INDEX TO FINANCIAL STATEMENTS

Report of Independent Auditors

To the Board of Directors and Shareholders of Syncora Guarantee Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Syncora Guarantee Inc. and its subsidiary (the “Company”) at December 31, 2008 and December 31, 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As described in Note 2 to the consolidated financial statements, following significant losses in 2007, the Company had its ratings downgraded by the three major rating agencies, and as a consequence the Company suspended writing substantially all new business. Furthermore, the Company reported a statutory policyholders’ deficit at December 31, 2008. Failure to maintain minimum policyholders’ statutory capital and surplus permits the New York State Insurance Department to intervene in the Company’s operations and seek court appointment as rehabilitator or liquidator of the Company and, accordingly, there is substantial doubt about the Company’s ability to continue as a going concern. Management’s plans in regard to this matter are described in Note 5. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 6 to the consolidated financial statements, the Company adopted SFAS No. 157, “Fair Value Measurements” in 2008.

/s/ PricewaterhouseCoopers LLP
New York, New York
April 30, 2009

SYNCORA GUARANTEE INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

(in thousands, except share amounts and per share amounts)	2008	2007
Assets		
Debt securities available for sale, at fair value (amortized cost: 2008—$1,930,251; 2007—$2,412,175)	$ 1,985,574	$ 2,430,772
Equity securities, at fair value (cost—$120,640)	22,720	—
Cash and cash equivalents	543,595	217,426
Total cash and invested assets	2,551,889	2,648,198
Restricted cash and cash equivalents	954,948	—
Accrued investment income	21,111	21,024
Deferred acquisition costs	110,062	108,117
Prepaid reinsurance premiums	7,791	101,122
Premiums receivable	14,623	24,494
Reinsurance balances receivable	2,010	—
Reinsurance balances recoverable on unpaid losses	6,011	266,945
Intangible assets-acquired licenses	—	11,529
Derivative assets	54,832	354,596
Other assets	85,438	2,198
Total assets	$ 3,808,715	$ 3,538,222
Liabilities, Minority Interest and Shareholders' Equity		
Liabilities		
Unpaid losses and loss adjustment expenses	$ 1,686,187	$ 402,519
Deferred premium revenue	655,928	927,385
Derivative liabilities	787,221	1,700,695
Reinsurance premiums payable	232	36,485
Accounts payable, accrued expenses and other liabilities	2,909	40,897
Total liabilities	3,132,477	3,107,981
Preferred shares		
Series A redeemable preferred shares	—	39,000
Shareholders' equity		
Series B non-cumulative perpetual preferred shares	20,000	—
Common shares—(Par value $7,500 per share; 8,000 shares authorized; shares issued and outstanding: 2008 – 2,000; 2007 – 2,000)	15,000	15,000
Additional paid-in-capital	2,766,621	1,148,393
Accumulated deficit	(2,179,734)	(789,960)
Accumulated other comprehensive (loss) income	54,351	17,808
Total common shareholder's equity	656,238	391,241
Total shareholders' equity	676,238	430,241
Total liabilities, redeemable preferred shares and shareholders' equity	$ 3,808,715	$ 3,538,222

See accompanying notes to consolidated financial statements.

SYNCORA GUARANTEE INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE (LOSS) INCOME
YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(in thousands, except per share amounts)	2008	2007	2006
Revenues			
Net premiums earned	$ 279,371	$ 168,660	$ 159,441
Net investment income	131,446	118,851	75,495
Net realized losses on investments	(240,323)	(2,517)	(16,279)
Change in fair value of derivatives			
Realized (losses) gains and other settlements	(126,646)	47,059	23,674
Unrealized gains (losses)	621,210	(1,342,299)	(10,453)
Net change in fair value of derivatives	494,564	(1,295,240)	13,221
Fee income and other	3,473	183	2,263
Total revenues	668,531	(1,010,063)	234,141
Expenses			
Net losses and loss adjustment expenses	1,797,877	69,366	12,890
Acquisition costs, net	17,101	19,971	16,240
Loss on commutation of reinsurance agreements	42,381	—	—
Operating expenses	206,419	81,310	72,276
Total expenses	2,063,778	170,647	101,406
(Loss) income before income tax	(1,395,247)	(1,180,710)	132,735
Income tax (benefit) expense	(2,695)	16,370	1,696
Net (loss) income	$ (1,392,552)	$ (1,197,080)	$ 131,039
Comprehensive (loss) income:			
Net (loss) income	$ (1,392,552)	$ (1,197,080)	$ 131,039
Currency translation adjustments	—	174	—
Change in unrealized appreciation of investments, net of deferred tax benefit	36,543	37,339	602
Total comprehensive (loss) income	$ (1,356,009)	$ (1,159,567)	$ 131,641

See accompanying notes to consolidated financial statements.

