# Statutory-Basis Financial Statements

Financial Guaranty Insurance Company
September 30, 2017

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## Contents

# Financial Guaranty Insurance Company

## Statutory-Basis Balance Sheets

*(Dollars in Thousands, Except per Share Amounts)*

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| **Admitted assets** | (Unaudited) | |
| Bonds | **$ 2,075,277** | $ 2,128,713 |
| Common stock | **185,191** | 131,109 |
| Common stock – investment in subsidiaries | **33,200** | 33,200 |
| Surplus notes | **8,873** | – |
| Short-term investments | **118,331** | 79,780 |
| Other invested assets | **14,876** | 20,703 |
| Receivable for securities sold | **–** | 44,571 |
| Cash and cash equivalents | **18,222** | 21,326 |
| Total cash and invested assets | **2,453,970** | 2,459,402 |
| Accrued investment income | **22,917** | 22,353 |
| Other assets | **1,141** | 1,311 |
| Federal income tax receivable | **1,570** | 2,101 |
| Reinsurance receivable | **537** | 26 |
| Receivable from parent and subsidiaries | **602** | 465 |
| Total admitted assets | **$ 2,480,737** | $ 2,485,658 |
| **Liabilities and capital and surplus** | | |
| Liabilities: | | |
| Losses | **$ 1,979,104** | $ 1,949,709 |
| Loss adjustment expenses | **23,467** | 24,081 |
| Unearned premiums | **41,676** | 47,876 |
| Contingency reserves | **346,294** | 318,257 |
| Other liabilities | **22,329** | 23,469 |
| Payable for securities purchased | **1,457** | 55,857 |
| Federal and foreign income tax payable | **10** | 9 |
| Total liabilities | **2,414,337** | 2,419,258 |
| Capital and surplus: | | |
| Common stock, par value $1,500 per share; 10,000 shares authorized, issued, and outstanding | **15,000** | 15,000 |
| Redeemable preferred stock, par value $1,000 per share; 3,000 shares authorized, issued and outstanding | **300,000** | 300,000 |
| Unassigned deficit | **(248,600)** | (248,600) |
| Total capital and surplus | **66,400** | 66,400 |
| Total liabilities and capital and surplus | **$ 2,480,737** | $ 2,485,658 |

*See accompanying notes.*

Financial Guaranty Insurance Company

Statutory-Basis Statements of Operations and Changes in Surplus
(Unaudited)

*(Dollars in Thousands)*

| | Three Months Ended September 30, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2017 | Nine Months Ended September 30, 2016 |
|---|---|---|---|---|
| Premiums earned | **$ 4,007** | $ 7,659 | **$ 11,911** | $ 15,390 |
| Loss reserve expense | **(19,761)** | (18,019) | **(54,600)** | (49,976) |
| Loss adjustment reserve expense | **(8,197)** | (13,592) | **(8,438)** | (19,309) |
| Other underwriting expenses | **(6,370)** | (6,600) | **(19,302)** | (20,688) |
| Ceding commission income | **2** | 57 | **110** | 84 |
| Underwriting loss | **(30,319)** | (30,495) | **(70,319)** | (74,499) |
| Net investment income | **22,297** | 21,220 | **66,133** | 65,016 |
| Net realized capital gains, net of tax expense of $0 and $0, and $1,400 and $5,294, for the three and nine months ended September 30, 2017 and 2016, respectively | **4,062** | 5,602 | **21,016** | 21,177 |
| Net investment gain | **26,359** | 26,822 | **87,149** | 86,193 |
| Other income | **5,683** | 3,747 | **2,456** | 8,718 |
| Income before all other federal and foreign income taxes | **1,723** | 74 | **19,286** | 20,412 |
| Federal and foreign income tax benefit | **–** | (1,923) | **–** | (5,734) |
| Net income | **$ 1,723** | $ 1,997 | **$ 19,286** | $ 26,146 |
| **Changes in surplus** | | | | |
| Surplus as regards policyholders, beginning of period | **$ 66,400** | $ 66,400 | **$ 66,400** | $ 66,400 |
| Net income | **1,723** | 1,997 | **19,286** | 26,146 |
| Change in net unrealized capital gains, net of tax expense of $2,414 and $3,111, and $1,113 and $2,577 for the three and nine months ended September 30, 2017 and 2016, respectively | **4,482** | 2,068 | **5,777** | 4,787 |
| Change in foreign exchange adjustment | **(2)** | (831) | **(1)** | (2,887) |
| Change in net deferred income tax | **2,414** | 1,113 | **3,111** | 2,577 |
| Change in non-admitted assets | **70** | (717) | **(135)** | (689) |
| Change in provision for reinsurance | **–** | 5,597 | **–** | – |
| Change in contingency reserve | **(8,687)** | (9,227) | **(28,038)** | (29,934) |
| Surplus as regards policyholders, end of period | **$ 66,400** | $ 66,400 | **$ 66,400** | $ 66,400 |

*See accompanying notes.*

# Financial Guaranty Insurance Company

## Statutory-Basis Statements of Cash Flows
## (Unaudited)

*(Dollars in Thousands)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2017** | **2016** |
| **Operations** | | |
| Premiums collected, net of reinsurance | **$ 5,778** | $ 5,989 |
| Losses paid, net | **(25,205)** | (18,446) |
| Loss adjustment expenses paid, net | **(9,052)** | (5,828) |
| Underwriting expenses paid | **(20,948)** | (12,406) |
| Ceding commission received | **109** | 84 |
| Net investment income received | **69,728** | 67,669 |
| Other income received | **12,851** | 8,718 |
| Federal and foreign income tax recovered (paid) | **533** | (1,836) |
| Net cash provided by operations | **33,794** | 43,944 |
| **Investment activities** | | |
| Proceeds from sales, maturities, or repayments of investments: | | |
| Bonds | **445,003** | 620,691 |
| Common stock | **61,701** | 26,986 |
| Other invested assets | **12,197** | 5,512 |
| Miscellaneous proceeds | **–** | – |
| Total investment proceeds | **518,901** | 653,189 |
| Cost of investments acquired: | | |
| Bonds | **(383,342)** | (568,893) |
| Common stock | **(98,261)** | (76,226) |
| Surplus notes | **(8,877)** | – |
| Other invested assets | **(5,465)** | (3,470) |
| Miscellaneous applications | **(21,128)** | (6,114) |
| Total investments acquired | **(517,073)** | (654,703) |
| Net cash provided by (used in) investment activities | **1,828** | (1,514) |
| **Financing and miscellaneous activities** | | |
| Other cash (applied) provided | **(175)** | 241 |
| Net increase in cash and short-term investments | **35,447** | 42,671 |
| Cash and short-term investments: | | |
| Beginning of period | **101,106** | 76,790 |
| End of period | **$ 136,553** | $ 119,461 |

*See accompanying notes.*

## 1. Organization and Background

Financial Guaranty Insurance Company (the "Company" or "FGIC"), a New York stock insurance corporation, is a wholly owned subsidiary of FGIC Corporation ("FGIC Corp."), a Delaware corporation which emerged from a proceeding under Chapter 11 of the United States Bankruptcy Code on April 19, 2013.

FGIC previously issued financial guaranty insurance policies insuring public finance, structured finance and other obligations, but it is no longer engaged in the business of writing new insurance policies. FGIC operates in accordance with the terms and conditions set forth in the Rehabilitation Plan (defined below). FGIC's primary regulator is the New York State Department of Financial Services (the "NYSDFS"). FGIC UK Limited ("FGIC UK"), a wholly owned United Kingdom insurance subsidiary of FGIC, previously issued financial guaranties covering public finance, structured finance and other obligations, but it is no longer engaged in the business of writing new financial guaranties. FGIC UK's primary regulator is the UK Prudential Regulation Authority.

On June 28, 2012, the Supreme Court of the State of New York (the "Rehabilitation Court") issued an order pursuant to Article 74 of the New York Insurance Law (the "NYIL") placing FGIC in rehabilitation and appointing the Superintendent of Financial Services of the State of New York as FGIC's rehabilitator.

On June 11, 2013, the Rehabilitation Court approved the First Amended Plan of Rehabilitation for FGIC, dated June 4, 2013, together with all exhibits and the plan supplement thereto (as the same may be amended from time to time, collectively, the "Rehabilitation Plan") in an order issued pursuant to Article 74 of the NYIL. The Rehabilitation Plan became effective on August 19, 2013 (the "Effective Date"), whereupon FGIC's rehabilitation proceeding terminated. By notice dated on the Effective Date, FGIC's rehabilitator set the initial cash payment percentage ("CPP") at 17%.

On the Effective Date, FGIC emerged from its rehabilitation proceeding as a solvent insurance company under the NYIL, with its policies restructured in a manner intended to ensure it remains solvent and the Rehabilitation Plan became the exclusive means for resolving and paying (i) all policy claims, whenever arising, (ii) all other claims arising during, or relating to, the period prior to the Effective Date and (iii) all equity interests in FGIC in existence as of the commencement date of FGIC's rehabilitation proceeding (June 28, 2012), in each case other than claims (including policy claims) paid in full by FGIC prior to such date. Claims arising during or relating to the period on and after the Effective Date (other than policy claims) are not covered by the Rehabilitation Plan and will be resolved and paid by FGIC in the ordinary course of business.

**1. Organization and Background (continued)**

As of the Effective Date, any and all policies in force as of the Effective Date (except for certain policies that were novated on that date) were automatically modified by the Rehabilitation Plan.

The Rehabilitation Plan, including the restructured policy terms attached to the Rehabilitation Plan as Exhibit B (the "Restructured Policy Terms"), supersedes any and all provisions of each policy that are inconsistent with the Rehabilitation Plan. FGIC is responsible for administering, reviewing, verifying, reconciling, objecting to, compromising or otherwise resolving all claims (including policy claims) not resolved prior to the Effective Date, in each case in compliance with the Rehabilitation Plan and any applicable guidelines the NYSDFS has issued or may issue to carry out the purposes and effects of the Rehabilitation Plan ("NYSDFS Guidelines").

With respect to any policy claim permitted by FGIC, pursuant to the Rehabilitation Plan and the applicable policy (as modified by the Rehabilitation Plan), FGIC is obligated to pay in cash to the applicable policy payee only an upfront amount equal to the product of the then-existing CPP and the amount of such permitted policy claim (subject to any setoff rights FGIC may have). The portion of such permitted policy claim not paid or deemed to be paid by FGIC generally comprises a deferred payment obligation ("DPO") with respect to the applicable policy. The DPO with respect to any policy generally represents the aggregate amount of all permitted policy claims under such policy minus the aggregate amount paid, or deemed to be paid, in cash by FGIC with respect to such policy (other than DPO Accretion, defined below) from and after the Effective Date, subject to further adjustments as provided in the Rehabilitation Plan. From and after the Effective Date, each policy with an outstanding DPO accrues an amount ("DPO Accretion") as described in Note 2, Significant Accounting Policies, under the sub-heading "Loss Reserves – DPO Accretion." The DPO for any policy and any related DPO Accretion shall only be payable by FGIC when, if and to the extent provided in the Restructured Policy Terms and the Rehabilitation Plan. In the absence of an upward adjustment of the CPP, FGIC shall have no obligation to pay any portion of any DPO or DPO Accretion.

