



February 29, 2012

Assured Guaranty Ltd. (AGO) - Q4 2011 Earnings Call

Corporate Participants:

Robert S. Tucker - Managing Director of Investor Relations and Corporate Communications
Robert A. Bailenson - Chief Financial Officer
Dominic J. Frederico – President and Chief Executive Officer

Other Participants:

Mark Palmer - BTIG LLC
Brian R. Meredith - UBS Securities LLC

Operator:

Good morning and welcome to the Assured Guaranty Limited Fourth Quarter 2011 Earnings Conference Call and Webcast. All participants will be in listen only mode. Please note this event is being recorded. I would now like to turn the conference over to Mr. Robert Tucker, Managing Director of Investor Relations and Corporate Communications. Mr. Tucker, please go ahead.

Robert S. Tucker

Managing Director of Investor Relations and Corporate Communications

Thank you. Good morning and thank you for joining Assured Guaranty for our Fourth Quarter 2011 Financial Results Conference Call. Today's presentation is made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. It may contain forward looking statements about our new business and credit outlooks, market conditions, credit spreads, financial ratings, loss reserves, financial results, future reps and warranty settlement agreements or other items that may affect our future results.

These statements are subject to change due to new information or future events. Therefore, you should not place undue reliance on them as we do not undertake any obligation to publicly update or revise them, except as required by law. If you're listening to a replay of this call or if you are reading the transcript of the call, please note that our statements made today may have been updated since this call. Please refer to the Investor Information section of our website for our recent presentations, SEC filings, most current financial filings, and for the risk factors.

And turning to the presentation, our speakers today are: Dominic Frederico, President and Chief Executive Officer of Assured Guaranty Limited; and Rob Bailenson, our Chief Financial Officer. At the end of this, we will open up the call to your questions. As the webcast is not enabled for Q&A, please dial in to the call if you'd like to ask a question. I would now turn the call over to Dominic.

Dominic Frederico
President and Chief Executive Officer

Thank you, Robert, and thanks to all of you for your interest in and in support of Assured Guaranty.

In 2011, we earned near-record full year operating income of \$604 million and continued our steady growth in adjusted book value per share which reached a new year-end high of \$49.32.

We successfully addressed new rating criteria from S&P by focusing on capital enhancement strategies that did not include raising common equity. Overall, we are very pleased with the results we achieved during a year filled with challenges from the housing market, the U.S. economy, Euro zone troubles and rating agency pressures.

We also continued to benefit from the success of our RMBS, R&W loss mitigation efforts. And finally, we took steps to further enhance shareholder value, including buying back 2 million shares at an average price of \$11.66 per share. And in the first quarter of 2012, we doubled our quarterly dividend to \$0.09 per share common share starting in March of 2012.

In terms of business production, our full year PVP was \$243 million. And while this fell short of what we thought we could achieve at the beginning of the year when we were rated AA+ stable by S&P, we view our origination results as encouraging in light of the significant obstacles we encountered, which also included the lowest U.S. municipal issuance in 10 years and the slow pace of recovery for the international infrastructure and structured finance markets.

In addition to our \$243 million in PVP, we created additional economic shareholder value by executing well planned alternative strategies. By purchasing \$856 million of par of our own insured securities at an average price of 49% of the par, we eliminated \$320 million of expected loss and embedded future earnings of \$103.2 million which we will receive as the collateral pay down. We also collected over \$1 billion of previously paid losses through our rep and warranty recovery process from originators of faulty mortgage loans.

And finally, we added \$34.5 million of unearned premium and commutation gains from the recapture of previously reinsured business.

One further note on earnings is that our operating income of \$604 million was negatively impacted by a change of approximately \$130 million due solely to a decline in the risk free interest rates that are used in GAAP to calculate the present value of future losses. The change in that rate and the corresponding impact on income, does not relate to any credit deterioration in the performance of our insured portfolio.

Our 2011 business production did demonstrate a fundamental demand for municipal bond insurance where we guaranteed 1,228 new municipal bond issues or over 12% or one out of almost every eight municipal issues sold during the year. Our total par insured amount was \$15.2 billion. We believe this is a strong showing considering the uncertainties surrounding our ratings during much of 2011 and the 34% decline in new issuance volume. Even at these levels of production, we estimate our insurance saved issuers as much as \$150 million in present value financing costs.

Looking closer at new business, in 2011, almost 80% of the U.S. public finance par we insured came from transactions in our principal target market which is issues of single A underlying credit quality where we guaranteed 38% of the transactions sold and 16% of the par issued in this rating category.

While most of our recent new business originations have been in the U.S. municipal market, we saw increasing opportunities in the international and structured finance areas. We are pleased that our U.S. municipal, international infrastructure and structured finance businesses all made meaningful contributions to our production in the fourth quarter.

In structured finance globally, we insured \$1.7 billion of par which generated \$67 million of PVP, twice the amount we produced in 2010, with \$30.2 million of that PVP in the fourth quarter alone. We continue to work with large financial institutions on transactions that provide credit protection for selected assets and enable more efficient capital management.

In the international market, we introduced a solution that should aid in our international production for infrastructure financing. The first such transaction which we closed in December, we replaced Ambac, the original guarantor with Assured Guaranty on a UK hospital transaction. Investors are interested in our replacement guaranty because of our ratings and comprehensive surveillance, both providing critical benefits to investors.

Turning to our insured risk portfolio at year-end, apart from RMBS and a limited number of one off transactions, our portfolio is performing well.