SYNCORA GUARANTEE INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(in thousands)	2008	2007	2006
Series A redeemable preferred shares			
Balance—beginning of year	$ 39,000	$ 54,016	$ 39,000
Reduction in stated value	—	(15,016)	—
Capital contribution	—	—	15,016
Cancellation of Series A preferred shares	(39,000)	—	—
Balance—end of year	—	39,000	54,016
Series B non-cumulative perpetual preferred shares			
Balance—beginning of year	—	—	—
Issuance of Series B perpetual preference shares	20,000	—	—
Balance—end of year	20,000	—	—
Common shares			
Balance—beginning of year	15,000	15,000	15,000
Balance—end of year	15,000	15,000	15,000
Additional paid-in capital			
Balance—beginning of year	1,148,393	923,393	591,118
Capital contribution	1,679,870	225,000	332,275
Investment in stock of parent company	(61,642)	—	—
Balance—end of year	2,766,621	1,148,393	923,393
Accumulated (deficit) retained earnings			
Balance—beginning of year	(789,960)	410,645	285,507
Net (loss) income	(1,392,552)	(1,197,080)	131,039
Cancellation of Series A preferred shares	39,000	—	—
Dividend to Syncora Holdings Ltd.	(30,790)	—	—
Dividends on redeemable preferred shares	(5,432)	(3,525)	(5,901)
Balance—end of year	(2,179,734)	(789,960)	410,645
Accumulated other comprehensive income (loss)			
Balance—beginning of year	17,808	(19,705)	(20,307)
Currency translation adjustments	—	174	—
Net change in unrealized appreciation of investments	36,543	37,339	602
Balance—end of year	54,351	17,808	(19,705)
Total common shareholder's equity—end of year	656,238	391,241	1,329,333
Total shareholders' equity—end of year	$ 676,238	$ 430,241	$ 1,383,349

See accompanying notes to consolidated financial statements.

SYNCORA GUARANTEE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

(in thousands)	2008	2007	2006
Cash provided by operating activities:			
Net (loss) income	$ (1,392,552)	$ (1,197,080)	$ 131,039
Adjustments to reconcile net (loss) income to net cash provided by operating activities			
Net realized losses on investments	240,323	2,517	16,279
Net unrealized (gains) losses on derivatives	(621,210)	1,342,299	10,453
Impairment of intangible assets-acquired licenses	11,529	—	—
Realized gain from exercise of option under capital facility	(179,559)	—	—
Realized losses and other settlements	(64,793)	—	—
Amortization of premium on bonds	2,270	3,004	3,434
Transfer to restricted cash	(954,948)	—	—
Increase in accrued investment income	(87)	(4,558)	(4,619)
Decrease (increase) in deferred acquisition costs	167	(14,308)	(34,217)
Decrease (increase) in prepaid reinsurance premiums	85,056	(41,139)	9,890
Decrease (increase) in premiums receivable	9,871	(11,558)	(5,166)
Increase in reinsurance balances receivable	(2,010)	—	—
Decrease (increase) in reinsurance balances recoverable on unpaid losses	244,334	(179,440)	(19,075)
Increase in unpaid losses and loss adjustment expenses	1,283,668	238,285	28,756
(Decrease) increase in deferred premium revenue	(271,458)	131,479	203,321
(Decrease) increase in reinsurance premiums payable	(35,848)	22,533	13,642
Other, net	(114,447)	(4,346)	36,119
Total adjustments	(367,142)	1,484,768	258,817
Net cash (used in) provided by operating activities	(1,759,694)	287,688	389,856
Cash flows from investing activities:			
Proceeds from sale of debt securities	100,512	92,249	336,303
Purchase of debt securities	(31,712)	(982,340)	(840,444)
Proceeds from maturity of debt securities and short-term investments	268,585	445,218	18,828
Purchases of fixed assets	—	(1,065)	—
Net cash provided by (used in) investing activities	337,385	(445,938)	(485,313)
Cash flows from financing activities:			
Proceeds from issuance of redeemable preferred shares	200,000	—	—
Proceeds from capital contribution	1,584,700	225,000	215,984
Dividend paid to Syncora Holdings Ltd.	(30,790)	—	—
Dividends paid on Series A redeemable preferred shares	(1,609)	(18,543)	(5,901)
Dividends paid on Series B non-cumulative perpetual preferred shares	(3,823)	—	—
Net cash provided by financing activities	1,748,478	206,457	210,083
Increase in cash and cash equivalents	326,169	48,207	114,627
Cash and cash equivalents—beginning of year	217,426	169,219	54,592
Cash and cash equivalents—end of year	$ 543,595	$ 217,426	$ 169,219
Supplemental Cash Flow Disclosure:			
Stock received in consideration for commutation	$ 87,111	$ —	$ —
Stock received as part of the consideration for cancellation of XLI guarantee (see Note 10)	33,529	—	—
Income tax paid	—	2,700	—

See accompanying notes to consolidated financial statements.