FGIC is required to re-evaluate the CPP (at least annually) pursuant to the procedures set forth in the Restructured Policy Terms to determine whether the CPP should remain the same or be adjusted upward or downward (each, a "CPP Revaluation"). All CPP Revaluations require review and approval by the board of directors of FGIC, and any change in the CPP (among other things) requires the approval of the NYSDFS. In October 2016, in connection with FGIC's annual CPP Revaluation for 2016, the NYSDFS approved an upward adjustment to the CPP from 22% to 25%. FGIC has submitted its annual CPP Revaluation for 2017 for consideration by the NYSDFS in accordance with the Rehabilitation Plan.

**1. Organization and Background (continued)**

The percentage of permitted policy claims that FGIC ultimately pays in cash in accordance with the Rehabilitation Plan, and the timing of any such payments, are subject to various factors and the outcome of future events, including the performance of FGIC's insured and investment portfolios and the results of FGIC's litigation and other loss mitigation efforts, and no assurance can be given with respect to the amount of any such percentage or the timing of any such payments. Based on the magnitude of FGIC's accrued and projected policy claims, while the CPP may further increase over time, FGIC expects to make payments in cash pursuant to the Rehabilitation Plan of only a fractional portion of its permitted policy claims and it does not expect to make any payments pursuant to the Rehabilitation Plan with respect to non-policy claims or equity interests.

References to and descriptions of provisions of the Restructured Policy Terms, the Rehabilitation Plan (and related agreements) and orders of the Rehabilitation Court included in these financial statements are merely summaries thereof, and do not contain all information necessary to fully understand such provisions and orders. Please refer to the specific terms, requirements and conditions of the Restructured Policy Terms, the Rehabilitation Plan (and related agreements) and orders of the Rehabilitation Court for a full understanding thereof, which in all cases shall govern, rather than any summary description contained in these financial statements.

**2. Significant Accounting Policies**

The accompanying financial statements of the Company have been prepared in conformity with statutory accounting practices prescribed or permitted by the NYSDFS as well as those accounting practices detailed in NYSDFS Guidelines, as described below ("SAP"). The preparation of financial statements in conformity with SAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates, and those differences could be material. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of results that may be expected for the year ending December 31, 2017. These unaudited interim financial statements should be read in conjunction with the audited Statutory Basis Financial Statements for the year ended December 31, 2016, including the accompanying notes. The December 31, 2016 balance sheet was derived from audited financial statements, but does not include all disclosures required by SAP for annual periods.

SAP differs in some respects from accounting principles generally accepted in the United States ("GAAP"). The effects of the variances from GAAP on the accompanying statutory-basis financial statements have not been determined for the three and nine months ended September 30, 2017 and 2016,

**2. Significant Accounting Policies (continued)**

but are presumed to be material. Significant accounting policies and variances from GAAP, where applicable, are as follows:

**NYSDFS Guidelines**

Pursuant to the provisions of the Rehabilitation Plan, the NYSDFS has issued NYSDFS Guidelines that define certain accounting practices for FGIC for reporting periods ending on or after the Effective Date. In accordance with such NYSDFS Guidelines, for reporting periods ending on or after the Effective Date, FGIC records loss reserves at the applicable reporting date in an amount equal to the excess of (i) the amount of FGIC's admitted assets minus FGIC's minimum required statutory surplus to policyholders at the reporting date (the "Minimum Surplus Amount," currently $66.4 million) over (ii) the sum of FGIC's statutory reserves excluding loss reserves (e.g., unearned premiums, contingency reserves, loss adjustment expense reserves) and other liabilities. In accordance with such NYSDFS Guidelines, the loss reserve amount comprises the total amount of (i) the sum, net of reinsurance, of (x) the total amount of all policy claims submitted to FGIC in accordance with the Rehabilitation Plan that are unpaid (excluding any portions of such policy claims that are being disputed by FGIC) and (y) the net present value of the total amount of all policy claims that the Company expects to receive in the future in accordance with the Rehabilitation Plan (using the prescribed statutory discount rate which is based on the average rate of return on FGIC's admitted assets) (such sum is referred to as the "Claims Reserve"), (ii) the DPO for all policies at such reporting date and (iii) the DPO Accretion for all policies at such reporting date, minus an adjustment (the "Policy Revision Adjustment") in an amount that will permit FGIC to report a surplus to policyholders at such reporting date equal to the Minimum Surplus Amount (See also Note 6, Loss Reserves).

**Investments**

Investments are valued in accordance with the requirements of the National Association of Insurance Commissioners ("NAIC").

Bonds with an NAIC designation of 1 or 2 determined by the Securities Valuation Office are stated at amortized cost, with premiums and discounts amortized to net income using the effective interest method over the remaining term of the securities. Bonds with an NAIC designation of 3 through 6 determined by the Securities Valuation Office are stated at the lower of amortized cost or fair value. Under GAAP, bonds are designated at purchase as either held-to-maturity, available-for-sale or trading. Bonds designated as held-to-maturity are reported at amortized cost. Bonds designated as available-for-sale are reported at fair value with unrealized gains and losses reported

**2. Significant Accounting Policies (continued)**

in stockholders' equity, net of tax. Bonds designated as trading are reported at fair value with unrealized gains and losses reported in net investment income.

Common stocks include shares of mutual funds that invest principally in common stocks. Common stocks (excluding investments in common stock of subsidiary, controlled and affiliated ("SCA") entities (which are included in the balance sheet as common stock – investment in subsidiaries)) are recorded at fair value. Changes in carrying values are recorded as changes in unrealized capital gains/losses, a component of surplus. Dividends are reported in net investment income. Under GAAP, investments in such common stocks are designated at purchase as either available-for-sale or trading. Common stocks designated as available-for-sale are reported at fair value with unrealized gains or losses reported as a component of stockholders' equity, net of tax.

Common stocks designated as trading are reported at fair value with unrealized gains and losses reported in net investment income. Under SAP, investments in common stock of SCA entities are recorded based on the audited underlying equity adjusted to a statutory basis to the extent admissible under Statement of Statutory Accounting Principles ("SSAP") 97, *Investments in Subsidiary, Controlled, and Affiliated Entities, A Replacement of SSAP No. 88* and subject to applicable limitations under the NYIL. One such limit restricts the amount reported as investments in common stock of SCA entities to 50% of the Company's statutory surplus to policyholders. Under SAP, the reporting entity cannot admit as an asset the investment in an SCA entity for which audited financial statements are not prepared. Changes in the values of SCA entities are recorded as unrealized gains or losses and reported as a component of unassigned deficit. Under GAAP, SCA entities meeting certain criteria are consolidated with the Company.

Surplus notes have an NAIC designation of 1 and are stated at amortized cost unless the issuer of the note is under regulatory action, with premiums and discounts amortized to net income using the effective interest method over the remaining term of the notes. If the issuer is under regulatory action, the surplus notes must be stated at zero until the regulatory action ends. Under GAAP, these notes are stated at fair value.

Short-term investments, including Class 1 NAIC money market securities, are stated at amortized cost, which approximates fair value. Realized gains and losses on the sale of investments are determined based on the specific identification method and are reflected in the determination of net income.

Included within bonds are loan-backed and structured securities, which are valued at amortized cost using the interest method, including anticipated prepayments. Prepayment assumptions are

## 2. Significant Accounting Policies (continued)

obtained from dealer surveys or internal estimates and are based on the current interest rate and economic environment. All such securities are adjusted for the effects of changes in prepayment assumptions on the related accretion of discount or amortization of premium of such securities using the retrospective method.

### Other-Than-Temporary Impairments

For all investments in bonds (including loan-backed and structured securities) acquired prior to October 1, 2015, a decline in the fair value of any such security below its cost basis as of a reporting date is automatically treated as an other-than-temporary impairment (“OTTI”).

FGIC conducts an impairment review no less than quarterly for all investments in bonds (including loan-backed and structured securities) and surplus notes acquired on or after October 1, 2015, and for all investments in common stocks, in each case which have fair values lower than their respective cost bases as of the review date. The analysis of a security’s decline in value is performed at the lot level. FGIC first determines whether it intends to sell the security. For loan-backed and structured securities, FGIC also determines whether it is more likely than not that it will be unable to hold the security for a period of time to recover its amortized cost basis. The impairment for any security that FGIC determines it intends to sell or, in the case of loan-backed and structured securities, it is more likely than not that it will be unable to hold for a period of time to recover its amortized cost basis, is considered to be an OTTI.

For bonds (other than loan-backed and structured securities), surplus notes and common stocks that FGIC does not intend to sell, FGIC conducts a quantitative and qualitative impairment review that requires management to make numerous judgments, estimates and assumptions concerning relevant factors, such as (i) the magnitude and duration of the impairment, and (ii) possible explanations for the impairment (e.g., general interest rate, credit spread, market index movements; issuer-specific developments such as material negative credit events (e.g., actual or threatened bankruptcy or similar proceedings or debt restructurings); and security-specific developments such as existing or projected monetary and material non-monetary defaults and credit rating downgrades). Based on this review, FGIC determines whether the decline in fair value for any such security is temporary or an OTTI, with the decline in fair value for any such security that does not satisfy the specified quantitative or qualitative criteria treated as temporary.

If the decline in fair value for any such bond or surplus note is determined to be temporary, an unrealized loss is not recorded. If the decline in fair value for any common stock is determined to be temporary, FGIC records it as an unrealized loss as common stocks are recorded at fair value.

**2. Significant Accounting Policies (continued)**

If the decline in fair value for any such bond, surplus note or common stock is treated as or determined to be an OTTI, the carrying value of such security is reduced to fair value as of the reporting date, establishing a new cost basis, with a charge to realized loss at the reporting date. Such realized losses are recorded through income and the new cost basis is not adjusted for subsequent recoveries in fair value. Amortization of any premium or discount from the date bonds or surplus notes are written down is based on the new cost basis.

For loan-backed and structured securities (e.g., asset-backed and mortgage-backed securities) that the Company does not intend to sell and has not determined that it is unable to hold until recovery of their amortized cost bases, the Company estimates the cash flows expected to be collected over the term of each security as of the review date and calculates the present value of those expected cash flows using a discount rate equal to the original effective yield of the security, or in the case of floating rate securities, the then-current coupon. If the present value of future expected cash flows is less than the amortized cost basis of the security, the carrying value of such security is reduced to such present value as of the reporting date, establishing a new cost basis, with a charge to realized loss at such date for the entire reduction. Such realized losses are recorded through income and the new cost basis is not adjusted for subsequent recoveries in fair value. Amortization of premium or discount, as applicable, from the date the securities are written down is based on the new cost basis.