In public finance, our overall U.S. municipal portfolio continues to maintain an average underlying internal credit rating of A+ and has experienced only modest loss development on a few isolated transactions. While we are anticipating some ongoing fiscal pressure for states and municipalities, we believe municipal bond defaults will remain rare. Nonetheless, many investors are sensitive to headline risk in this environment which should increase the demand for bond insurance going forward.

For municipal defaults in 2011, we did provide uninterrupted payments for bond holders most notably to holders of our insured sewer system warrants of Jefferson County, Alabama, and of our resource recovery facility bonds for a project in Harrisburg, Pennsylvania. This relieved our insured investors that the need to participate in what is turning out to be a prolonged and politicized process. This is exactly what bond insurance is for and clearly reinforces the value of our product.

Having first made sure investors were protected, we attempted to work constructively with local authorities on both cases, and negotiations had produced reasonable settlement proposals with concessions from all parties. Unfortunately, elected officials lack the political will to accept them. Instead, they are attempting aggressive usage of Chapter 9 with the Federal Bankruptcy Code to avoid their debt obligations. We are closely monitoring this new development, and it is weighing more heavily in our analysis of the legal framework for bankruptcy in every state where we insure municipal securities.

We believe that local governments must recognize their responsibilities to honor commitments established by current and former duly elected officials and follow through on them. Some local officials seem to believe that threatening bond defaults and not utilizing all means available to honor contractual commitments will help their constituents. Such short term thinking is a breach of trust with creditors and ultimately will hurt local communities through higher

expenses and limited access to debt markets. We also believe that by defending investors' rights and challenging abuses of the Bankruptcy Code, we are supporting the integrity of the municipal bond market which is long term beneficial for all parties.

Moving on to our structured finance portfolio, in 2011, we ran off \$33.5 billion or 22% of the par in deploying that portfolio.

The U.S. RMBS portion decreased by \$3.6 billion to bring its balance at yearend to \$21.6 billion, of which only \$14.7 billion is non investment grade. And of this, \$4.4 billion or 30% is covered by loss mitigation agreements. This further runoff of these exposures will continue to enhance our rating agency capital.

Loss mitigation continues to be a central part of our management focus. In 2011, in the RMBS area, we concentrated on exercising recovery rights and improving performance in transactions where we paid claims where we expect losses. To do this, we continued to examine loan files for rep and warranty breaches in RMBS. By year end, for RMBS transactions with unsettled R&W claims, we've reviewed more than 37,000 nonperforming loan files representing \$7.3 billion of par in our outstanding financial guaranty and in CDS transactions.

We are among the first companies to substantiate to a very specific stand of misbehavior in this market and since we've begun to focus on this process in 2008, our efforts have produced a cumulative total of \$2.4 billion in settlement recipients commitments from rep and warranty providers in our transactions. An outstanding result that sets Assured apart from others in the market.

As we said in previous presentations, because of our confidence in our rep and warranty rights, we anticipated that the bulk of our RMBS losses will ultimately be paid by third parties. In 2011, this is exactly what happened as further reserve increases due to the slow recovery of the RMBS market were offset by rep and warranty recoveries. We are hopeful that we will see further improvement in this performance during 2012 as we move closer to trial dates regarding the merits of the rep and warranty disputes. Further, we believe when these cases are litigated, that the outcomes will be favorable to the monoline industry.

Our RMBS loss mitigation activities also involved servicing intervention where we continue to move more aggressively to reduce delinquencies and collateral losses in our outstanding RMBS transactions. By year end, we had made arrangements to replace the servicer or impose special servicing contracts on 23 transactions with an aggregate outstanding collateral balance of \$3.6 billion.

Our goal for 2012 is to transfer or to place under special servicing contracts approximately \$4 billion of additional collateral. We are already seeing improvement in collateral performance that may ultimately reduce future claims. For example, in our first lien book under special servicing, we have seen significantly better performance when compared with industry statistics, including improvements of as high as 12% in loss severities, 50% in re default rates on loan modifications, and 71% in the average days delinquent in the 90 plus buckets. This effort could lead to reduced loss costs in 2012 and beyond.

In turning to our international exposures, we are closely monitoring several countries affected most affected by Europe's economic, fiscal and political strains. In these countries, our exposure to purely sovereign bonds is limited to Greece where we have \$282 million of net

exposure to the Greek government. This exposure consists of a bilateral guarantees of \$214 million due in 2037 and \$68 million due in 2057. Both exposures are bullet maturities, and our guaranty does not cover accelerated principal or voluntary exchange. To this point in time, Greece has been paying interest on this debt on a timely basis. We have considered a variety of scenarios in looking at a potential loss on these transactions and as of the fourth quarter we have posted a \$43 million net reserve. While we guarantee certain international infrastructure and receivable financings, some of which depend on payments from sources which could include government entities or agencies in such European countries. We do not guarantee any sovereign debt of those countries other than the Greek debt previously mentioned. We are publishing more detail on our European exposure in our 10K.

I want to close by thanking our shareholders and policy holders for their patience and support during the year that presented significant challenges. I am pleased to say that in my view, we have come through in excellent shape.

We clearly demonstrated the value of our product in 2011. We've prevented payment interruptions for our insured investors while providing capital market access and improved execution for a wide range of public finance issuers, helping them save an estimated \$150 million in financing costs.

Our guaranty also enabled institutions outside the public finance sector to achieve more efficient capital management.

We are well positioned to expand our direct financial guaranty business based on the proven strength of our value proposition. We honor our financial guaranties whenever an issuer fails to pay, no matter the reason, whether due to a lack of funds, fraud, or a lack of political will. In our recent experience, fraud and politics have driven most of our losses and we have worked hard for recoveries and vigorously defended the investor protections built into our transactions.