1. Organization

On March 17, 2006, XL Capital Ltd ("XL Capital") formed Syncora Holdings Ltd. ("Syncora Holdings") (formerly known as Security Capital Assurance Ltd), as a wholly-owned Bermuda based subsidiary holding company. On July 1, 2006, XL Capital contributed all its ownership interests in its financial guarantee insurance and financial guarantee reinsurance operating businesses to Syncora Holdings. The aforementioned operating businesses consisted of: (i) Syncora Guarantee Inc. ("Syncora Guarantee" or the "Company") (a New York domiciled financial guarantee insurance company formerly known as XL Capital Assurance Inc.) and its wholly-owned subsidiary, Syncora Guarantee (U.K.) Ltd (formerly known as XL Capital Assurance (U.K.) Limited) and (ii) Syncora Guarantee Re Ltd. ("Syncora Guarantee Re") (a Bermuda domiciled financial guarantee reinsurance company formerly known as XL Financial Assurance Ltd.). The Company was an indirect wholly-owned subsidiary of XL Capital and all of Syncora Guarantee Re was indirectly owned by XL Capital, except for a preferred stock interest which was owned by Financial Security Assurance Holdings Ltd. ("FSA"), an entity which is otherwise not related to XL Capital, Syncora Holdings, Syncora Guarantee Re or the Company (see Note 9). On August 4, 2006, Syncora Holdings completed an initial public offering (the "IPO"). In addition, XL Capital sold common shares of Syncora Holdings from its holdings directly to the public in a secondary offering concurrent with the IPO. Immediately after the IPO and the secondary offering, XL Capital, through its wholly-owned subsidiary XL Insurance (Bermuda) Ltd ("XLI"), owned approximately a 63% economic interest in Syncora Holdings, adjusted for restricted share awards to employees and management granted at the effective date of the IPO. In June 2007, XLI completed the sale of additional common shares of Syncora Holdings from its holdings. Immediately after such sale, XLI owned approximately a 46% voting and economic interest in Syncora Holdings, adjusted for restricted share awards to employees and management outstanding as of such date. Prior to XLI's sale of common shares of Syncora Holdings in June 2007, its voting interest in Syncora Holdings was subject to limitations contained in Syncora Holdings' bye-laws. On August 5, 2008, Syncora Holdings, Syncora Guarantee Re, the Company and XL Capital consummated the transactions described in Note 4 below and, as a result thereof, XL Capital transferred all of the common shares of Syncora Holdings it owned to a trust (see Note 4 for additional information). On September 4, 2008, Syncora Guarantee Re merged with and into Syncora Guarantee, with Syncora Guarantee being the surviving company (see Note 4).

2. Recent Developments

Adverse developments in the credit markets generally and the mortgage market specifically that began in the second half of 2007 and continued through 2008 have resulted in material adverse effects on the Company's business, results of operations, and financial condition, including (i) significant adverse development of anticipated claims on the Company's guarantees, under its credit default swap ("CDS") contracts, of collateralized debt obligations ("CDOs") of asset-backed securities ("ABS CDOs") and significant adverse development of reserves for unpaid losses and loss adjustment expenses on the Company's guarantees, under its insurance contracts, of residential mortgage-backed securities ("RMBS"), and (ii) downgrades of the insurance financial strength ratings of the Company by Moody's Investors Service, Inc. ("Moody's"), Fitch Ratings ("Fitch") and Standard & Poor's Ratings Services ("S&P"), which ratings had been fundamental to the Company's ability to conduct business and which have caused the Company to cease writing substantially all new business since January of 2008, resulting in the loss of future incremental earnings and cash flow.

During the second quarter of 2008, the Company recorded a material increase in adverse development of anticipated claims on its guarantees of ABS CDOs and reserves for unpaid losses and loss adjustment expenses on its guarantees of RMBS causing it to be unable to maintain compliance with its $65 million minimum policyholders' surplus requirement under New York Insurance Law as of June 30, 2008. In light of this material adverse development, and in accordance with its previously disclosed strategic plan, on July 28, 2008 the Company, certain financial institutions that are counterparties to credit default swap ("CDS") contracts with the Company (the "Counterparties"), Merrill Lynch & Co., Inc. ("Merrill Lynch") and certain of its affiliates, and XL Capital and certain of its affiliates, entered into a Master Commutation, Release and Restructuring Agreement, dated July 28, 2008, as amended (the "Master Transaction Agreement"), and certain other related agreements (hereafter referred to collectively as "the 2008 MTA"). The transactions comprising the 2008 MTA closed on August 5, 2008 (the "Closing Date"), except for the transactions comprising the FSA Master Agreement (as defined below), which closed on August 4, 2008. The transactions comprising the 2008 MTA are described in Note 4 along with summary financial information presenting the effect of the transactions comprising the 2008 MTA on the Company's financial position and results of operations as of and for the year ended December 31, 2008.