**Fair Value Measurements**

The Company discloses the fair value of its investments in bonds, common stocks, surplus notes, other invested assets, short-term investments and other financial instruments in accordance with SSAP 100, *Fair Value Measurements* ("SSAP 100"), which requires the use of a fair value hierarchy with the highest priority given to quoted prices in active markets. The general disclosure requirements are for those items measured and reported at fair value in the balance sheet. Securities that are reported at amortized cost, but for which amortized cost equals fair value (such as a bond with a recognized OTTI on the reporting date) would not be included in the disclosures. SSAP 100 also requires certain disclosures of fair value measurements and valuation techniques, where practicable to determine, for financial instruments not carried at fair value in the balance sheet. SSAP 100 does not require companies to distinguish between recurring and non-recurring fair value measurements, which is required under GAAP.

## 2. Significant Accounting Policies (continued)

### Cash and Cash Equivalents

The Company considers all bank deposits and all certificates of deposit with maturities of three months or less at the date of purchase to be cash equivalents. Cash equivalents are carried at cost, which approximates fair value. In the event that a highly liquid security is determined to be impaired, the security is adjusted to fair value in accordance with NAIC regulations. Under GAAP, these securities are adjusted to fair value and included in cash and cash equivalents.

### Other Invested Assets

Other invested assets include FGIC-insured securities purchased by FGIC and securities or other non-cash assets received or recovered by FGIC, in connection with its loss mitigation efforts.

For FGIC-insured securities purchased in connection with loss mitigation efforts, the value of the security comprises two components: (i) the portion representing the value of FGIC's insurance (the "Insurance Portion") and (ii) the remaining portion representing the value of the security without giving credit for FGIC's insurance (the "Non-Insurance Portion"). For each security, the Company estimates the value of the Insurance Portion using internally developed formulas, with the remainder of the value being the Non-Insurance Portion. The Insurance Portion is included in losses incurred and is deducted from the amortized cost and fair value of these FGIC-insured securities at the time of purchase and at each reporting date, respectively. For each FGIC-insured security purchased in connection with loss mitigation efforts, FGIC reduces the related Claims Reserve at each reporting date on a pro rata basis for the ratable portion of the securities purchased by FGIC. The reduction in Claims Reserves is also included in losses incurred.

The remaining Non-Insurance Portion of each purchased security is classified as other invested assets in the balance sheet and is subject to impairment analysis at each subsequent balance sheet date. Realized gains or losses and OTTI on the Non-Insurance Portion of these securities are recorded in other income. The amortized cost and fair value of these securities are shown excluding the Insurance Portion. Under SAP, these securities are carried at the lower of amortized cost or fair value as these securities have an NAIC designation of 3 through 6. Under GAAP, these securities are carried at fair value.

For securities or other non-cash assets received or recovered by FGIC in connection with its loss mitigation efforts, FGIC records the asset at the lower of cost or fair value at acquisition. FGIC generally does not consider the payment of claims to be included in the determination of the cost basis of assets received or recovered in connection with such claims. Realized gains or losses and

**2. Significant Accounting Policies (continued)**

OTTI on these assets are recorded in other income. Under SAP, these assets are carried at the lower of amortized cost or fair value. Under GAAP, these securities are carried at fair value.

**Premium Revenue Recognition**

For SAP, premiums collected in a single payment at policy inception are earned in proportion to the scheduled principal and interest payments over the legal lives of the insured bonds. Premiums collected periodically are reflected in income pro rata over the period covered by the premium payment. Under GAAP, premiums are earned in proportion to the amount of insurance protection provided over the expected life for homogeneous pools and over the legal life for non-homogeneous pools of policies. Ceded premiums are earned in a manner consistent with the underlying policies. Under SAP, the liability for unearned premiums is reflected net of reinsurance. Under GAAP, ceded unearned premiums are reported as an asset. When an obligation insured by the Company is refunded prior to the end of the expected policy coverage period, any remaining unearned premium is recognized at that time. A refunding occurs when an insured obligation is repaid or retired in full or legally defeased.

**Non-admitted Assets**

Certain assets are charged directly against surplus, but are reflected as assets under GAAP. Such assets principally include property and equipment.

**Loss Reserves**

Loss reserves comprise the total amount of (i) the Claims Reserve, (ii) the DPO for all policies and (iii) the DPO Accretion for all policies, *minus* the Policy Revision Adjustment. The Policy Revision Adjustment is prescribed by NYSDFS Guidelines and reflects the reduction in the loss reserve components necessary to reflect a Minimum Surplus Amount of $66.4 million (See "NYSDFS Guidelines" above). Under GAAP, unpaid losses are reported on a gross basis (i.e., before reinsurance), and are discounted based on the risk-free rate for the anticipated shortfall in excess of the related unearned premium revenue, and the Policy Revision Adjustment is not recognized. The Company's loss expenses are disclosed in Note 6, Loss Reserves.

**2. Significant Accounting Policies (continued)**

*Claims Reserve*

The Claims Reserve is calculated on a policy-by-policy basis, net of reinsurance, as of the reporting date. The Claims Reserve is adjusted to reflect the Company's potential obligations in respect of reimbursements received, as well as the projected reimbursements the Company expects to receive in the future, in each case determined as of the reporting date. For each FGIC-insured security purchased (or for which FGIC has effectively stripped its insurance) in connection with loss mitigation efforts, FGIC reduces the related Claims Reserve at each reporting date on a pro rata basis for the ratable portion of the securities purchased (or stripped) by FGIC. The reduction in Claims Reserves is also included in losses incurred. Permitted policy claims that have been paid (or deemed paid) by FGIC in accordance with the Rehabilitation Plan are not included in the Claims Reserve; the portions of such claims not paid or deemed paid in cash, however, are reflected in the DPO balance.

The net present value of the total amount of all policy claims the Company expects to receive in the future is determined for each policy using internally developed cash flow projections or other methods for estimating losses and represents an estimate of the anticipated shortfall between (1) the insured payments of principal and interest due on the insured obligations and (2) the insured payments of principal and interest due on the insured obligations that are anticipated to be made by the issuer or other obligor of the insured obligations, including payments from the projected cash flows from, and proceeds to be received on, any collateral or other security supporting the insured obligation and/or other anticipated recoveries and/or premiums expected to be earned and/or collected in the future.

*DPO*

When FGIC pays (or is deemed to have paid) in cash the CPP of a permitted policy claim, the remaining unpaid balance of such permitted policy claim is added to the DPO under the related policy.

If, as a result of any CPP Revaluation, the CPP is adjusted upward, FGIC is obligated to pay the applicable policy payee in respect of the DPO under each policy an amount, determined in accordance with the Rehabilitation Plan, to true up the amounts of cash previously paid (or deemed to have been paid) by FGIC in respect of permitted policy claims paid at the prior CPP, which payment will generally reduce the DPO by an equal amount.

**2. Significant Accounting Policies (continued)**

*DPO Accretion*

Under the Restructured Policy Terms, each policy with an outstanding DPO accrues DPO Accretion in accordance with the Rehabilitation Plan based on such DPO at a rate of 3% per annum (on a daily basis on the basis of a 365-day year). DPO Accretion is calculated using the DPO with respect to the applicable policy as of the preceding June 30 or, with respect to the first year in which there is a DPO under such policy and until the next June 30, the first day on or after the Effective Date on which the DPO exists (the "First Payment Date"). DPO Accretion for any policy with a DPO commences on the First Payment Date for such policy and continues until such time (if ever) as the DPO for such policy is permanently reduced to zero. All DPO Accretion is calculated on a simple basis rather than a compound basis (i.e., no DPO Accretion accretes based on accumulated DPO Accretion). No DPO Accretion is added to a DPO, but is recorded separately. If, as a result of any CPP Revaluation, the CPP is adjusted upward, FGIC will pay in cash to the applicable policy payee a portion of the DPO Accretion under each policy having a DPO in an amount determined in accordance with the Rehabilitation Plan, which will reduce the DPO Accretion balance.

**Loss Adjustment Expense Reserve**

A reserve for loss adjustment expense is recorded as a liability on the balance sheet. The loss adjustment expense reserve represents management's best estimate of the ultimate future net cost, determined using internally developed estimates, of the efforts involved in managing and mitigating existing and future policy claims. Such loss adjustment expense reserve is not subject to a Policy Revision Adjustment. The Company's loss adjustment expense reserve is disclosed in Note 7, Loss Adjustment Expense Reserves.

**Contingency Reserves**

Contingency reserves are computed on the basis of statutory requirements for the security of all policyholders, regardless of whether loss contingencies actually exist. The Company establishes contingency reserves in accordance with the NYIL, which is consistent with the requirements of SSAP 60, *Financial Guaranty Insurance*. Changes in the contingency reserve are charged directly to surplus. Under GAAP, contingency reserves are not required.

During 2016, the Company was granted permission by the NYSDFS to decrease contingency reserves by $30.9 million.

**2. Significant Accounting Policies (continued)**

**Federal Income Taxes**

Deferred tax assets and liabilities are recognized to reflect the tax impact attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases.

Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled and are recorded as a component of surplus. Under SAP and GAAP, a valuation allowance is established for deferred tax assets that are not expected to be realized. Under SAP, a net deferred tax asset is subject to limitations and may be non-admitted.

**Reinsurance**

A liability is recorded for uncollateralized amounts due from unauthorized reinsurers. Changes in this liability are charged or credited directly to unassigned surplus. Amounts due from unauthorized reinsurers that are secured by letters of credit or trust agreements are not included in this liability. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to earnings.

Ceded loss reserves are calculated as reductions of the related gross claims reserves rather than assets, as would be required under GAAP. Prospective ceded losses are accounted for on a basis consistent with that used in accounting for the original policies issued, the terms of the reinsurance contracts, and the terms of the Rehabilitation Plan, which provides that payments are due in full from reinsurers with respect to any permitted policy claims covered by the reinsurance without regard to (i) the timing or amount of any cash payment made by FGIC on the underlying claims, (ii) the modification pursuant to the Rehabilitation Plan of FGIC's obligations to pay such permitted policy claims in cash or (iii) any language in the applicable reinsurance agreements that would contradict this result. The net claims reserve amount is reduced to give effect to such reinsurance. Ceded loss adjustment expense reserves and unearned premiums ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP. Prospective reinsurance premiums and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

## 2. Significant Accounting Policies (continued)

### Consolidation

The accounts and operations of the Company’s subsidiaries are not consolidated with the accounts and operations of the Company, as would be required under GAAP.

