December 31, 2011, various agreements among its affiliates and subsidiaries for cooperative and joint use of personnel, property and services. Under these agreements, the Company provides property, equipment and services available, with respect to administrative, audit, underwriting, accounting, legal, marketing, claims, electronic data processing, compliance and surveillance, reinsurance, as will enable them to conduct their business and other corporate functions. The Company charges costs (direct and indirect) and expenses for providing such services. These agreements were non-disapproved by the Department.

#### Guaranty Underwriting

Effective July 1, 2000, the Company entered into a guaranty underwriting representative agreement with its affiliate, Assured Guaranty (Australia) PTY Limited (“AG Australia”), whereby AG Australia provides services to the Company for the issuance of guaranties with respect to financial transactions involving Australia assets or obligors. This agreement was non-disapproved by the Department on June 5, 2001.

#### Surplus Notes

On September 8, 2008, the Company borrowed \$300 million from its parent, AGMH, in the form of convertible surplus notes. These notes are non interest bearing and have no stated maturity. Principal of the notes are payable at any time at the option of the Company, subject to prior approval

by the Department. The Company repaid \$125 million during the examination period. The remaining outstanding balance is \$175 million at December 31, 2011. The purchase and repayments of these notes were approved by the Department.

On December 18, 2009, the Company purchased \$300 million of surplus notes from AGC. These notes are interest bearing at a rate of 5% per annum. Principal of the surplus notes are payable at December 31, 2029 or sooner at the option of AGC, subject to prior approval of the Maryland Insurance Administration and compliance with the conditions to such payments as contained in the laws of the State of Maryland. The Company received \$15.0 million and \$15.5 million of interest on these surplus notes from AGC on December 30, 2011 December 31, 2010, respectively. Purchase of these surplus notes was approved by the Department on December 15, 2009.

#### E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2011, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	12%
Liabilities to liquid assets (cash and invested assets and accrued income less investments in affiliates and other invested assets)	101% *
Premiums in course of collection to surplus as regards policyholders	2%

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC. The outrange ratio is caused by the substantial amounts of unearned premium reserves and contingency reserves the Company required to maintain for financial guaranty business.

The underwriting ratios presented below are on an earned/incurred basis and encompass the four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$1,510,930,043	141.59%
Other underwriting expenses incurred	251,832,610	23.60
Net underwriting loss	<u>(695,613,729)</u>	<u>(65.18)</u>
Premiums earned	<u>\$1,067,148,924</u>	<u>100.00%</u>

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2011 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u> Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$2,778,465,903	\$ 0	\$2,778,465,903
Common stocks	626,259,355	0	626,259,355
Cash, cash equivalents and short-term investments	319,756,872	0	319,756,872
Other invested assets	337,082,440	0	337,082,440
Receivables for securities	3,917,525	0	3,917,525
Investment income due and accrued	32,204,912	0	32,204,912
Uncollected premiums and agents' balances in the course of collection	36,748,747	12,372,276	24,376,471
Amounts recoverable from reinsurers	80,859,470	0	80,859,470
Current federal and foreign income tax recoverable and interest thereon	123,015,209	0	123,015,209
Net deferred tax asset	141,222,600	88,784,566	52,438,034
Electronic data processing equipment and software	44,728	41,094	3,634
Furniture and equipment, including health care delivery assets	16,625,397	16,625,397	0
Receivables from parent, subsidiaries and affiliates	2,756,481	1,018,346	1,738,135
Miscellaneous receivable	4,969,252	366,210	4,603,042
Prepaid expenses	2,487,736	2,487,736	0
Other assets	<u>1,563,355</u>	<u>660,651</u>	<u>902,704</u>
Totals	<u>\$4,507,979,982</u>	<u>\$122,356,276</u>	<u>\$4,385,623,706</u>

## Liabilities, surplus and other funds

	<u>Examination</u>
Losses	\$ 198,617,696
Loss adjustment expenses	13,423,865
Other expenses (excluding taxes, licenses and fees)	19,051,620
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,606,569
Unearned premiums	1,398,563,863
Ceded reinsurance premiums payable (net of ceding commissions)	33,206,349
Funds held by company under reinsurance treaties	103,089,601
Amounts withheld or retained by company for account of others	11,624
Payable to parent, subsidiaries and affiliates	16,763,797
Payable for securities	8,110,296
Contingency Reserve	1,238,030,526
Miscellaneous Liability	<u>143,843,918</u>
Total liabilities	\$3,176,319,724
Common capital stock	\$ 15,000,000
Surplus notes	175,000,000
Gross paid in and contributed surplus	776,884,430
Unassigned funds (surplus)	<u>242,419,552</u>
Surplus as regards policyholders	<u>\$1,209,303,982</u>
Totals	<u>\$4,385,623,706</u>

Note: The Internal Revenue Service is currently auditing the Company's consolidated Federal Income Tax returns covering tax year 2006 through 2009. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2010 through 2011. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders decreased \$419,635,598 during the four-year examination period January 1, 2008 through December 31, 2011, detailed as follows:

Underwriting Income

Premiums earned		\$1,067,148,924
Deductions:		
Losses and loss adjustment expenses incurred	\$1,510,930,043	
Other underwriting expenses incurred	251,832,610	
Total underwriting deductions		<u>1,762,762,653</u>
Net underwriting gain or (loss)		\$ (695,613,729)

Investment Income

Net investment income earned	\$ 653,383,122	
Net realized capital gain	<u>(62,092,206)</u>	
Net investment gain or (loss)		591,290,916

Other Income

Aggregate write-ins for miscellaneous income	\$ <u>56,550,565</u>	
Total other income		<u>56,550,565</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ (47,772,248)
Federal and foreign income taxes incurred		<u>(79,213,980)</u>
Net Income		\$ <u>31,441,732</u>