During the third quarter of 2008, the Company recorded further significant adverse development of its anticipated claims on its guarantees of ABS CDOs and reserves for unpaid losses and loss adjustment expenses on its guarantees of RMBS which would have caused the Company to be unable to maintain its compliance with its $65 million minimum policyholders' surplus requirement under New York Insurance Law as of September 30, 2008. However, at the request of the Company, the New York State Insurance Department (the "NYID"), pursuant to section 6903 of New York Insurance Law, granted the Company approval in connection with the preparation of its statutory financial statements for the quarter ended September 30, 2008 to release statutory-basis contingency reserves on policies that have been terminated and on policies on which the Company has established case basis reserves for losses and loss adjustment expenses, which differs from accounting practices prescribed by the National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures Manual and adopted by the State of New York ("NAIC SAP"). As a result of such approval, the Company reported policyholders' surplus of $83.3 million at September 30, 2008. Absent such approval, the Company would have reported a policyholders' surplus at September 30, 2008 of $19.1 million. Policyholders' surplus is based on statutory-basis accounting practices which differ from accounting principles generally accepted in the United States of America ("GAAP"). Such differences may be material. The aforementioned approval was also extended by the NYID in connection with the preparation of the Company's statutory financial statements as of and for the year ended December 31, 2008. There can be no assurance that the NYID will continue to allow the Company to apply such practices.

During the fourth quarter of 2008, the Company recorded a material increase in adverse development relating to anticipated claims on our guarantees of ABS CDOs and reserves for unpaid losses and loss adjustment expenses on our guarantees of RMBS. As a result of the material adverse development relating to anticipated claims on the Company's guarantees of ABS CDOs and reserves for unpaid losses and loss adjustment expenses on the Company's guarantees of RMBS recorded during 2008, the Company reported a policyholders' deficit of $2.4 billion as of December 31, 2008. Failure to maintain positive statutory policyholders' surplus or non-compliance with the $65 million statutory minimum policyholders' surplus requirement permits the New York Superintendent of Insurance (the "New York Superintendent") to seek court appointment as rehabilitator or liquidator of the Company. As a result of this material adverse development, and in accordance with our previously disclosed strategic plan, effective as of March 5, 2009, the Company signed a non-binding letter of intent with certain of the Counterparties (the "Letter of Intent") whereby the parties agreed to negotiate in good faith to seek to promptly agree on mutually agreeable definitive documentation, in the form of a master transaction agreement and related agreements (hereafter referred to collectively as the "2009 MTA"). In addition, pursuant to the RMBS Transaction Agreement, dated as of March 5, 2009 (the "RMBS Transaction Agreement"), on March 11, 2009, the fund referenced therein (the "Fund") commenced a tender offer to acquire certain residential mortgage-backed securities that are insured by the Company (the "RMBS Securities"). The 2009 MTA and tender offer represent the principal elements of the second phase of our strategic plan. The transactions contemplated by the Letter of Intent and the related transactions and the tender offer are described in Note 3.

On April 10, 2009, the NYID, pursuant to Section 1310 of the New York Insurance Law, issued an order stating that, without limiting its power to institute rehabilitation or liquidation at an earlier date, the Company shall take such steps as may be necessary to remove the impairment of its capital an return to compliance with its regulatory required minimum surplus to policyholders by no later than May 29, 2009. Additionally, as set forth in the order, the Company shall not write any new business and, as of April 26, 2009, the Company shall suspend payment of any and all claims and otherwise operate only in the ordinary course and as necessary to effectuate a restructuring. On April 27, 2009, pursuant to the aforementioned order, the Company announced that it has suspended the payment of all claims from and after April 26, 2009 and is operating only in the ordinary course and as necessary to complete a successful comprehensive restructuring. As of April 29, 2009, the Company has failed to pay claims aggregating $21.4 million on four insurance policies pursuant to this suspension. The Board of Directors of Syncora Guarantee will continue to monitor the situation on a daily basis and, in the absence of a successful restructuring, may, in the exercise of its fiduciary duties, request the NYID to seek court appointment of a rehabilitator or liquidator of Syncora Guarantee.

As a result of the aforementioned recent developments and the continuing risks and uncertainties affecting the Company discussed in Note 5, the Company has concluded that there is substantial doubt about its ability to continue as a going concern. The Company's financial statements as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007, and 2006 are prepared assuming the Company continues as a going concern and do not include any adjustment that might result from its inability to continue as a going concern. See Note 5 for a more detailed discussion.