As part of its structured finance business, the Company may have insured debt obligations or certificates issued by special purpose entities that could be considered variable interest entities (“VIE”). Under SAP, the Company does not consolidate the assets and liabilities of a VIE. Under GAAP, the Company would be required to consolidate the assets and liabilities of a VIE if the Company were to determine that it was the primary beneficiary because it directs significant activities of and holds an economic interest in the entity.

### Foreign Currency Translation

The Company had foreign branches in the United Kingdom and France that were deregistered in 2016. The Company had determined that, prior to deregistration, these branches were foreign operations with transactions in their respective local currencies, which were their functional currencies. Once deregistered, the assets and liabilities were included in FGIC’s operations with the U.S. dollar as functional currency.

### Statements of Cash Flow

The statutory-basis statements of cash flow are presented in a specified format, which differs from the format prescribed under GAAP. Cash, cash equivalents, and short-term investments in the statements of cash flow represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

### Comprehensive Income

Comprehensive income is not determined under SAP.

**2. Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment consists of office furniture, fixtures, computer equipment and software that are non-admitted assets under SAP. Under GAAP, these assets are reported at cost less accumulated depreciation.

**Reclassifications**

Certain 2016 amounts in the Company's statutory-basis financial statements have been reclassified to conform to the 2017 statutory-basis financial statement presentation.

**3. Fair Value Measurements**

SSAP 100 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's assumptions about market participants' assumptions based on the best information available in the circumstances. The fair value hierarchy prioritizes model inputs into three broad levels: quoted prices for identical instruments in active markets are Level 1 inputs; quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets are Level 2 inputs; and model-driven valuations in which one or more significant inputs or significant value drivers are unobservable are Level 3 inputs.

Transfers among Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification of financial instruments in Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. There have been no transfers into or out of Levels 1, 2 or 3 during the period.

**3. Fair Value Measurements (continued)**

The fair values of admitted investments in bonds, surplus notes, common stocks, other invested assets and short-term investments by level are as follows:

| | Level 1 | Level 2 | Level 3 | Admitted Value |
|---|---|---|---|---|
| | *(In thousands)* | | | |
| **September 30, 2017** | | | | |
| Bonds: | | | | |
| Obligations of states and political subdivisions | $ – | $ 551,476 | $ – | $ 509,255 |
| Loan-backed and structured securities | – | 311,007 | – | 311,882 |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | – | 261,344 | – | 257,655 |
| Corporate | – | 1,046,158 | – | 996,485 |
| Total bonds | – | 2,169,985 | – | 2,075,277 |
| Surplus notes | – | 9,628 | – | 8,873 |
| Common stocks | 185,191 | – | – | 185,191 |
| Other invested assets | – | – | 41,538 | 14,876 |
| Short-term investments | – | 118,331 | – | 118,331 |
| Total | $ 185,191 | $ 2,297,944 | $ 41,538 | $ 2,402,548 |

**3. Fair Value Measurements (continued)**

| | Level 1 | Level 2 | Level 3 | Admitted Value |
|---|---|---|---|---|
| | | *(In thousands)* | | |
| **December 31, 2016** | | | | |
| Bonds: | | | | |
| Obligations of states and political subdivisions | $ – | $ 638,307 | $ – | $ 606,449 |
| Loan-backed and structured securities | – | 264,842 | – | 266,966 |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | – | 229,384 | – | 235,854 |
| Corporate | – | 1,047,009 | – | 1,019,444 |
| Total bonds | – | 2,179,542 | – | 2,128,713 |
| Common stocks | 131,109 | – | – | 131,109 |
| Other invested assets | – | – | 72,743 | 20,703 |
| Short-term investments | – | 79,780 | – | 79,780 |
| Total | $ 131,109 | $ 2,259,322 | $ 72,743 | $ 2,360,305 |

## 4. Investments

The amortized cost and fair value of admitted investments in bonds, surplus notes, common stocks, other invested assets and short-term investments are as follows:

| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
|---|---|---|---|---|
| | *(In thousands)* | | | |
| **September 30, 2017** | | | | |
| Bonds: | | | | |
| Obligations of states and political subdivisions | **$ 509,255** | **$ 43,454** | **$ (1,233)** | **$ 551,476** |
| Loan-backed and structured securities | **311,882** | **3,106** | **(3,981)** | **311,007** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | **257,655** | **10,296** | **(6,607)** | **261,344** |
| Corporate | **996,485** | **52,120** | **(2,447)** | **1,046,158** |
| Total bonds | **2,075,277** | **108,976** | **(14,268)** | **2,169,985** |
| Surplus notes | **8,873** | **755** | **–** | **9,628** |
| Common stocks | **164,348** | **20,843** | **–** | **185,191** |
| Other invested assets | **14,876** | **26,662** | **–** | **41,538** |
| Short-term investments | **118,331** | **–** | **–** | **118,331** |
| Total | **$ 2,381,705** | **$ 157,236** | **$ (14,268)** | **$ 2,524,673** |

**4. Investments (continued)**

| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
|---|---|---|---|---|
| | *(In thousands)* | | | |
| **December 31, 2016** | | | | |
| Bonds: | | | | |
| Obligations of states and political subdivisions | $ 606,449 | $ 34,561 | $ (2,703) | $ 638,307 |
| Loan-backed and structured securities | 266,966 | 3,252 | (5,376) | 264,842 |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | 235,854 | 6,658 | (13,128) | 229,384 |
| Corporate | 1,019,444 | 33,162 | (5,597) | 1,047,009 |
| Total bonds | 2,128,713 | 77,633 | (26,804) | 2,179,542 |
| Common stocks | 118,454 | 12,663 | (8) | 131,109 |
| Other invested assets | 20,703 | 52,040 | – | 72,743 |
| Short-term investments | 79,780 | – | – | 79,780 |
| Total | $ 2,347,650 | $ 142,336 | $ (26,812) | $ 2,463,174 |

The Company has recorded OTTI of $0.0 million and $0.7 million, and $0.0 million and $0.5 million, on certain bonds for the three and nine months ended September 30, 2017 and 2016, respectively. The Company has recorded OTTI of $0.0 million and $0.0 million, and $0.5 million and $2.4 million, on common stocks for the three and nine months ended September 30, 2017 and 2016, respectively. OTTI is included in “Net realized capital gains or losses net of tax” in the statutory-basis statements of operations and represents the difference between the cost bases of these securities and their fair values (or, in the case of loan-backed and structured securities, the present value of expected cash flows) at the reporting date. The Company has recorded OTTI on other invested assets of $0.1 million and $10.4 million, and $0.0 million and $0.6 million, for the three and nine months ended September 30, 2017 and 2016, respectively. OTTI on other invested assets is included in “Other income” in the statutory-basis statements of operations and represents the difference between the cost bases of these securities and their fair values at the reporting date.

**4. Investments (continued)**

In accordance with SSAP 43R, the Company is required to categorize its OTTI on loan-backed and structured securities based upon the reason for which the Company recognized an OTTI. The following summarizes those securities held at September 30, 2017 and 2016 for which an OTTI was recorded during the nine months ended September 30, 2017 and 2016:

| | **Nine Months Ended September 30, 2017** | **Nine Months Ended September 30, 2016** |
|---|---|---|
| | *(In thousands)* | |
| Intent to sell | **$ 20** | $ – |
| Inability to retain the investment in the security for a period of time sufficient to recover the amortized cost basis | **–** | – |
| Present value of the cash flows expected to be collected is less than the amortized cost basis of the security | **–** | – |
| Total OTTI on loan-backed and structured securities | **$ 20** | $ – |

The amortized cost and fair value of investments in bonds (including loan-backed and structured securities) at September 30, 2017, by contractual maturity date, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | **Amortized Cost** | **Fair Value** |
|---|---|---|
| | *(In thousands)* | |
| Due in one year | $ 3,421 | $ 3,454 |
| Due after one through five years | 192,129 | 198,740 |
| Due after five years through ten years | 425,458 | 442,607 |
| Due after ten years | 1,142,387 | 1,214,177 |
| Loan-backed and structured securities | 311,882 | 311,007 |
| Total | $ 2,075,277 | $ 2,169,985 |

**4. Investments (continued)**

The amortized cost, fair value and unrealized holding losses for bonds and common stocks for which fair value declined and remained below cost at September 30, 2017 and 2016 were as follows:

| | Less Than 12 Months | | | Greater Than 12 Months | | |
|---|---|---|---|---|---|---|
| | *(In thousands)* | | | | | |
| | Amortized Cost | Fair Value | Unrealized Holding Loss | Amortized Cost | Fair Value | Unrealized Holding Loss |
| **September 30, 2017:** | | | | | | |
| Bonds: | | | | | | |
| Obligations of states and political subdivisions | **$ 12,856** | **$ 12,749** | **$ (107)** | **$ 11,302** | **$ 10,176** | **$ (1,126)** |
| Loan-backed and structured securities | **150,863** | **148,011** | **(2,852)** | **24,439** | **23,310** | **(1,129)** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | **95,534** | **90,947** | **(4,587)** | **18,651** | **16,631** | **(2,020)** |
| Corporate | **126,273** | **124,058** | **(2,215)** | **4,928** | **4,696** | **(232)** |
| Total bonds | **$ 385,526** | **375,765** | **$ (9,761)** | **$ 59,320** | **$ 54,813** | **$ (4,507)** |

**4. Investments (continued)**

| | Less Than 12 Months | | | Greater Than 12 Months | | |
|---|---|---|---|---|---|---|
| | *(In thousands)* | | | | | |
| | Amortized Cost | Fair Value | Unrealized Holding Loss | Amortized Cost | Fair Value | Unrealized Holding Loss |
| **September 30, 2016:** | | | | | | |
| Bonds: | | | | | | |
| Obligations of states and political subdivisions | $ 11,373 | $ 11,020 | $ (353) | $ – | $ – | $ – |
| Loan-backed and structured securities | 28,375 | 28,184 | (191) | – | – | – |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | 18,713 | 18,372 | (341) | – | – | – |
| Corporate | 10,927 | 10,851 | (76) | – | – | – |
| Total bonds | $ 69,388 | $ 68,427 | $ (961) | $ – | $ – | $ – |
| Common stocks | $ 8,400 | $ 8,368 | $ (32) | $ – | $ – | $ – |

Based on the results of the impairment review process, the Company considered these declines in fair value to be temporary based on facts and circumstances at September 30, 2017 and 2016, respectively.