At the same time, we have insulated insured bond holders from the long and arduous recovery process by making timely payments. These benefits provide investors with greater confidence so issuers can more efficiently fund their communities or businesses.

As for 2012, we have already made a good start. We've received a payment of \$108 million for reassumption and reinsurance transaction that added \$15 billion of net par to our insured portfolio which was almost entirely public finance exposure and nearly as much par as our full year 2011 public finance originations. As we have said in the past, we will continue to seek out opportunities to make strategic acquisitions of existing financial guaranty portfolios.

Further, as part of that transaction which is subject to regulatory approval, we agreed to acquire MIAC from Radian Asset Assurance. MIAC is licensed to provide financial guaranty insurance in 38 U.S. jurisdictions. This acquisition enhances our flexibility to respond to future demands of financial guaranty industry. I look forward to reporting to you on our 2012 business activities and financial results over the coming year.

I will now turn the call over to Rob Bailenson for more details on full year and fourth quarter financial results.

Robert Bailenson
Chief Financial Officer

Thank you, Dominic, and good morning to everyone on the call. Today, I will briefly review the financial highlights before providing more detail on the individual components of operating income and economic loss development in the insured portfolio. I refer you to our press release and financial supplement for explanations and reconciliations of our non-GAAP financial measures. In my commentary, all comparisons are to comparable prior year periods.

Overall, I am very pleased with the 2011 financial results, particularly considering today's global market challenges. Our fourth quarter 2011 operating income increased 13.6% to 173.5 million, or \$0.95 per share. This brings our full year 2011 operating income to \$604.4 million or \$3.26 per share. The largest driver of the increase in fourth quarter 2011 operating income is a 62% decrease in the loss expense.

Operating income was the primary driver of the 11.7% increase in the operating shareholders' equity per share, which reached \$28.91 per share. This resulted in annualized operating ROE of 12.1% in 2011. Adjusted book value edged upwards to \$49.32 per share from \$48.92 per share at yearend 2010. Before I begin my operating income summary, I would like to highlight the financial impact of some of our strategic initiatives on the full year 2011 financial results and also update you on some 2012 developments. New business development increased our adjusted book value and added to our future earnings stream by \$242.7 million on a pretax basis. In addition, the company recognized \$32.2 million in commutation gains related to the cancellation of several reinsurance contracts.

As Dominic noted earlier, we continue to generate future earnings in 2012 with the Radian transaction which increases net par outstanding by \$14.7 billion and future net earned premium by approximately \$110 million. Loss mitigation efforts had a direct benefit on the financial condition of the company particularly our pursuit of recoveries for breaches of reps and warranties. In 2011 we closed the Bank of America Agreement, which resolved claims with our largest rep and warranty provider and we made significant progress with other counterparties. Resulting increase in the rep and warranty benefit almost entirely offset loss development caused by the slow recovery of the U.S. mortgage market.

As part of our approach to increase rating agency capital, we terminated contracts for the total of \$12.8 billion in net par in 2011. Additionally, in January 2012, we entered into an excess of loss reinsurance facility that provides up to \$435 million of claims paying resources. The facility covers investment grade, U.S. public finance credits insured or reinsured by AGM or AGC. This facility is a cost-efficient source of rating agency capital at an annual cost of 5% of the \$435 million in covered losses. These are just a few of the many approaches employed to achieve our goals. In addition to the obvious financial benefits I just described, the normal runoff of our legacy structured finance book of business provides us capital flexibility. It's enabled us to take advantage of new business opportunities and enhance shareholder value through stock buybacks and increased dividends. As such, we recently doubled our quarterly dividend to \$0.09 per share.

I will now discuss the components of operating income, which is one of the most significant measures that management uses to evaluate our results. Net earned premiums and credit derivative revenues were in line with expectations and totaled \$280.2 million for the fourth quarter 2011. Fourth quarter 2010 net earned premiums and credit derivative revenues of \$352.7 million were higher due primarily to a larger portfolio of structured finance in force business at that time.

Decline in net earned premiums and credit derivative revenues reflect scheduled amortization of par and the related unearned revenue. This was partially offset by higher refundings and accelerations in the public finance portfolio. Full year comparison shows a consistent pattern.

Full year 2011 net investment income was up 9.4% due primarily to the investment of a larger portion of our cash and short term liquid assets in longer term maturities and higher average invested assets.

The average size of the investment portfolio, increased to \$10.5 billion in 2011 from \$10.3 billion in 2010, predominantly as result of cash collected from rep and warranty providers. The pretax book yield on the investment portfolio was 4% at December 31, 2011 compared with 3.72% at December 31, 2010.

Our operating expenses decreased 7.1% to \$45.8 million in fourth quarter 2011. For the full year 2011, operating expenses declined 8.7%. Lower compensation expenses were the primary drivers of the decline. The effective tax rate on operating income varies from quarter to quarter due to the amount of income in different jurisdictions. It was 19.7% for the fourth quarter of 2011. Year to date, the effective tax rate on operating income was 24.5%, which is in line with our expectations of 24% to 28%.

I will now turn to losses. Total economic loss development was \$28.5 million during the fourth quarter of 2011.

U.S. RMBS contributed \$16.5 million to the total economic loss development in the fourth quarter of 2011, representing the continuation of higher than projected early stage delinquencies and the addition of a new scenario for first lien transactions whereby loss severities improve more slowly than had previously been modeled. These increases were largely offset by improvements in liquidation rates for first lien transactions, and the effects of ongoing loss mitigation.