3. Description of the Transactions Contemplated by the Letter of Intent and Related Transactions

The non-binding terms and conditions in the Letter of Intent provide that the Company and the Counterparties will commute or transfer to an affiliate of the Company, or cause their respective affiliates to commute or transfer to an affiliate of the Company, their respective CDS contracts and financial guarantee insurance contracts and in exchange the Company will pay to the Counterparties certain consideration to include, in the aggregate, (i) approximately $1.2 billion in cash consideration, (ii) common shares of Syncora Holdings, such shares to represent approximately 40% of the outstanding common shares of Syncora Holdings following the transaction, (iii) a $150 million short-term surplus note and a $475 million long-term surplus note, and (iv) additional consideration that may include an increase in the principal amount of, or interest rate on the, surplus notes, and cash consideration based on certain specified calculations. Such non-binding terms and conditions also provide that the Company will form a New York financial guarantee insurance subsidiary ("Drop-Down Company") to (a) reinsure, on a cut-through basis, certain of the Company's public finance and selected global infrastructure in-force business, and (b) assume through consensual novations certain of the Company's in-force guarantees of CDS business, in connection with which the Company would enter into a new swap contract with the respective counterparties to such guarantees to provide a financial guarantee that guarantees certain of the payments under such novated swap contract. The Company will capitalize Drop-Down Company with $185 million in equity and the purchase of two surplus notes of Drop-Down Company in the aggregate principal amount of $350 million. Such non-binding terms and conditions also contemplate certain closing conditions to the 2009 MTA, including the receipt of regulatory approvals and a process for selecting members of the Board of Directors of each of the Syncora Holdings, the Company, and Drop-Down Company and certain officers of the Company.

The non-binding terms and conditions in the Letter of Intent contemplate the participation of all of the 23 Counterparties. To date, all of the Counterparties have indicated their willingness to enter into the transactions contemplated by the Letter of Intent, subject to final documentation. One significant Counterparty has indicated that it is contemplating entering into the transactions contemplated by the Letter of Intent subject to a condition that is outside of the Company's control. There can be no assurance that the 2009 MTA will be consummated.

All of the terms and conditions described above are subject to definitive documentation satisfactory to all of the parties. There can be no assurance that the parties will enter into such agreements in accordance with these terms and conditions or at all. In addition, consummation of the transactions contemplated by the 2009 MTA will be subject to various closing conditions and there can be no assurance that the transactions contemplated thereby will be consummated. In addition, we need to enter into settlement agreements with certain third-parties as part of the second phase of our strategic plan.

An additional element of the second phase of the Company's strategic plan is the tender offer contemplated by the RMBS Transaction Agreement. On March 11, 2009, the Fund commenced a tender offer to acquire the RMBS Securities either in consideration for cash or for a certificate representing the uninsured cash flows of the tendered RMBS Securities and a cash payout. Subject to closing conditions, the Company will purchase class B shares of the Fund and receive certificates representing the insurance cash flows on all RMBS Securities acquired by the Fund for an amount not to exceed $375 million in the aggregate. If the minimum amount of RMBS Securities is successfully acquired, the tender offer would significantly reduce the Company's exposure to residential mortgages. Consummation of the transactions contemplated by the RMBS Transaction Agreement is subject to various closing conditions and there can be no assurance that the transactions contemplated thereby will be consummated.

If the transactions contemplated by the 2009 MTA and the RMBS Transaction Agreement are not consummated, the Company is expected to continue to report a policyholders' deficit and may therefore be subject to action by the NYID.

On April 10, 2009, the NYID, pursuant to Section 1310 of the New York Insurance Law, issued an order stating that, without limiting its power to institute rehabilitation or liquidation at an earlier date, the Company shall take such steps as may be necessary to remove the impairment of its capital an return to compliance with its regulatory required minimum surplus to policyholders by no later than May 29, 2009. Additionally, as set forth in the order, the Company shall not write any new business and, as of April 26, 2009, the Company shall suspend payment of any and all claims and otherwise operate only in the ordinary course and as necessary to effectuate a restructuring. On April 27, 2009, pursuant to the aforementioned order, the Company announced that it has suspended the payment of all claims from and after April 26, 2009 and is operating only in the ordinary course and as necessary to complete a successful comprehensive restructuring. As of April 29, 2009, the Company has failed to pay claims aggregating $21.4 million on four insurance policies pursuant to this suspension. The Board of Directors of Syncora Guarantee will continue to monitor the situation on a daily basis and, in the absence of a successful restructuring, may, in the exercise of its fiduciary duties, request the NYID to seek court appointment of a rehabilitator or liquidator of Syncora Guarantee.

See Note 5 for a description of continuing risks and uncertainties affecting the Company.

4. Description of the Transactions Comprising the 2008 MTA and Certain Summary Financial Information

Set forth below is a description of agreements comprising the 2008 MTA, as well as certain summary financial information presenting the effect of the transactions comprising the 2008 MTA on the Company's financial position and results of operations as of the Closing Date.