**4. Investments (continued)**

Net investment income was derived from the following sources:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| | *(In thousands)* | | | |
| Income from bonds | **$ 21,442** | $ 21,068 | **$ 64,256** | $ 64,892 |
| Income from common stocks | **966** | 644 | **2,673** | 1,613 |
| Income from surplus notes | **103** | – | **206** | – |
| Income from cash, cash equivalents and short-term investments | **318** | 95 | **609** | 271 |
| Total investment income | **22,829** | 21,807 | **67,744** | 66,776 |
| Investment expenses | **(532)** | (587) | **(1,611)** | (1,760) |
| Net investment income | **$ 22,297** | $ 21,220 | **$ 66,133** | $ 65,016 |

For the three and nine months ended September 30, 2017 and 2016, proceeds from dispositions of investments in bonds carried at amortized cost were $121.9 million and $445.0 million, and $271.6 million and $620.7 million, respectively. For the three and nine months ended September 30, 2017 and 2016, gross realized gains on such dispositions were $4.5 million and $15.1 million, and $5.9 million and $28.2 million, respectively. For the three and nine months ended September 30, 2017 and 2016, gross realized losses on such dispositions were $0.5 million and $2.8 million, and $0.1 million and $0.4 million, respectively. For the three and nine months ended September 30, 2017 and 2016, proceeds from dispositions of investments in common stock were $0.0 million and $61.7 million, and $13.2 million and $27.0 million, respectively. Gross realized gains on such dispositions were $0.0 million and $9.9 million, and $1.5 million and $2.1 million, for the three and nine months ended September 30, 2017 and 2016, respectively. Gross realized losses on such dispositions were $0.0 million and $0.5 million, and $0.0 million and $1.9 million, respectively, for the three and nine months ended September 30, 2017 and 2016, respectively.

Investments in cash, cash equivalents, short-term investments and bonds carried at amortized cost of $4.2 million and $4.7 million as of September 30, 2017 and December 31, 2016, respectively, were on deposit with various regulatory authorities.

The carrying values of the Company’s investment in the common stock of SCA entities were $33.2 million as of both September 30, 2017 and December 31, 2016. There were no changes in the

**4. Investments (continued)**

carrying values of the Company's investments in SCA entities for the three and nine months ended September 30, 2017 and 2016.

**5. Income Taxes**

FGIC Corp. files a consolidated U.S. federal income tax return which includes FGIC. The method of allocation between FGIC Corp. and FGIC is determined under an amended and restated income tax allocation agreement approved by the NYSDFS, and is based upon separate return calculations.

The following is a reconciliation of current federal income taxes computed on income before provision for federal and foreign income taxes at the statutory rate and the provision for current federal income taxes.

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| | *(In thousands)* | | | |
| Income tax expense at the statutory rate, computed on income before provision for federal and foreign income taxes | **$ 1,447** | $ (418) | **$ 7,594** | $ 8,706 |
| Tax effect of: | | | | |
| Tax-exempt interest | **(536)** | (556) | **(1,842)** | (2,687) |
| Provision to return adjustment | **–** | 345 | **–** | 345 |
| NOL carryforward adjustment | **–** | 12 | **–** | 12 |
| Change in valuation allowance | **(3,179)** | (973) | **(8,324)** | (8,504) |
| Other, net | **(146)** | (46) | **(539)** | (889) |
| Expense for federal and foreign income taxes | **$ (2,414)** | $ (1,636) | **$ (3,111)** | $ (3,017) |
| | | | | |
| Federal and foreign income taxes incurred | **$ –** | $ (523) | **$ –** | $ (440) |
| Change in net deferred income taxes | **(2,414)** | (1,113) | **(3,111)** | (2,577) |
| Total statutory income taxes | **$ (2,414)** | $ (1,636) | **$ (3,111)** | $ (3,017) |

**5. Income Taxes (continued)**

The composition of total tax expense for the three and nine months ended September 30, 2017 and 2016 is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2017** | **2016** | **2017** | **2016** |
| | *(In thousands)* | | *(In thousands)* | |
| Current: | | | | |
| Federal | **$ –** | $ (523) | **$ –** | $ (523) |
| Foreign | **–** | – | **–** | 83 |
| Federal and foreign income tax expense | **$ –** | $ (523) | **$ –** | $ (440) |

The change in net deferred income taxes is composed of the following:

| | September 30, 2017 | December 31, 2016 | Change |
|---|---|---|---|
| | | *(In thousands)* | |
| Current: | | | |
| Total adjusted gross deferred assets | **$ 558,381** | $ 324,817 | $ 233,564 |
| Total adjusted gross deferred liabilities | **(558,381)** | (324,817) | (223,564) |
| Federal and foreign income tax expense | **$ –** | $ – | $ – |
| Less: tax effect of unrealized gains | | | (3,111) |
| Change in net deferred tax | | | $ 3,111 |

As of September 30, 2017, the Company had a domestic net operating loss ("NOL") carryforward of $3,669.5 million for federal income tax purposes, which will be available (subject to certain limitations) to offset future taxable income. If not used, the NOL carryforward will start expiring in 2029 through 2037 depending on the originating year. As of September 30, 2017, the Company had an alternative minimum tax ("AMT") credit carryforward of $11.5 million for federal income tax purposes, which will be available to offset future regular tax. AMT credit carryforwards do not

**5. Income Taxes (continued)**

expire. As of September 30, 2017, the Company had a foreign tax credit carryforward of $0.9 million which will be available to offset future regular tax. If not used, the foreign tax credit carryforward will start expiring in 2034 through 2036 depending on the originating year.

The amount of federal income taxes incurred and available for recoupment in the event of future losses is $0.

In accordance with SSAP 101, *Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10* ("SSAP 101"), the Company evaluates its deferred income tax asset to determine if valuation allowances are required. SSAP 101 requires that companies assess whether valuation allowances should be established based on the consideration of all available evidence using a "more likely than not" standard. In making such judgments, significant weight is given to evidence that can be objectively verified. Management believes it is more likely than not that the amortization of the net unearned premium reserve, collection of future installment premiums on contracts already written, and income from the investment portfolio will not generate sufficient taxable income to realize the entire deferred tax asset that currently exists. Accordingly, a full valuation allowance was established against the Company's domestic net deferred tax asset of $776.2 million as of September 30, 2017. The Company will continue to analyze the need for a valuation allowance on a quarterly basis. The Company's tax returns are subject to routine audits by the Internal Revenue Service and other taxing authorities. On June 6, 2016, the Internal Revenue Service notified the Company that it had concluded its audit of the 2012 and 2013 tax years with no changes to taxable income.

**5. Income Taxes (continued)**

The following table presents the total of deferred tax assets and liabilities by tax character:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | *(In thousands)* | |
| Deferred tax assets: | | |
| Ordinary income | **$ 1,320,346** | $ 1,091,969 |
| Capital losses | **14,239** | 17,377 |
| Gross deferred tax asset | **1,334,585** | 1,109,346 |
| Valuation allowance | **(776,204)** | (784,529) |
| Adjusted deferred tax asset | **558,381** | 324,817 |
| Non-admitted adjusted deferred tax asset | **–** | – |
| Total admitted gross deferred tax asset | **558,381** | 324,817 |
| Deferred tax liabilities: | | |
| Ordinary income | **(551,035)** | (320,582) |
| Capital gains | **(7,346)** | (4,235) |
| Total gross deferred tax liability | **(558,381)** | (324,817) |
| Net admitted deferred tax asset | **$ –** | $ – |

**5. Income Taxes (continued)**

The tax effects of temporary differences that give rise to significant portions of the net deferred tax asset at September 30, 2017 and December 31, 2016 are presented below by tax component:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | *(In thousands)* | |
| Deferred tax assets: | | |
| Premiums revenue recognition | **$ 1,656** | $ 1,873 |
| Net operating loss carryforward | **1,284,317** | 1,054,321 |
| Impairment losses on investments | **12,409** | 15,549 |
| AMT credit | **11,504** | 11,504 |
| Losses-salvage and subrogation recoverable | **15,266** | 15,924 |
| Other | **9,433** | 10,175 |
| Gross deferred tax asset | **1,334,585** | 1,109,346 |
| | | |
| Valuation allowance | **(776,204)** | (784,529) |
| Adjusted deferred tax asset | **558,381** | 324,817 |
| Non-admitted adjusted deferred tax asset | **–** | – |
| Total admitted gross deferred tax asset | **558,381** | 324,817 |
| | | |
| Deferred tax liabilities: | | |
| Tax basis losses incurred adjustment | **(548,295)** | (317,744) |
| Discount on bonds and other | **(10,086)** | (7,073) |
| Total gross deferred tax liability | **(558,381)** | (324,817) |
| Net admitted deferred tax asset | **$ –** | $ – |

**6. Loss Reserves**

Loss reserves comprise the total amount of (i) the Claims Reserve, (ii) the DPO for all policies and (iii) the DPO Accretion for all policies, *minus* the Policy Revision Adjustment. The Policy Revision Adjustment shown in the table below is prescribed by NYSDFS Guidelines and reflects the reduction in the loss reserve components necessary to reflect a Minimum Surplus Amount of $66.4 million.

**6. Loss Reserves (continued)**

The loss reserve components as of September 30, 2017 and December 31, 2016 are summarized as follows:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | *(In thousands)* | |
| Claims Reserve | **$ 1,652,445** | $ 1,311,571 |
| DPO | **1,739,953** | 1,678,310 |
| DPO Accretion | **167,388** | 128,836 |
| Total | **3,559,786** | 3,118,717 |
| Policy Revision Adjustment | **(1,580,682)** | (1,169,008) |
| Loss reserve | **$ 1,979,104** | $ 1,949,709 |

**Claims Reserve**

The Claims Reserve is calculated on a policy-by-policy basis for insured obligations, net of reinsurance, as of the reporting date (using the prescribed statutory discount rate which is based on the average rate of return on the Company's admitted assets, which was 4.27% at both September 30, 2017 and December 31, 2016). The amount of the discount as of September 30, 2017 and December 31, 2016 was $1,038.7 million and $896.8 million, respectively.

**6. Loss Reserves (continued)**

Activity related to the Claims Reserve for the nine months ended September 30, 2017 and the year ended December 31, 2016 is summarized as follows:

| | **September 30, 2017** | **December 31, 2016** |
|---|---|---|
| | *(In thousands)* | |
| Claims Reserve, beginning of period | **$ 1,311,571** | $ 1,362,406 |
| Incurred related to: | | |
| Current year | **–** | – |
| Prior years | **427,722** | 9,160 |
| Total incurred | **427,722** | 9,160 |
| Paid related to: | | |
| Current year | **–** | – |
| Prior years | **(25,205)** | (12,383) |
| Total paid | **(25,205)** | (12,383) |
| Transferred to DPO: | | |
| Current year | **–** | – |
| Prior years | **(61,643)** | (47,612) |
| Total transferred to DPO | **(61,643)** | (47,612) |
| Claims Reserve, end of period | **$ 1,652,445** | $ 1,311,571 |

**6. Loss Reserves (continued)**

The Claims Reserve increased $340.8 million to $1,652.4 million at September 30, 2017 from $1,311.6 million at December 31, 2016, primarily driven by increases in estimated losses relating to Puerto Rico-related exposures insured by FGIC, partially offset by decreases in estimated losses relating to certain RMBS and other exposures insured by FGIC arising principally from loss mitigation efforts, claims paid by FGIC, and improved transaction performance.