During the quarter, we increased net expected losses related to Greek sovereign debt exposures by \$36.3 million, bringing the total net expected loss to \$42.6 million. In accordance with our accounting policy, we probability weighted various scenarios, which take into account the nature of our obligation and possible outcomes in Greece. Total economic loss development for the full year 2011 was \$123.8 million.

Economic loss development on U.S. RMBS before consideration of rep and warranty benefit was due mainly to an increase in projected defaults and the first lien loss severities. However, due to our success in negotiating rep and warranty recoveries, the increase in benefit for reps and warranties offset substantially all of the adverse development on the underlying collateral. Remaining economic loss development is primarily due to the decline in risk free rates used to discount expected losses, and the development on our Greek exposures. However, these were partially offset by improvements in certain other structured finance transactions.

Development attributable to changes in the risk-free rates used to discount losses is not indicative of additional credit impairment, nor is it reflective of our own investment yield.

I will now turn the call over to our operator to give you the instructions for the question and answer period. Thank you.

Operator: Thank you. We will now begin the question and answer session. And our first question this morning will come from Mark Palmer of BTIG. Please go ahead, sir.

Mark Palmer
Good morning.

Dominic Frederico
Good morning.

Robert Bailenson
Good morning.

Mark Palmer
Particularly in light of your recent dividend increase, could you comment on your thinking about the balance between capital return and the concerns of the ratings agencies regarding capital levels, particularly with your goal of achieving a more solid AA rating.

Dominic Frederico
I think you've hit the nail in the head. I mean basically we continue to await a final review that we expect some time in the first half of the year for Moody's, which I think will further allow us to then measure not only capital adequacy but obviously look at capital opportunities in terms of further capital management strategies like we've done in the past in terms of stock buybacks and increase in dividend. That number, hopefully, we should have we would believe in the first half of the year also gives us a better chance through the half of 2012 in sizing up business opportunities both from the standpoint of the normal markets plus other opportunities we see to acquire portfolios of risks and therefore, we can kind of work that into our overall capital model. But we're very focused on capital management. We're very focused on rating agency, capital adequacy and shareholder return. And as you could imagine, it's kind of a delicate balance act that we go through as we look to see what are the best decisions we can make relative to what we believe is excess capital in the company.

Mark Palmer
Thank you.

Operator
Our next question will come from Brian Meredith of UBS. Please go ahead.

Brian Meredith
Hey. Good morning. A couple of questions for you guys. First one, Skyway Concessions, could you tell us a bit what is that? It popped up on your list.

Dominic Frederico

That's a toll road around Chicago that we have exposure on. We don't believe there is an economic loss potential on this thing as we have concessions from the road that went to the 2105 or 2104 year, but there is a refinancing bullet that's due I think in 2017. So, really, we'll look at the ability of accomplishing a full refinancing which could leave us with a short term cash payment position that we believe is recoverable because of the extended concessions to the toll for the road that go out over a significant period of time that will allow us to fully recover our exposure.

Brian Meredith

Okay. Great. And then next question. The thing that happened with R&W, did you have to actually take down your R&W balance because it appeared like that you actually had additional losses in some of your second liens, but the R&Ws actually went down. Am I looking at that right?

Dominic Frederico

Well, you're looking at it right but for a couple of wrong reasons.

Brian Meredith

Okay.

Dominic Frederico

So, that went down because in some cases, deals which we had calculated an R&W benefit for actually reduced their ultimate loss cost. Therefore, we would then give the credit back to the R&W provider, right?

Brian Meredith

Yes.

Dominic Frederico

So, it kind of worked out. Two, we continue to receive payments. Therefore, that's going to reduce the balance. In terms of the activity in rep and warranty, we talked about the advances we made with another counterparty. They have continued, but I guess, as of this point in time, as we look to who's left in our queue for rep and warranty, it would appear that litigation is going to be or the near term dread of going to trial on some of these deals will be the only way we're going to get further agreements at this point in time.

If you look at the disclosure and I think in our K we'll be a little bit more specific. But some of the counterparties that you're well aware of if you read their disclosures as of yearend, some of them continue to recognize liability. They've increased their reserves. Therefore, we expect they will be still open to negotiation and settlement. Others have continued to bury their head in the sand like Credit Suisse for a good example that have no reserves up and do not seem to admit to any liability. So, those types of situations are going to ultimately get settled. And we do still think we're optimistic that it's this year because there are three trials that theoretically will be heard this year. We are one of them, Ambac is another, and MBIA is the third. And obviously, we believe very optimistically that if any of these actually do get into a courtroom, it will be a very good day for the monoline industry and the bond insurers.

Brian Meredith

Great. And lastly, any thoughts on Moody's and when we're going to hear from them?

Dominic Frederico

If I had a thought, Brian, I'd tell you but it's been a little bit of a surprise. Obviously, as you will know, the last time they gave us a review was in 2009 on our portfolio as of June 30 of 2009, you could think of the dramatic changes as I've said. Just look at in the current year, we ran off a significant amount of the structure just in 2011 let alone going all the way back to 2009. So, I think we've got a more risk adverse portfolios. Some of the troubled exposures have run down. Obviously, our reserve position is different, the excess of loss program that Rob Bailenson put into place, the rep and warranty settlements that we've made. We obviously believe that they would have a positive impact but it's still a process that we've not been given a whole lot of information that would lead us to a conclusion that will the timing and/or the result is eminent.

Brian Meredith

Thanks

Dominic Frederico

You're welcome.

Operator

Our next question will come from Geoffrey Dunn of Dowling & Partners. Please go ahead.

Geoffrey Dunn

Thank you. Good morning.