Master Transaction Agreement and Merrill Agreement

The Master Transaction Agreement provided for the termination, commutation or elimination of certain reinsurance agreements, guarantees and other arrangements among the Company and XL Capital and certain of its subsidiaries, and between the Company and Syncora Guarantee Re, in exchange for a cash payment by XL Capital to the Company and Syncora Guarantee Re of $1.775 billion, the issuance and transfer of 8 million class A ordinary shares of XL Capital in the aggregate to the Company and Syncora Guarantee Re, and the transfer of XL Capital's common shares of Syncora Holdings to a trust, the SCA Shareholder Entity, for the benefit of the Company until such time as an agreement between the Company and the Counterparties is reached, and thereafter the Syncora Holdings shares will be held for the benefit of the Counterparties. As a result of the transfer of the shares of Syncora Holdings to the SCA Shareholder Entity, XL Capital no longer has the right to vote, nominate directors to Syncora Holdings' Board of Directors or any other rights. On the Closing Date, the four XL Capital-nominated directors on Syncora Holdings' Board of Directors resigned. Pursuant to a shareholders agreement with the SCA Shareholder Entity, the trust has a number of rights including the right to vote the shares and to nominate to Syncora Holdings' Board of Directors, such number of directors as would equal one nominee less than a majority (if Syncora Holdings' Board of Directors consists of nine or fewer Directors) or two nominees less than a majority (if Syncora Holdings' Board of Directors consists of ten or more Directors). Effective November 19, 2008, pursuant to the shareholder agreement, the SCA Shareholder Entity appointed four members to Syncora Holdings' Board of Directors. The Company also entered into a registration rights agreement with the SCA Shareholder Entity providing for demand registration rights, a shelf registration if the Company is so eligible and piggyback registration rights. Until the common shares of Syncora Holdings are transferred from the aforementioned trust to Counterparties or otherwise sold in the open market, for accounting purposes, they are considered to be treasury shares.

Under a registration rights agreement, dated as of August 5, 2008, by and among the Company, Syncora Guarantee Re and XL Capital, XL Capital agreed to provide the Company and Syncora Guarantee Re with two demand registration and unlimited piggyback registration rights with respect to the 8 million class A ordinary shares issued by XL Capital to the Company and Syncora Guarantee Re. The Company and Syncora Guarantee Re also agreed to hold such shares for a period of six months, which expired on February 5. 2009, and any sale of class A ordinary shares of XL Capital by the Company or Syncora Guarantee Re will be subject to a right of first offer in favor of XL Capital. In addition, pursuant to a letter, dated July 29, 2008, from Syncora Holdings to the underwriters named in the underwriting agreement entered into by XL Capital for a public offering of its class A ordinary shares, Syncora Holdings agreed, and agreed to cause its subsidiaries to agree, to a six month lock-up period with respect to class A ordinary shares of XL Capital, which expired on January 29, 2009.

Concurrent with the execution of the Master Transaction Agreement, Syncora Holdings, the Company and Syncora Guarantee Re entered into an agreement (the "Merrill Agreement") with Merrill Lynch, Merrill Lynch International ("MLI") and eight trusts affiliated with Syncora Holdings (the "CDS Trusts"), the obligations of which were guaranteed by policies issued by the Company. The Merrill Agreement provided for the termination of eight CDS contracts (the "Swaps") and the related financial guarantee insurance policies issued by the Company with insured gross par outstanding as of June 30, 2008 of approximately $3.7 billion, in exchange for a payment by the Company to Merrill Lynch of an aggregate amount of $500 million. As part of the closing of the transactions comprising the Merrill Agreement, the parties provided mutual releases of claims with respect to the Swaps and the related policies. In addition, the Company and MLI have agreed to dismiss previously disclosed litigation related to seven of the Swaps. As a result of the termination of the Swaps, the Company recorded a realized loss of $94.0 million during the year ended December 31, 2008.

The Company and XL Capital obtained approvals from the NYID and the Bermuda Monetary Authority (the "BMA") for the Master Transaction Agreement and the transactions comprising such agreement. Other required approvals related to the Master Transaction Agreement have been received from the Delaware Department of Insurance. The NYID has also approved the Merrill Agreement and the transactions comprising such agreement.