The following table shows the gross and net par in force for FGIC's Puerto Rico-related insured exposures as of September 30, 2017:

| | Gross Par In Force* | Net Par In Force* |
|---|---|---|
| | *(In thousands)* | |
| Puerto Rico General Obligation | $ 223,600 | $ 221,105 |
| Puerto Rico Convention Center District Authority | 97,075 | 97,075 |
| Puerto Rico Highways and Transportation Authority (Trans Revs - Senior) | 381,855 | 354,184 |
| Puerto Rico Highways and Transportation Authority (Trans Revs - Subordinate) | 49,370 | 49,370 |
| Puerto Rico Infrastructure Financing Authority ** | 340,080 | 340,080 |
| Total | $ 1,091,980 | $ 1,061,814 |

* *With respect to any FGIC-insured exposure, (i) gross par in force is based on the outstanding principal amount of such exposure, as of the date of determination, but, if such exposure has been the subject of any permitted policy claim paid by FGIC at the CPP in accordance with the Rehabilitation Plan, the gross par in force is reduced by the total amount of all such permitted policy claims relating to principal (without duplication of any other actual reductions), not merely by the CPP portion thereof paid in cash, since the Rehabilitation Plan prohibits future policy claims for that principal amount or interest thereon, and (ii) net par in force means the gross par in force for such exposure net of any related reinsurance.*

** *Includes capital appreciation bonds (CABs) using the principal amount at the time they were insured. As of September 30, 2017, the accretion on these CABs totaled $196.0 million.*

**6. Loss Reserves (continued)**

The following table shows the scheduled net debt service due on FGIC's Puerto Rico-related insured exposures as of September 30, 2017 for each of the calendar years presented:

| | Puerto Rico General Obligation | Puerto Rico Convention Center District Authority | Puerto Rico Highways and Transportation Authority (Trans Revs - Senior) | Puerto Rico Highways and Transportation Authority (Trans Revs - Subordinate) | Puerto Rico Infrastructure Financing Authority | Total |
|---|---|---|---|---|---|---|
| 2018 | $ 28,381 | $ 4,755 | $ 18,943 | $ 17,872 | $ 17,048 | $ 86,999 |
| 2019 | 25,998 | 4,755 | 32,301 | 8,910 | 54,714 | 126,678 |
| 2020 | 26,241 | 4,755 | 24,820 | 12,571 | 54,716 | 123,103 |
| 2021 | 95,317 | 19,075 | 38,486 | 17,258 | 54,712 | 224,848 |
| Thereafter | 99,787 | 95,370 | 516,189 | – | 553,559 | 1,264,905 |
| Total | $ 275,724 | $ 128,710 | $ 630,739 | $ 56,611 | $ 734,749 | $ 1,826,533 |

There is no scheduled net debt service due for the remainder of 2017.

FGIC's Puerto Rico-related insured exposures are subject to significant stress and credit deterioration arising from Puerto Rico's fiscal, financial, liquidity and other challenges. There is substantial uncertainty as to Puerto Rico's ability and willingness to pay its various debt service obligations in a timely manner, as discussed below.

Puerto Rico has defaulted on all semi-annual debt service payments on FGIC-insured Puerto Rico Infrastructure Financing Authority (PRIFA) bonds due from and after January 1, 2016, FGIC-insured General Obligation (GO) and GO Guaranteed bonds due from and after July 1, 2016, and FGIC-insured Puerto Rico Highways and Transportation Authority (PRHTA) and Puerto Rico Convention Center District Authority (PRCCDA) bonds due on July 1, 2017. Due to Puerto Rico's defaults, FGIC has made payments in accordance with the terms of its related policies (as modified by the Rehabilitation Plan) in respect of aggregate policy claims of approximately $140.1 million through September 30, 2017. To the extent Puerto Rico continues to fail to pay scheduled debt service on FGIC-insured exposures as and when due, FGIC would be obligated to pay the related claims under its policies (as modified by the Rehabilitation Plan), and such claims could be material. While FGIC will seek to recover any claim payments it makes, there can be no assurance that FGIC will be able to recover any such payments.

On June 30, 2016, the President of the United States signed into law the Puerto Rico Oversight Management and Economic Stability Act ("PROMESA"). PROMESA, among other things, establishes the Financial Oversight and Management Board (the "Oversight Board") with broad

**6. Loss Reserves (continued)**

responsibilities and authority for (i) overseeing the development of budgets and fiscal plans for the Commonwealth and its instrumentalities and (ii) initiating judicial processes under Title III of PROMESA to restructure the debts of the Commonwealth and its instrumentalities, by accessing multiple sections of the U.S. Bankruptcy Code (including cramdown provisions) that were not previously available to Puerto Rico. PROMESA also sets forth collective action provisions intended to facilitate consensual debt restructurings pursuant to Title VI of PROMESA. PROMESA provided for an automatic stay of debt-related litigation and other enforcement actions upon its enactment (the "PROMESA Stay"), which expired on May 1, 2017.

On March 13, 2017, the Oversight Board certified a fiscal plan for the Commonwealth, which allocates funds available for the payment of Puerto Rico's debt service, including public corporation debt, in an aggregate amount that is materially less than the aggregate amount required to pay such debt service. On April 28, 2017, the Oversight Board certified fiscal plans for certain public corporations, including PRHTA, which it asserts complies with PROMESA. The PRHTA certified fiscal plan allocates no funds as available for the payment of PRHTA's debt service on bonds. These fiscal plans were challenged by creditors and other interested parties and may be modified in light of the impact of the Hurricanes (as defined below).

The Commonwealth publicly disclosed certain settlement proposals it made shortly before the filing of the Commonwealth's PROMESA Title III proceeding, which it stated were based on the cash flow available for debt service under its certified fiscal plan. These settlement proposals taken together, among other things, provide for (i) new senior bonds and/or (ii) new senior or junior cash flow bonds that would not receive any payments unless and to the extent that Puerto Rico outperforms its certified fiscal plan, to be issued and allocated among the various kinds of Puerto Rico-related debt, in satisfaction of those debt obligations. Puerto Rico offered both senior bonds and senior cash flow bonds in respect of its GO and GO Guaranteed bonds and offered only junior cash flow bonds in respect of PRHTA, PRIFA and PRCCDA bonds, in each case in principal amounts that were materially lower than the respective outstanding principal amounts thereof.

On May 3, 2017, the Oversight Board filed a petition in the U.S. District Court for the District of Puerto Rico and thereby commenced a debt adjustment proceeding for the Commonwealth of Puerto Rico under Title III of PROMESA. On May 21, 2017, the Oversight Board filed a petition in the U.S. District Court for the District of Puerto Rico and thereby commenced a debt adjustment proceeding for PRHTA under Title III of PROMESA. The terms and timing for any final outcome of these Title III proceedings are uncertain, but could materially impact FGIC. On June 3, 2017, FGIC and other parties commenced an adversary proceeding in the PRHTA Title III case seeking to enforce the special revenue protections of the U.S. Bankruptcy Code, which Congress

**6. Loss Reserves (continued)**

incorporated into Title III proceedings under PROMESA, with respect to special revenues pledged to secure the repayment of PRHTA bonds (See Note 10, Legal Proceedings).

On June 14, 2017, the federal judge hearing the Title III cases entered an order designating a mediation team comprising five sitting federal judges to facilitate confidential settlement negotiations of any and all issues and proceedings arising in the Title III cases. FGIC has participated in these negotiations.

During September 2017, the Commonwealth was battered by Hurricane Irma and Hurricane Maria (the "Hurricanes"). According to various media and government reports, the Hurricanes caused widespread devastation in the Commonwealth. In light of the aftereffects of the Hurricanes, the timing of the Title III proceedings and ostensibly the terms of the certified fiscal plans have and will continue to be impacted. The extent of any prospective changes with respect to the Title III proceedings and any certified fiscal plans arising from the Hurricanes, and their impact on estimated losses relating to Puerto Rico-related exposures insured by FGIC, cannot reasonably be estimated until, at a minimum, such time as conditions in the Commonwealth have stabilized. The timetable for the Commonwealth's stabilization and recovery is uncertain.

On November 30 and December 7, 2015, the Governor of Puerto Rico issued executive orders (the "Clawback Orders") authorizing the Commonwealth's Treasury Department to retain or redirect certain revenues that the Commonwealth had previously assigned to particular public corporations (the "Clawback"), including PRIFA, PRHTA and PRCCDA, which revenues had been pledged to secure bonds issued by these public corporations, including bonds insured by FGIC. On January 19, 2016, FGIC filed a complaint against the Governor of Puerto Rico and other Commonwealth officials asserting, among other things, claims challenging the constitutionality of the Clawback and the Clawback Orders under the U.S. Constitution (See Note 10, Legal Proceedings).

On April 6, 2016, the Governor of Puerto Rico signed into law the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act (the "Moratorium Act"). Pursuant to the authority purportedly granted by the Moratorium Act, the Governor issued various executive orders affecting Puerto Rico-related obligations insured by FGIC or the issuers thereof or the pledged security therefor (the "Moratorium Orders"), including executive orders suspending payments on the Commonwealth's GO and GO Guaranteed bonds and diverting revenues pledged to secure the repayment of PRIFA, PRHTA and PRCCDA bonds. On March 16, 2017, FGIC filed a motion to intervene as a plaintiff in litigation challenging portions of the Moratorium Act and various Moratorium Orders (See Note 10, Legal Proceedings).

**6. Loss Reserves (continued)**

The ultimate impact of the Hurricanes, PROMESA (including the Title III proceedings that have been or may be filed), laws enacted by the Commonwealth, executive orders issued by the Governor of Puerto Rico, and actions taken (or not taken) by the Oversight Board or the Commonwealth, on Puerto Rico and its fiscal, financial, liquidity and other challenges, including the payment or restructuring of its debt obligations (including those insured by FGIC), is uncertain, but could be material to FGIC.

As of September 30, 2017, FGIC maintained a Claims Reserve for its Puerto Rico-related insured exposures based on various factors and assumptions, including the timing and outcome of the Title III proceedings, the Commonwealth's most recent settlement proposal prior to filing of the Title III proceedings and other matters highlighted above. Rulings, outcomes or other developments relating to Puerto Rico, including the nature, timing and impact of recovery and relief efforts relating to the Hurricanes, may lead to changes in the Claims Reserve for FGIC's Puerto Rico-related insured exposures and the policy claims that FGIC may be required to pay under its related policies, and such changes could be material. It is impossible to predict with any certainty how or when Puerto Rico will be able to resolve its debt and other challenges, and any such resolution could have a material effect on FGIC's Claims Reserve and the related policy claims that FGIC would be required to pay.