Dominic Frederico

Hey, Geoff.

Robert Bailenson

Hey

Geoffrey Dunn

Good morning. This is the first chance I'm going to ask you in an open forum, what do you think the implications are on the capital changes from the S&P model? How much has it narrowed the market, if at all, versus the historical market, and how the charges generally affected the returns on new business prospects?

Dominic Frederico

Geoff, as you know, we have to manage ourselves relative to the three capital models, right, our own view of risk and the equity capital we hold, the S&P risk model and then the Moody's risk model. And we do not leave ourselves a slave to one. We don't take the lowest common denominator as we assess risks. So, for instance, you would point out or I could point out to you that if were in a certain healthcare deal, if you look at the S&P model that would have very low single digit return. But remember, the S&P model counts things beyond equity capital as part of the capital ways to which we can write against.

So, we did a reinsurance program at a 5% cost, obviously, that allows us more flexibility in writing lower ROE "program" relative to an S&P capital base. While at the same time, that same deal might be a plus 20% return under the Moody's model and a 15% return under our own equity model. So, we don't leave ourselves a slave to anyone model as the way we look at returns. We look at returns overall, and since we can create rating agency capital that's got equity capital, the cost of that capital obviously varies and therefore, it allows us more flexibility in terms of permissible writings relative to a return scenario.

Geoffrey Dunn

Okay. And then just revisiting the capital management question. I think historically, it's been a battle to even, for you guys, to get copies of the rating agency capital model. So, going forward, is capital management going to be completely an interactive experience for the rating agencies or are you going to have a decent way of judging what your excess capital truly is against their models?

Dominic Frederico

Well, it's been a little bit interactive and challenging I think as they've been trying to assess where is the bottom of the market in this freefall economy and through the financial crisis that we've gone through, I don't think they knew. So, therefore, they were going to react without a whole lot of advanced notice and very conservatively, I think as more stability comes to the market, you're going to see more certainty around capital benefits or capital requirements. So, one of the things I'd tell you is I think internally, and we won't release it, we have a very good comfort level in terms of what our excess capital is under the S&P model and therefore we can react accordingly to that. We would hope that coming out of the Moody's review, we get that same kind of confirmation, and therefore, I think capital management for the company. As you look at 2012 and 2012 is still a bad benchmark. We always hope to look for normalcy in the markets but with the zero interest rate environment, there is no normalcy. You're not going to see penetration at any level, a real normalcy at that level of interest rates because people are going to be fighting for yields and returns and therefore insurance becomes kind of the last thing you want to think about. So, it's not an easy market for us to gauge business opportunities. However, we are working hard in other areas to create other business opportunities, and specifically in the portfolio and servicing side that we continue to spend a lot of time in strategic manpower to address and to try to cultivate this opportunity.

So, obviously, we'd like to get a good capital base, a good capital requirement, understand where our capital flexibility is, look at our business opportunities to gauge that capital need against that and then, sort of, balance, obviously, do aggressive capital management to benefit the shareholders. That's kind of the game plan, that's the formula we have. And we see some of the pieces falling in place except for, as I said, it's hard to judge to business opportunities in a zero interest rate environment. It just won't give us a good proper reading on what demand will be in that market. So, you got to be a little cautious, but I think we're willing to be as aggressive as we can be once we get the Moody's review, kind of, finished and done and get a good feeling for what that capital position is.

Geoffrey Dunn

And then last question, obviously, it's only been a couple of months but can you qualitatively discuss the reaction of issuers to the S&P's stable rating? It looked like maybe you probably have some recovery in the fourth quarter from penetration level. Have you seen continued either true penetration increasing in January, February or at least on a qualitative level acceptance with emerging with that rating now stable?

Dominic Frederico

Well, the statistics would support that, Geoff. Obviously, penetration rates in the quarter, in the fourth quarter were better than the previous quarters. First quarter, if you look at January, I don't if it's public or not, but the numbers are up again. And significantly over January of last year, but that's not meaningful because that's the time when S&P came out with their new rating criteria proposal.

So, we are seeing that. We're seeing ourselves being used on bigger deals. We're seeing some institutional buying. But it's still sporadic. And as I said, and as your interest rate environment, it's just hard to really say that this is a good measuring point. Therefore, we should then base all of our forecasts on something that's artificial. And until we get real interest rates and real spreads back at the market, it's going to be harder to really say, here its victory or its defeat.

But we are encouraged by the results we see today. We continue to work very hard on the calendar to make sure that we're getting a good look at every deal that comes to the market in the U.S. municipal marketplace. And obviously, well, based on this guarantor replacement deal we did in the UK, we're somewhat optimistic. Although we still think that activity will be sporadic in 2012. At least we're on the map, we've got a clear direction on how we think we can add value and therefore create opportunities in a market that's been basically dormant for two years.

For ourselves, we're seeing kind of snippets here and there that show a positive value. And if you say, "some of that relates S&P," I could tell you yes because when they came out in January, we got a whole lot of negative feedback from the market saying, "We're not sure where you guys are going to wind up. It's going to be hard for us to support using your guaranty when we're unsure of what your ultimate future looks like from an S&P criteria point of view. So, I think it has been helpful that they came to a conclusion that we're able, because of the strategies that we put into place, to generate rating agency capital that we are able to maintain that in the AA category. Yes, you're right; it's a AA minus level. But if you read their announcement is a chance for upgrade, if we get some further capital enhancement things done. And remember, they give us no credit for rep and warranty asset on the books. So, we're optimistic that we're going to be able to do something in that line in 2012 as well. So, I think all in, yes, I there's a more positive view of us, of our insurance. I think S&P helped tremendously in getting rid of some of the uncertainty. It's just a hard market to gauge throughout the zero interest rate environment but we're still reasonably optimistic that we're making inroads and starting to build back demand in this marketplace.