FSA Master Agreement

Concurrent with the execution of the Master Transaction Agreement, the Company also entered into an agreement (the "FSA Master Agreement") with FSA. The FSA Master Agreement provided for the commutation of all reinsurance ceded by FSA and its subsidiaries to Syncora Guarantee Re, including that ceded under the amended and restated master facultative reinsurance agreement, dated as of November 3, 1998 (the "Old Master Facultative Agreement") that was the subject of a guarantee issued by XLI (see Note 10). Commutation of the Old Master Facultative Reinsurance Agreement and all cessions thereunder was a condition to the obligations of XL Capital under the Master Transaction Agreement. Pursuant to the FSA Master Agreement, FSA and Syncora Guarantee Re entered into the commutation and release agreement (the "Commutation Agreement"), under which all existing cessions to Syncora Guarantee Re by FSA were commuted in return for a payment by Syncora Guarantee Re of approximately $165.4 million, representing statutory reserves less ceding commission plus a commutation premium. In turn, FSA and one of its subsidiaries entered into a new master facultative reinsurance agreement (the "New Master Facultative Agreement") and related reinsurance memorandum (the "Reinsurance Memorandum") with Syncora Guarantee, under which FSA ceded certain of the commuted risks to the Company in return for a payment by FSA to the Company of approximately $88.6 million, representing the statutory unearned premium reserve for such risks, less ceding commission. FSA has undertaken to use its best efforts to reassume such reinsurance from the Company for a period of nine months after the closing, subject to limitations under Article 69 of the New York Insurance Law, which imposes aggregate and single risk limits on insurance that can be written by a financial guaranty insurer, FSA's internal and rating agency single risk limits, other potential limitations and FSA's underwriting guidelines. The Company was required to fund a trust in an initial amount of approximately $104.1 million to collateralize its obligations to FSA under the reinsurance agreement ($92.7 million as of December 31, 2008), which includes regulatory mandated contingency reserves. As a result of the Commutation Agreement and New Master Facultative Agreement, the Company recorded a loss of $17.9 million during the year ended December 31, 2008. Finally, Syncora Holdings purchased all class A preferred shares of Syncora Guarantee Re held by FSA and its subsidiary, with a liquidation preference of $39 million, for approximately $2.9 million pursuant to an agreement for the sale and purchase of preferred shares. These class A preferred shares were subsequently cancelled. In addition, as a result of Syncora Holdings' purchase of the class A preferred shares of Syncora Guarantee Re, the Company recorded a gain of $36.1 million during the year ended December 31, 2008, which was recorded in retained earnings and not reflected in the Company's net loss.

Credit Agreement Amendment

Concurrent with the execution of the Master Transaction Agreement, the Company entered into Amendment No. 2, Forbearance and Limited Waiver Agreement ("Amendment No. 2") with the lenders under the Company's credit agreement, dated as of August 1, 2006 (the "Credit Agreement"). Pursuant to Amendment No. 2, Forbearance and Limited Waiver Agreement, the Company agreed (i) to permanently reduce the availability under the revolving credit facility from $250 million to zero, (ii) to reduce the availability under the letter of credit facility to the amount of the letter of credit exposure as of July 28, 2008 and subsequently further reduce such exposure for any outstanding letters of credit for FSA's benefit upon the closing the Commutation Agreement, and (iii) to collateralize the remaining letters of credit after the consummation of the transactions comprising the Master Transaction Agreement. In consideration of the foregoing, the lenders under the Credit Agreement agreed to (i) forbear from declaring certain defaults, if any, as set forth in the Amendment No. 2, (ii) waive such defaults, if any, upon the satisfaction of certain conditions set forth in the Amendment No. 2, (iii) grant certain waivers in connection with the consummation of the Master Transaction Agreement and (iv) not instruct the Administrative Agent to send, and the Administrative Agent has agreed that it shall not send, a notice of non-renewal with respect to any outstanding letters of credit (other than the letter of credit for FSA's benefit, which was canceled and returned to the Administrative Agent prior to the Closing Date) with regard to any renewal of a letter of credit during calendar year 2008. There can be no assurance that the Administrative Agent and the lenders will renew the outstanding letters of credit when they are subject to renewal during calendar year 2009. The amount of letters of credit outstanding under the Credit Agreement and the amount of collateral posted by the Company in support of such letters of credit was approximately $15.2 million and $24.3 million as of the December 31, 2008, respectively.

On March 31, 2009, the Company entered into Amendment No. 3 and Waiver Agreement ("Amendment No. 3") with the lenders under the Credit Agreement, whereby the Company agreed to collateralize the remaining letters of credit in an amount equal to 105% of the total letter of credit exposure as of such date, plus any accrued and unpaid interest and fees thereon, plus all other accrued and unpaid obligations of the account parties under the Credit Agreement. In consideration of the foregoing, the lenders under the Credit Agreement have agreed to permanently waive (i) the requirement that audited financial statements of each account party (other than the Company) be delivered within 90 days of the end of the fiscal year (provided that such audited financial statements shall be delivered within 120 days of the end of the fiscal year); (ii) the requirement that audited financial statements as reported on by the independent public accountants not have a "going concern" or like qualification or exception nor any qualification or exception as to the scope of such audit; (iii) the covenant relating to Syncora Holdings' ratio of total funded debt to total capitalization; (iv) the covenant relating to Syncora Holdings' consolidated net worth; and (v) any defaults as a result of the account parties not satisfying the requirements waived in clauses (i) through (iv) above or certain other requirements set forth in the Credit Agreement (as more fully described in Amendment No. 3). The amount of letters of credit outstanding under the Credit Agreement and the amount of collateral posted by the Company in support of such letters of credit was approximately $15.2 million and $24.3 million as of the December 31, 2008, respectively.