C. Capital and Surplus

Surplus as regards policyholders per report on examination as of December 31, 2007			\$1,628,939,580
	<u>Gains in</u> <u>Surplus</u>	<u>Losses in</u> <u>Surplus</u>	
Net income	\$ 31,441,732		
Net unrealized capital gains or (losses)		\$ 531,834,468	
Change in net unrealized foreign exchange capital gain (loss)	34,361,644		
Change in net deferred income tax	13,955,090		
Change in nonadmitted assets	34,895,332		
Change in surplus notes	175,000,000		
Capital changes transferred from surplus (stock dividend)	615,687		
Capital changes transferred to surplus		615,687	
Surplus adjustments paid in	421,681,645		
Surplus adjustments transferred to capital (stock dividend)		615,687	
Dividends to stockholders		40,000,000	
Change in contingency reserves		461,891,847	
Change in net unrealized on other assets		1,244,337	
Tax and loss bonds		95,108,547	
Other adjustment	<u>23,846</u>	<u>0</u>	
Net increase (decrease) in surplus	<u>\$711,974,976</u>	<u>\$1,131,310,573</u>	<u>(419,635,598)</u>
Surplus as regards policyholders per report on examination as of December 31, 2011			<u>\$1,209,303,982</u>

#### 4. **LOSSES AND CONTINGENCY RESERVES**

The examination liabilities for losses and contingency reserves are \$198,617,696 and \$1,238,030,526, respectively, as of December 31, 2011. These are the same as the amounts reported by the Company in its 2011 filed annual statement.

In addition to case reserves, the Company is required to establish and maintain contingency reserves for the protection of insureds and claimants against the effect of excessive losses occurring during adverse economic cycles. The amount required for these reserves depends on the type of bonds being insured and are established pursuant to the provisions of Section 6903(a) of the New York Insurance Law.

A review of the Company's case reserve losses methodology, surveillance and modeling was conducted. Losses were evaluated for selected liabilities in Public Finance, RMBS, CMBS, CRE CDO, CLO and other structured credit securities. It was found the surveillance and reserve setting processes adequate and largely in line with accepted market practices.

The Company's estimate of reserves for losses on its exposures is based on certain assumptions. Changes in such assumptions could materially adversely affect such reserve estimates, including those as a result of more adverse macroeconomic conditions, the bankruptcies of issuers of bonds insured or swap counterparties, and the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company; these exposures may result in significant increases in claims beyond that assumed in the Company's reserve estimates (that may or may not result in an increase in such loss reserves) against the Company. In addition, the value of its investment portfolio could change and have material adverse affect.

#### 5. **SUBSEQUENT EVENTS**

##### Rating Downgrade

On January 17, 2013, Moody's Investors Service ("Moody's") downgraded the Insurance Financial Strength ("IFS") rating of the Company to A2 from Aa3. Moody's also downgraded AGC's IFS rating to A3 from Aa3 and AG Re's IFS rating to Baa1 from A1. In the same rating action, Moody's also downgraded the senior unsecured debt ratings of both Assured Guaranty US

Holdings Inc. and AGMH, to Baa2, from A3. The outlook for the ratings is stable. The rating action has implications for the various transactions wrapped by the Company and AGC.

### Restructuring Plan

AGL has proposed an internal reorganization, which includes the capitalization of its indirect, 100% owned insurance company subsidiary, MAC, and certain related transactions. As part of this reorganization, AGMIC is expected to merge with and into the Company, with the Company continuing as the surviving company, and AG Bermuda is also expected to cease to exist. Following completion of the entire reorganization transaction, the Company and/or AGC will indirectly own 100% of MAC. The proposed reorganization, including the foregoing transactions, is subject to regulatory approval which is pending.

6. **COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report on examination contained one recommendation as follows (page number refers to the prior report):

<u>ITEM</u>		<u>PAGE NO.</u>
A	It was recommended that the Company does not set subrogation recoverable as an asset but rather as a debit against the reported case reserves.	17

The Company has complied with this recommendation.

7. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>		<u>PAGE NO.</u>
A	<u>Management</u> It is recommended that the Company hold Annual shareholders' meetings in accordance with schedule specified in its by-laws and maintain minutes for those meetings.	6

Respectfully submitted,

\_\_\_\_\_/s/  
Ian Martin  
Senior Insurance Examiner

STATE OF NEW YORK     )  
  )ss:  
COUNTY OF NEW YORK    )

Ian Martin, being duly sworn, deposes and says that the foregoing report, subscribed by him is true to the best of his knowledge and belief.

\_\_\_\_\_/s/  
Ian Martin

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2013

*APPOINTMENT NO. 30849*

*NEW YORK STATE*

***DEPARTMENT OF FINANCIAL SERVICES***

*I, BENJAMIN M. LAWSKY, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:*

*Ian Martin*

*as a proper person to examine the affairs of the*

***ASSURED GURANTY MUNICIPAL CORP.***

*and to make a report to me in writing of the condition of said*

***CORPORATION***

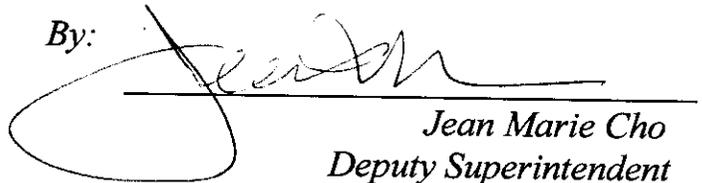
*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed my name  
and affixed the official Seal of the Department  
at the City of New York*

*this 8th day of May, 2012*

*BENJAMIN M. LAWSKY  
Superintendent of Financial Services*

*By:*

  
*Jean Marie Cho  
Deputy Superintendent*