The Company has insured LIBOR-based floating rate RMBS transactions. Accordingly, the Company is exposed to interest rate risk. For Claims Reserve purposes, each quarter the Company projects its insured exposure on these transactions using forward LIBOR curves (1-month or 6-month as applicable) as of the end of the second month of such quarter. For such RMBS transactions where FGIC projects losses, all other things being equal, increases or decreases in the interest rates comprising such curves as compared to the prior quarter would increase or decrease FGIC's Claims Reserve, and such changes could be material. The Claims Reserve should be most significantly impacted on such RMBS transactions where FGIC is not required to pay policy claims relating to principal losses until legal maturity of the transactions (2035-2037) because they will continue to have relatively high principal balances on which interest generally will accrue except as otherwise provided in the transaction documents.

The Company believes that the Claims Reserve as of September 30, 2017 is adequate to reflect the sum, net of reinsurance, of (i) the present value of net policy claims submitted to the Company in accordance with the Rehabilitation Plan that are unpaid and not objected to by FGIC as of such date and (ii) the present value of net policy claims that are expected to be received by FGIC in the future. The total amount of policy claims FGIC expects to receive in the future is determined for each policy using internally developed cash flow projection models or other methods for

**6. Loss Reserves (continued)**

estimating losses. However, the establishment of the appropriate level of the Claims Reserve to reflect the future policy claims expected by the Company is an inherently uncertain process involving numerous assumptions, estimates and subjective judgments by management about the outcome of future events, including as to the final resolution of FGIC's Puerto Rico-related insured exposures, the default probability and liquidation value of assets supporting the insured obligations, future interest rate movements, the amount and timing of collateral cash flows, the priority of application of those cash flows under the transactions documents, and the behavior of the underlying borrower.

Small changes in the assumptions, estimates or judgments used by management, which may arise from, among other things, further deterioration in FGIC-insured Puerto Rico-related exposures or the performance of FGIC-insured RMBS, interest rate movements, or changes in the ability or willingness of insured obligors (including Puerto Rico-related entities) to pay their debt service obligations, could result in significant changes in the Company's loss expectations and the related Claims Reserve. These changes will not affect the Company's loss reserve or operating results as long as a Policy Revision Adjustment is required to be made. There can be no assurance that the Company's estimate of the Claims Reserve is accurate. Accordingly, there can be no assurance that the total amount of policy claims permitted by the Company after September 30, 2017 will not exceed or be less than its Claims Reserve at September 30, 2017, and it is possible that they could significantly exceed such reserve.

The Company evaluates the portfolio of insured financial obligations on a regular basis to determine if there has been credit deterioration. The Company evaluates such factors as rating agency downgrades, significant changes in a specific industry and specific events impacting a particular credit, such as a negative credit event, performance below expectations, breaches of representations, warranties, covenants or deal triggers, management changes, regulatory changes, material litigation and other legal issues. Based on the Company's evaluation of these and other factors, the Company assigns credits to risk ratings categories, which assignment determines the level of on-going monitoring and surveillance efforts required and whether a Claims Reserve is recorded. The Company uses the following risk categories to define and monitor insured financial obligations:

**Risk Category 1 – Performing Credits**

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

## 6. Loss Reserves (continued)

Transactions are considered to be investment grade by the Company. Although rating changes may occur, it is not expected that a downgrade would be to below investment grade.

### Risk Category 2 – Watchlist Credits Under Heightened Surveillance

Credits in this category typically would be considered marginal investment grade or higher rated "non-investment grade." Credits in this risk category have been determined to require heightened surveillance, taking into account the totality of circumstances surrounding the particular credit, but have not deteriorated to the level that they would be considered impaired and require a Claims Reserve.

### Risk Category 3 – Watchlist Credits Experiencing Credit Impairment

Credit deterioration has occurred and there is substantial uncertainty as to the credit's ability or willingness to pay its debt service obligations in a timely manner. Credits in this category typically would have suffered sustained negative trends or would have been the subject of a significant adverse event, but are currently not in payment default. Credits in this category have been determined to be impaired, and there is an increased probability of default, but FGIC has not determined, or been able to determine, that policy claims are probable and estimable.

### Risk Category 4 – Watchlist Credits Currently or Likely to Be in Payment Default

Credits that have deteriorated to the point where payment default on their debt service obligations has occurred or is probable and the ultimate loss can be reasonably estimated. Claims Reserves are established on a case basis and are inclusive of any anticipated recoveries from the particular credit or the related collateral. Credits in this category would be consistent with the lowest or in-default credit ratings. Credits in risk category 4 are reviewed and updated on at least a quarterly basis for any change in status.

**6. Loss Reserves (continued)**

The following table is a breakdown, as of September 30, 2017, of the Company's portfolio of insured financial obligations assigned to risk category 4:

| | **Risk Category 4** |
|---|---|
| | *(Dollars in Thousands)* |
| Number of policies | 85 |
| Remaining weighted-average contract period (in years) | 9 |
| Insured contractual payments outstanding: | |
| Principal | $ 4,037,878 |
| Interest | 1,749,009 |
| Total | $ 5,786,887 |
| | |
| Gross Claims Reserve | $ 2,909,278 |
| Less: | |
| Gross projected recoveries | (155,704) |
| Discount, net | (1,062,595) |
| Gross Claims Reserve, net of discount and projected recoveries | $ 1,690,979 |
| | |
| Unearned premiums | $ 29,002 |
| Reinsurance recoverable reported in the balance sheet | $ 537 |

In RMBS, asset-backed securities and other securitization transactions insured by FGIC, the structure of the waterfall of cash flows in the transaction documents and applicable terms and conditions of the Rehabilitation Plan may permit FGIC to recover claims paid from subsequent cash flows. The projected recoveries in the above table reflect FGIC's current estimate of these recoveries, but there can be no assurance that such recoveries will be received by FGIC. The Company's insured financial obligations are structured to provide for rights and remedies in order to mitigate claim loss exposure. Loss mitigation activities may include making repurchase claims or pursuing other claims for breaches of representations and warranties by the originator or others, obtaining appraisals of collateral or reviews of loan files, enforcing collateral provisions and covenants of the servicer or others, more frequent meetings with the issuer or servicer, evaluating the financial position of the originator or servicer, renegotiating financial covenants, triggers, or terms of servicing, enforcing rights to

**6. Loss Reserves (continued)**

remove and replace the servicer, evaluating restructuring plans or bankruptcy proceedings, and commencing litigation or arbitration proceedings as and where appropriate.

There can be no assurance that any loss mitigation efforts will be successful, or as to the magnitude of any benefit that might be derived from any such efforts that are successful.

In accordance with the Rehabilitation Plan, each reinsurer is obligated to pay FGIC in full in cash for such reinsurer's reinsured portion of the entire amount of each permitted policy claim covered by the reinsurance, in each case without giving effect to the modification of FGIC's policy obligations and regardless of the amount paid in cash by FGIC on account of such policy claim. Any reinsurance recoverable on losses is calculated in a manner consistent with the calculation of gross Claims Reserve and reflected in the Claims Reserve as a reduction of the liability.

**DPO**

Activity in the DPO for the nine months ended September 30, 2017 and for the year ended December 31, 2016 is summarized as follows:

| | **September 30, 2017** | **December 31, 2016** |
|---|---|---|
| | *(In Thousands)* | |
| Balance, beginning of period | **$ 1,678,310** | $ 1,700,456 |
| Payments of DPO | **–** | (69,758) |
| Additions: | | |
| DPO relating to Permitted Policy Claims that were initially paid (or deemed to be paid) in cash during the period | **61,643** | 47,612 |
| Balance, end of period | **$ 1,739,953** | $ 1,678,310 |

With respect to FGIC-insured securities purchased and owned by FGIC for which there is a DPO outstanding under the related policy, if the CPP is increased in the future, FGIC, as the holder of

**6. Loss Reserves (continued)**

such insured securities, would be entitled to receive a ratable portion of the related DPO and DPO Accretion payments that would be payable by FGIC under such policy.

**DPO Accretion**

Activity in the DPO Accretion for the nine months ended September 30, 2017 and the year ended December 31, 2016 is summarized as follows:

| | **September 30, 2017** | **December 31, 2016** |
|---|---|---|
| | *(In thousands)* | |
| Balance, beginning of period | **$ 128,836** | $ 80,446 |
| Accretion on outstanding DPO | **38,552** | 51,727 |
| Payment of DPO Accretion | **–** | (3,337) |
| Balance, end of period | **$ 167,388** | $ 128,836 |

**PRA**

Activity in the PRA for the nine months ended September 30, 2017 and the year ended December 31, 2016 is summarized as follows:

| | **September 30, 2017** | **December 31, 2016** |
|---|---|---|
| | *(In thousands)* | |
| Balance, beginning of period | **$ (1,169,008)** | $ (1,247,386) |
| (Increase) decrease in PRA | **(411,674)** | 78,378 |
| Balance, end of period | **$ (1,580,682)** | $ (1,169,008) |

**7. Loss Adjustment Expense Reserves**

The Company estimates a loss adjustment expense reserve based on the ultimate future net cost, determined using internally developed estimates, of the efforts involved in managing and mitigating existing and future policy claims.

Activity in the loss adjustment expense reserve for the nine months ended September 30, 2017 and the year ended December 31, 2016 is summarized as follows:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | *(In thousands)* | |
| Net balance at beginning of period | **$ 24,081** | $ 13,643 |
| Incurred related to: | | |
| Current year | – | – |
| Prior years | **8,438** | 19,480 |
| Total incurred | **8,438** | 19,480 |
| Paid related to: | | |
| Current year | – | – |
| Prior years | **(9,052)** | (9,042) |
| Total paid | **(9,052)** | (9,042) |
| Net balance at end of period | **$ 23,467** | $ 24,081 |

**8. Employee Benefit Plans**

Effective April 1, 2014, the Company adopted a Long-Term Incentive Plan, a non-qualified, unfunded deferred compensation plan for certain employees (the "LTIP"). All LTIP units that are issued will be valued at least annually by the Compensation Committee of the Board of Directors based on specified metrics in accordance with the LTIP. The LTIP units issued in 2014 vested 100% on December 31, 2016 and the benefits under 50% of the units were paid in the first quarter of 2017 and the benefits under the remainder will be paid in the first quarter of 2019. The LTIP units issued in 2015 will vest 100% on December 31, 2017 (or earlier under certain conditions) and the benefits under all such units will be paid in the first quarter of 2018. The LTIP units issued in 2016 will vest 100% on December 31, 2019 (or earlier under certain conditions) and the benefits

**8. Employee Benefit Plans (continued)**

under all such units will be paid in the first quarter of 2020. For the three and nine months ended September 30, 2017 and 2016, the benefits accrued under the plan were $0.6 million and $1.8 million, and $0.9 million and $3.3 million, respectively.