Geoffrey Dunn

Okay. Thanks for the color.

Dominic Frederico

You're welcome.

Operator

And our next question will come from Larry Vitale of Moore Capital. Please go ahead.

Larry Vitale

Thank you. Good morning. I have a few questions. First is on the reinsurance transaction, I just want to make sure – Dominic, I understand what you said, it was \$435 million limit or you ceded away \$435 million of par outstanding? How did that work?

Dominic Frederico

Yes. Well, I'll let Rob talk to you about it.

Robert Bailenson

Hi, Larry. It's an excess of loss agreement whereby the reinsurers will attached excess of a certain amount within the S&P capital model within their seven year depression test. And it will be \$435 million excess of that amount. So, we get full capital credit for the purchase of that cover.

Larry Vitale

Okay. And did you consider buying more? Was it a matter of price? Was it a matter of how much cover they're willing to provide?

Larry Vitale

Can you give us any color on that at all?

Robert Bailenson

Well, we were very sensitive to price and at some point, we were just not going to do it because, we've been saying all along that we're not going to pay for something that is not going to be a good source of capital, a good cost efficient source of capital. Raising equity in this market would have been very expensive. The cost of debt in this market would have been expensive. A 5% cost on a excess of loss muni portfolio provides a rating agency benefit for S&P, a 100% benefit within their depression model and we were very sensitive on price. We thought the price was appropriate. We thought it was cost efficient. And we have very good syndicate, five highly rated reinsurers in the property casualty market. So, we're very pleased with it.

Larry Vitale

Okay.

Dominic Frederico

I think, Larry, kind of look at here from the top, a: it creates a new source of capital for not only Assured but for the industry that brings new players into our market. Obviously, the first one is always the most difficult to get done. Obviously, we believe in the integrity of our underwriting and therefore, the results and therefore, we don't expect the cover to be used. But obviously it does create the rating agency relief that we needed to continue to manage the company to the highest ratings possible and yet balancing what is the component of that rating agency capital. We continue to look for the most efficient kind of capital mix, bringing in something like this, obviously, create more efficiency, lowers the overall cost of capital, very effective from the rating agency. And if we finally, and I'll give Rob Bailenson all the credits since he ran with this solely. Once we actually got the recovery in place, got through all the agreements and how this thing was structured and where it participates, we didn't start to get offers of additional capacity which we did turn down because obviously we could buy as much we want but it's not beneficial. That would make no sense. We were looking...

Larry Vitale

Great.

Dominic Frederico

We were looking to create great headlines here. We were looking at rating agency capital. And we're optimistic that this will become a future part of our capital strategy. And we do believe that the cost will lower upon subsequent renewals.

Larry Vitale

Yeah, I know. It all seems to make sense. My second question, Dominic, I just want to make sure I heard you correctly. You said you have comfort that you have excess capital on the S&P model. You're not going to tell us how much but you do, in fact, have excess relative to S&P?

Dominic Frederico

Yes.

Larry Vitale

Okay. And my third question is you talked about actually what appeared to be a pickup in the yield on the investment portfolio. And I'm just wondering how you're thinking about new money reinvestment rates or reinvesting coupons and maturities in this environment. You talked a lot about the zero interest rate environment and that's one place where I would think it's going to bite. So, if you could just talk about that a bit, that'll be great. Thanks.

Robert Bailenson

Larry, you're right, reinvestment rates are a problem, but what we have done is we have strategically taken some of our short term portfolio and gone a bit longer on the curve. We have not gone down from credit. We've not gone down the credit curve but we've gone a bit longer, so put more money to work on my short term portfolio.

And what you're seeing in the investment yield going up is, this loss and these bonds that Dominic and I talked about, the purchase of those bonds, once you buy those for loss mitigation, they become an investment in your investment portfolio, and the accretion that you have on those bonds go through your investment yield. So, we've seen a big pickup from the loss mitigation bonds in the investment portfolio.

Larry Vitale

And if you're paying \$0.49 for those, I would imagine you'd target your hands on as many as you could?

Robert Bailenson

And that's right. So, you have loss mitigation on loss side, as well as a pickup in yield on the investment side.

Larry Vitale

Okay. All right, great. Thank you, guys.

Dominic Frederico

You're welcome.

Operator

Our next question will be from Matthew Howlett of Macquarie. Please go ahead.

Matt Howlett

Hey, guys, thanks for taking my question. Just on a high sort of level analysis, when you look at the tax exempt, this will mark – I mean, Dom, like you said, it's 10year low, what do we need to see change in that market? I know there's a tax proposal with the Obama lowering maybe the exemption. And then, of course, when you see the credit card steepen, do we need to see states, municipalities get their budgets in line? What do we need to see before that market begins to sort of pick up again? And do you expect that going forward?

Dominic Frederico

Well, I think first and foremost, you need economic growth, right. These guys rely on revenue and obviously in good years of revenue based expense, they go and authorize new projects or go back and correct some things that they needed to correct via bridges, roads, et cetera. And so, economic expansion is the biggest key. We've been in a declining revenue environment through most of the crisis now in recent periods. State revenue has started to pick up but local revenues are still under a lot of pressure because, remember, they're dominated by real estate taxes. And the real estate market, for a lot of reasons, it maybe some failed governmental policies as well, just that it's not showing any signs of real stabilization, let alone improvement. And until that changes, you're not going to see I think a real pickup in municipal originations and therefore, the market is going to stay relatively mute for the near term.

Matt Howlett

Great. That's it. And then you said you acquired the MIAC from Radian. Could you just go over what was the sort of strategy behind that again because that was sort of a shell municipal insurer?

Dominic Frederico

Yeah. And what we're looking for is that – we try to build flexibility into our capital, we try to build flexibility into our business. This builds a tremendous amount of flexibility into our business model. As we look forward and we're trying to anticipate the demands in the market, one of the things we continue to consider is their need to be or doesn't need to be a pure municipal type of insurer out there. And although we have AGM that we consider pure municipal at least it only does municipal risk going forward, it still has a component of structured finance in its portfolio. Obviously, MIAC gives us the ability to focus strictly on a pure municipal basis if and when we decide to do that.

Number two, as we look at the markets, there are certain segments of the markets that still haven't come back or have had the same level of participation or opportunity and can we focus that as kind of a strategic weapon aimed at that specific segment of the market to generate new business originations, new penetrations to help the overall recovery of the total municipal market.

So, for us, it's a very strategic, obviously gives us a third capital base, gives us a third license carrier. So, when you think about spread of risk, and how you meet the individual risk limits of any individual company, it gives us another company to put risk in. So, it's a very flexible vehicle for us. It was one of the critical things that we look for when we negotiate at the reassumption transaction with Radian because of this perception of ours is the – what does the future market look like? What are going to be the demands of that market? How can we best continue to improve this company to meet those demands whatever they'd be and give us this flexible platform that allows us to move in those directions?

Matt Howlett

That's great. Thanks. And then just last question, Dominic, you mentioned Jefferson County and following the developments down there, could you just kind of go over where you see things potentially settling out? I mean, from what I understand the bankruptcy filing that the potential to move the revenue away from the sewers bond take expenses and do other things. I know Zelcon development on the other that sort of could shape the market's confidence in

those type of transactions. I mean, how do you see that all playing out down there and what do you think the implications are?

Dominic Frederico

Boy, if I had the answer to that question, I'd be way ahead of the curve. I've got my general council scribbling furiously. Obviously, there was a negotiated settlement that took in consideration from all parties and basically came out with a formula where everyone took some level of responsibility on an acceptable level.

Matt Howlett

Right.

Dominic Frederico

Each individual that was agreed to by the creditors and the authority and then got voted down by the governmental folks. We would hope to a bit go back and relook at that negotiated settlement. I am constantly amused and obviously very concerned that we've got these municipalities that believe somehow the bond holders are responsible for their own actions. And remember, the bond holders have really been a huge source for local municipalities, states, et cetera, in allowing them to accomplish their own plans of growth expansion, improvement, save them costs, provide them access, and yet, now they're supposed to be punished when they didn't make the decision. They didn't create these contracts that provide lifetime benefit that no normal commercial enterprise provides anymore and yet we believe that they have this inalienable right to do that. It makes no sense. And then we're almost painted as the bad guys. And yet, last time I checked, we saved you, but it got you access, helped you accomplished various goals and objectives, and including needed investments and infrastructure, et cetera.

And here, we've had deals both in Harrisburg and in Jefferson County that were negotiated, that would have resolved by in large the majority of the issues, and yet we now have politicians that say, there's got to be more paying suffered by the bond holders. I don't know what their thinking is. Where are their long term views of how they think they ultimately emerge from this. Once you go to this junk status, how you're going to get financing at a wood cost and therefore what is the value of that municipality, et cetera, as it's looked to from the outside as well.

The long term damage can't be good, and when you're compensated by what you think you'll accomplish in the front. Now, in terms of Jefferson County you have a water authority, so it's kind of a standalone. But at some of the municipalities that we're talking about not making bond payments, the bond debit is a small percentage of their annual budget. So, if you look at, say, Stockton in California, debt is 6% of their budget. Killing 6% does not solve your lifetime medical benefits problem, does not solve that 80% of the costs are related to compensation and benefits. You're looking at the wrong end of the telescope. These will look awfully small when you're looking at the backend of it.

Matt Howlett

Great.

Dominic Frederico

And what you're going to do in the future of that municipality? How are they going to borrow? Who's going to have any confidence in them when they go to the market because they're going to need to do that to fund anything on a go forward basis, let alone their own operations.

I am still just absolutely amazed when I see this happen every day, like this is a get out of jail free card. It's like monopoly. I have no idea what these people are thinking. And yet, we will continue to make payments to our bondholders because that's our contract. And we're in an incredibly strong financial position. It's not an issue for us. Number two, we will defend our right. And we will defend them vigorously. And whether that makes us bad guy or good guy, it really doesn't matter. It's the right thing for us to do and it's the right thing that should be done in the market.

And what's the long term implication? The good news about insurance is if you pay claims, it increases demand, right? And if you make this an issue of credit that people don't honor their commitments, then, therefore, more people should seek insurance. So, we kind of sit here at that corner or that intersection to, well, I'm really going to go from one side or the other. So we are going to be pretty well positioned to go forward and I hope the market recognizes that this type of behavior should have a long term chilling effect on peoples' views

Matt Howlett

Exactly. Thanks.

Dominic Frederico

You're welcome.

Operator: Our next question will come from Shobha Frye of Putnam Investments

Shobha Frey

Hi Dominic. I had two questions. One, I think in your last call mentioned another potential settlement. Is that still going forward?

Dominic Frederico

Yes it is.

Shobha Frey

Okay. I guess that's all you can say.