**9. Related-Party Transactions**

The Company is a party to cost-sharing agreements with FGIC Corp. and FGIC UK, pursuant to which the Company may provide these affiliates with management, administrative and other services, the Company may incur and pay costs and other expenses that benefit these affiliates, and these affiliates are obligated to pay the Company for the allocated cost of such services and to reimburse the Company for their allocated share of such expenses paid by the Company. Such shared costs and expenses are allocated to affiliates and vary depending on the assumptions underlying the allocations.

The Company is a party to an amended and restated income tax allocation agreement with FGIC Corp. (see Note 5, Income Taxes).

The assets provided by the City of Detroit, Michigan in connection with the settlement of certain claims related to the FGIC-insured certificates of participation (the "COPs") issued by the Detroit Retirement Systems Funding Trust 2005 and the Detroit Retirement Systems Funding Trust 2006 (together, the "COPs Trusts") pursuant to Detroit's bankruptcy plan, are held by Gotham Motown Recovery, LLC ("GMR"), a Delaware limited liability company formed on February 5, 2016 for the purpose of owning, managing, administering, and otherwise dealing with such assets. FGIC is the managing member of GMR and as such is entitled to receive expense reimbursement from GMR, but such membership interest does not entitle FGIC to receive any distributions made by GMR or to any direct economic ownership of GMR. The COPs Trusts are members of GMR holding in the aggregate a 100% economic interest in GMR on behalf of the holders of the COPs (including FGIC to the extent it has acquired or will acquire COPs by paying policy claims in cash or otherwise acquires COPs). All distributions made by GMR are payable to the COPs Trust Members, which in turn will generally pay such distributions to the holders of the COPs. FGIC currently owns 25% of the COPs by virtue of having paid policy claims in cash, and accordingly is currently entitled to receive 25% of all payments on the COPs made by the Trusts. All such payments received by FGIC are recorded as reductions to incurred losses when received. In accordance with SAP, FGIC does not assign any value as an asset to its membership interest in GMR or its ownership of COPs. Expense reimbursements that FGIC receives from GMR in

**9. Related-Party Transactions (continued)**

connection with acting as the managing member of GMR are recorded as reductions to other underwriting expenses.

**10. Legal Proceedings**

FGIC may be involved from time to time in various legal proceedings filed against it, including the case described below. In addition, FGIC has received, and may in the future receive, various subpoenas, regulatory inquiries, requests for information and document preservation letters. Defending against legal proceedings and responding to subpoenas, regulatory inquiries, requests for information and document preservation letters may involve significant expense and diversion of management's attention and other FGIC resources.

In *Modern Art Services LLC v. Financial Guaranty Insurance Company*, (N.Y. Sup.Ct., Index No. 651115/2016, filed on March 3, 2016), plaintiff sued FGIC alleging breach of contract, breach of the implied covenant of good faith and fair dealing and unjust enrichment, arising out of FGIC's purported failure to compensate plaintiff for its role in connection with the bankruptcy of the City of Detroit. On October 11, 2016, the Court granted in part and denied in part FGIC's motion to dismiss each of plaintiff's causes of action. On March 17, 2017, plaintiff appealed such decision. On March 22, 2017, FGIC filed its answer to the complaint.

FGIC has asserted, and from time to time may assert, claims in legal or arbitration proceedings against third parties to recover losses already incurred by FGIC or to mitigate future losses that FGIC may incur, including the lawsuits described below. The amount of losses that FGIC may recover or mitigate as a result of these proceedings is uncertain, although, in the event of favorable outcomes or settlements, such amount could be material to FGIC's results of operations, financial position, profitability or cash flows.

In *Financial Guaranty Insurance Company v. The Putnam Advisory Company, LLC* (U.S. District Court for the Southern District of New York, filed October 1, 2012 and thereafter amended on November 19, 2012), FGIC sued The Putnam Advisory Company ("Putnam"), alleging fraud, negligent misrepresentation and negligence by Putnam in connection with the Pyxis ABS CDO 2006-1 transaction for which Putnam acted as collateral manager. On September 10, 2013, FGIC's complaint was dismissed, with leave to file a further amended complaint. On September 30, 2013, FGIC filed a further amended complaint. On April 28, 2014, the District Court granted Putnam's motion to dismiss all of FGIC's claims. On April 15, 2015, the United States Court of Appeals for the Second Circuit vacated the District Court's dismissal of FGIC's complaint and remanded the case for further proceedings. On May 18, 2015, Putnam filed its answer to the complaint.

**10. Legal Proceedings (continued)**

In *Financial Guaranty Insurance Company v. Morgan Stanley ABS Capital I Inc. and Morgan Stanley Mortgage Capital Holdings LLC*, (N.Y. Sup.Ct., Index No. 652853/2014, filed on September 19, 2014), FGIC sued Morgan Stanley ABS Capital I Inc. ("MSAC") and Morgan Stanley Mortgage Capital Holdings LLC ("MSMC"), alleging, *inter alia*, that MSAC and MSMC breached various warranties and affirmative covenants in connection with the securitization transaction known as Basket of Aggregated Residential NIMS 2007-1, including their obligations to repurchase breaching net interest margin securities that collateralized the insured securities, and to reimburse FGIC for payments made under the related FGIC policy. On January 19, 2017, the Court denied in its entirety MSAC and MSMC's motion to dismiss FGIC's claims. On February 24, 2017, defendants appealed such decision. On March 1, 2017, defendants filed their answer to the complaint.

In *Financial Guaranty Insurance Company v. Morgan Stanley, et al.*, (N.Y. Sup.Ct., Index No. 652914/2014, filed on September 23, 2014), FGIC sued MSAC, MSMC, Morgan Stanley ("MS") and Morgan Stanley & Co. LLC (collectively, "Morgan Stanley"), and Saxon Mortgage Services, Inc. ("Saxon"), alleging, *inter alia*, that (i) Morgan Stanley fraudulently induced FGIC to insure the RMBS transaction known as MSAC 2007-NC4; (ii) MSAC, MSMC and MS breached various warranties and affirmative covenants, including their obligations to repurchase breaching or fraudulent mortgage loans and to reimburse FGIC for payments made under the related FGIC policy; and (iii) Saxon and MS breached their warranties and obligations under the Pooling and Servicing Agreement for the MSAC 2007-NC4 transaction, including their obligation to provide notice of breaching mortgage loans. On January 23, 2017, the Court denied in its entirety Morgan Stanley's motion to dismiss FGIC's claims. On February 24, 2017, Morgan Stanley appealed such decision. On March 1, 2017, Morgan Stanley filed its answer to the complaint.

In *Assured Guaranty Corp., et al. v. Commonwealth of Puerto Rico, et al.*, (D.P.R., Case No. 17-00156-LTS, filed on June 3, 2017, and thereafter amended on July 23, 2017), FGIC, Assured Guaranty Corp., Assured Guaranty Municipal Corp., and National Public Finance Guarantee Corporation commenced an adversary proceeding in the PRHTA Title III case seeking to enforce the special revenue protections of the U.S. Bankruptcy Code (11 U.S.C. §§ 902, 922(d), 928(a)), which Congress incorporated into Title III proceedings under PROMESA, with respect to special revenues pledged to secure the repayment of PRHTA bonds. Plaintiffs seek a declaration that defendants have violated Sections 922(d) and 928(a) of the U.S. Bankruptcy Code, and that efforts to compel defendants to transfer such revenues to pay for debt service on PRHTA bonds are not stayed pursuant to Section 922(d) of the U.S. Bankruptcy Code. Plaintiffs also seek injunctive relief prohibiting defendants from taking or causing to be taken any action that would further violate Sections 922(d) and 928(a) of the U.S. Bankruptcy Code and ordering defendants to remit

**10. Legal Proceedings (continued)**

revenues securing the PRHTA Bonds in accordance with such Sections. Plaintiffs also seek declaratory relief that all funds held in reserve accounts are property of the PRHTA bondholders and are being improperly withheld. On July 28, 2017, defendants filed a motion to dismiss the claims made by FGIC and the other plaintiffs. On September 12, 2017, plaintiffs, including FGIC, filed their opposition to the motion to dismiss. On October 26, 2017, defendants filed their reply briefs in support of the motion to dismiss.

In *Financial Guaranty Insurance Company v. Alejandro García Padilla, et al.,* (D.P.R., Case No. 3:16-cv-01095, filed on January 19, 2016), FGIC sued Governor Alejandro García Padilla and certain other officials of the Commonwealth of Puerto Rico alleging Section 8 of Article VI of the Commonwealth Constitution ("Section 8," and defendants' stated basis for the Clawback (which is discussed in Note 6, Loss Reserves)), the Management and Budget Office Organic Act (the "OMB Act," and defendants' stated law regarding procedures implementing the Clawback), and the Clawback Orders (directing the Clawback) are unconstitutional on the grounds that they: (1) are preempted by federal law; (2) violate the Contracts Clause of Article I of the United States Constitution; and (3) violate the Fifth and Fourteenth Amendments of the United States Constitution. FGIC is seeking a judgment declaring Section 8, the OMB Act and the Clawback Orders to be unconstitutional, and also is seeking an injunction enjoining the defendants from taking or causing to be taken any and all acts under Section 8, the OMB Act and the Clawback Orders. On January 21, 2016, FGIC's action was consolidated with an analogous action brought by Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Ambac Assurance Corporation. On February 10, 2016, defendants filed motions to dismiss FGIC's claims. On October 4, 2016, the District Court entered an order denying all defendants' motions to dismiss, except that it granted the motion to dismiss FGIC's claim that the Clawback was preempted by federal law. The commencement of the Commonwealth's PROMESA Title III proceeding stays this action.

On March 16, 2017, FGIC filed a motion for leave to intervene as a plaintiff in Lex Claims, LLC, et al. v. The Commonwealth of Puerto Rico, et al., (D.P.R. Case No. 3:16-cv-02374, filed on July 20, 2016), which case was filed by a group of holders of the Commonwealth's GO bonds challenging, inter alia, the validity of the Moratorium Act, the Moratorium Orders, and the availability of resources pledged to pay bonds issued by the Puerto Rico Sales Tax Financing Corporation (also known by its acronym in Spanish, "COFINA"). Before the District Court ruled on FGIC's motion to intervene, the United States Court of Appeals for the First Circuit, on April 4, 2017, ruled that the PROMESA Stay applied to all claims asserted by the original plaintiffs in this action. Therefore, FGIC's motion for leave to intervene was similarly subject to the

**10. Legal Proceedings (continued)**

PROMESA Stay. While the PROMESA Stay expired on May 1, 2017, the commencement of the Commonwealth's PROMESA Title III proceeding stays this action.

**11. Subsequent Events**

Subsequent events described elsewhere in the notes to these financial statements include in Note 10, Legal Proceedings, information about developments concerning certain legal proceedings.

The date through which subsequent events have been evaluated is November 14, 2017.