Dominic Frederico

We have made very good progress. There are still some things we like to get accomplished with that counterparty. I think that will for us be significant as I said to date about 30% of our below-investment grade RMBS is now subject to loss sharing agreement. We hope to move that percentage up a little higher. But in order to make the quantum leap to say 80%, you are going to have to see some of these things get ready to go to trial.

We have got one case that's supposed to be heard in the short term and we are very much looking forward to that. We are still amused by the fact that it doesn't seem like regulators in certain jurisdictions are paying attention to the non-regulated entities in those jurisdictions as to how they are adjusting this liability and it's not like this liability is going away. Every time you take up the press, there is another case being investigated, there is another level of charges being leveled against the banks and the originators. So, we are extremely bullish on this, obviously we are optimistic. We have been incredibly successful. We continue to make success in that one counterparty and just finalizing some things and hope to expand that program a little further in the current year. And then the rest as I said, we are willing to dig into the trenches and go to our neutral corners and come out fighting.

Shobha Frey

Okay, great. So, I assume the one that you are negotiating with is not listed as one you are litigating against, right?

Dominic Frederico

No, we are not at liberty to release their name. Obviously, we got to get comfortable with the disclosure they are going to have us make, etcetera. So, that's for future periods.

Shobha Frey

Okay. My second question is, I guess if you can give a little color in terms of the RMBS severities that you saw productive in first liens and also the offsets. Should we look at these offsets in RMBS and TruPS as some sort of stabilization in losses in your portfolio, or is it just something that was a 4Q phenomenon or last year's phenomenon?

Dominic Frederico

Yes, I don't think it's 4Q, Shobha, I think it is – and I wouldn't call stabilization either. I mean. If you go back to our discussions and we have been pretty direct about this, at some point of time a few years back or maybe a couple of years back, we had made the comment that as we looked at this RMBS issue that we thought that ultimately liability once either litigated or negotiated would pass from us, the substantial parts obviously we think are some of the responsible parties and that goes around originators principally at this point in time. So, that's the future, that's the past, that's we always believed. In the current quarter, that's exactly – or the current year, that's exactly what happened.

And that, we have continued to still look at real estate market that although deteriorates more slowly or improves at even slower pace, it's not to a level that we get confidence that you hit bottom yet. Therefore we have got to look very closely at the reserves that we are holding and making sure that they are reasonable and based on our view how we look at information.

We continue to up the severity charge, because that's we see coming through the statistics, but if you think about it, that severity charges meant it's based on two things. One, the service we did a bit for closure process therefore extended the amount of time and therefore incurred additional costs, we would hope someday we will be go back and recover that and what you are seeing is a lot of the litigation in the market today is around the servicer not the originator. Remember, we are kind of unique in that, we want to have the originators, and we have got the servicer out there as kind of the next target in line, and we have not taken any credit for that. Therefore, our reserves are gross on that basis, but we do have enough originator benefit that has been offsetting that continued increase in reserves relative to what we see in statistical data. Like I said, we don't take credit for the things that we think will benefit us. We did the servicer transferring that we talked about and we started transferring back in first quarter of last year, so we had about nine months of data.

Therefore, the deals that we did transfer, we saw significant improvement in delinquencies and modifications that have held beyond six and nine months as well as in the amount of time it's taking to foreclose. We have not changed our assumptions in any of our reserve models to reflect that. Obviously, in 2012, we want to move another \$4 billion of RMBS transactions in that basis and I think we will now say, with 18 months of data, we are going to take a hard look at what does that mean relative to reserves. So, we have got some good guys out there that we don't recognize until we can actually prove the data, but as we said, the originator liability in

our recovery and the rep of warranties has been enough, that it's been able to negate what we continue to see as statistical kind of deterioration in RMBS performance.

Shobha Frey

Okay. And just all these policy issues that are being kind of proposed, foreclosure settlements to sort of stabilize housing. Do you actually benefit from any of that in terms of the bank's foreclosure settlements that are kind of discussed, talked about?

Dominic Frederico

Yes. We believe we do, and we either are benefiting by – to the extent that it deals with loans at our portfolios that helps obviously tremendously to get a mandatory write-down that's paid for somebody else, not us, that will put cash back into the securitizations. Even if it's not our deal, it will still help the overall stability of the real estate market, because if you prevent a number of loans in going to foreclosure, obviously, that keeps the inventory of houses and that are under distress sales down, which makes the market start to act more normally, and therefore, you will see a more stability and pricing, which will help our severity numbers, whether it's our deal or not our deal. So, anything that's done in this regard to help the real estate or the residential marketplace will ultimately benefit us either directly or indirectly, but still be a positive.

Shobha Frey

All right. Thanks very much, Dominic.

Dominic Frederico

You are welcome, Shobha.

Operator

And our next question will come from Andrew Kleinberg of Glickenhous. Please go ahead.

Andrew Kleinberg

Hi, good morning. I have just a couple of data points. Shares outstanding from the third quarter to the fourth quarter went from 184 million to 185.5 million, was that mostly employee compensation?

Dominic Frederico

Yes.

Andrew Kleinberg

And were any shares bought back in the fourth quarter?

Rob Bailenson

No, they were bought back in the third quarter.

Andrew Kleinberg

So, nothing in the fourth quarter?

Rob Bailenson

No.

Andrew Kleinberg

Got you, thank you very much.

Dominic Frederico

You are welcome.

Operator

And ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Robert Tucker for any closing comments.

Robert Tucker

Thank you, operator. I would like to thank everyone for joining us on the call today. If you have additional questions, please feel free to give us a call. My number is listed on the press release. Thank you very much.

Operator

The conference had now concluded. Thank you for attending today's presentation. You may now disconnect.