Agreement with Counterparties

In consideration for the releases and waivers agreed to by the Counterparties as part of the Master Transaction Agreement, the Company agreed to segregate an aggregate amount of $820 million in cash plus interest thereon, premiums paid by the Counterparties from July 28, 2008 through October 31, 2008 and any proceeds from the sale by the trust of the common shares of Syncora Holdings formerly owned by XL Capital (in the event such shares are sold) for the purpose of commuting, terminating, amending or otherwise restructuring existing agreements with the Counterparties pursuant to an agreement to be negotiated with the Counterparties, which agreement is contemplated by the Letter of Intent. At December 31, 2008, the carrying value of invested assets in the segregated account was approximately $837.6 million. Pursuant to the terms of the 2008 MTA, the Company agreed to certain restrictions on its ability to access the segregated funds and to commute, terminate, amend or otherwise restructure policies and contracts to which it is a party. In the event that the Company becomes subject to a rehabilitation or liquidation proceeding, the funds shall no longer be separately held, segregated or limited in use for commutations or restructurings, and will be part of the general assets of the Company.

Related Transactions

In addition to that discussed above, with the exception of the merger of Syncora Guarantee Re with and into Syncora Guarantee discussed below which was consummated on September 4, 2008, the Company executed the following transactions on or about the Closing Date:

- commutation of certain retrocession agreements the Company had in place with non-affiliates,
- distribution from Syncora Guarantee Re of $30.8 million to Syncora Holdings, and
- discontinuance of Syncora Guarantee Re as a Bermuda corporation and continuance of Syncora Guarantee Re as a Delaware corporation, contribution by Syncora Holdings of all its ownership interests in Syncora Guarantee Re to Syncora Guarantee, which was followed by the merger of Syncora Guarantee Re with and into the Company on September 4, 2008, with the Company being the surviving company.

Total expenses (consisting of legal, investment advisory, accounting and consulting fees) incurred in connection with the transactions comprising the 2008 MTA and the work through December 31, 2008 on the transactions contemplated by the Letter of Intent were approximately $41.5 million.

Summary Financial Information

The effect of the transactions comprising the 2008 MTA on the Company's financial position and results of operations as of the Closing Date:

	Summary Balance Sheet Information As of the Closing Date Increase/(Decrease)						
(in millions)	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**Total**
Assets:							
Equity securities, at cost	$ 120.6	$ —	$ —	$ —	$ —	$ —	$ 120.6
Cash and cash equivalents	1,775.0	115.6	(500.0)	(88.6)	—	(820.0)	482.0
Restricted cash and cash equivalents	—	—	—	—	—	820.0	820.0
Deferred acquisition costs	17.4	13.8	—	(10.8)	—	—	20.4
Prepaid reinsurance premiums	(38.4)	(47.4)	—	—	—	—	(85.8)
Reinsurance balances receivable	(100.0)	(1.3)	—	—	—	—	(101.3)
Reinsurance balance recoverable on unpaid losses	(82.3)	(59.2)	—	—	—	—	(141.5)
Derivative assets	(140.0)	(177.2)	—	—	—	—	(317.2)
Total assets	$ 1,552.3	$ (155.7)	$ (500.0)	$ (99.4)	$ —	$ —	$ 797.2
Liabilities:							
Unpaid losses and loss adjustment expenses	$ —	$ —	$ —	$ (7.7)	$ —	$ —	$ (7.7)
Deferred premium revenue	—	—	—	(27.9)	—	—	(27.9)
Derivative liabilities	—	—	(406.0)	—	—	—	(406.0)
Reinsurance premiums payable	(11.1)	(1.1)	—	(45.9)	—	—	(58.1)
Total liabilities	(11.1)	(1.1)	(406.0)	(81.5)	—	—	$ (499.7)
Shareholders' equity:							
Series A redeemable preferred shares	—	—	—	—	(39.0)	—	(39.0)
Common shares	1,618.2	—	—	—	—	61.6	1,679.8
Treasury stock	—	—	—	—	—	(61.6)	(61.6)
Accumulated deficit	(54.8)	(154.6)	(94.0)	(17.9)	39.0	—	(282.3)
Total shareholders' (deficit) equity	1,563.4	(154.6)	(94.0)	(17.9)	39.0	—	1,335.9
Total liabilities and shareholders' (deficit) equity	$ 1,552.3	$ (155.7)	$ (500.0)	$ (99.4)	$ —	$ —	$ 797.2

	Summary Statement of Operations Information As of the Closing Date			
(in millions)	**(1)**	**(2)**	**(3)**	**(4)**
Revenues:				
Change in fair value of derivatives				
Realized gains and losses and other settlements	$ 66.8	$ 65.4	$ (500.0)	$ —
Unrealized (losses) gains	(140.0)	(177.2)	406.0	—
Net change in fair value of derivatives	(73.2)	(111.8)	(94.0)	—
Total revenues	(73.2)	(111.8)	(94.0)	—
Expenses:				
Gain (loss) on commutation of reinsurance agreements	18.4	(42.8)	—	(17.9)
Total expenses	18.4	(42.8)	—	(17.9)
Net loss	$ (54.8)	$ (154.6)	$ (94.0)	$ (17.9)

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(1) Represents effect of termination, commutation or elimination of certain reinsurance agreements and other arrangements between the Company and XL Capital (see Note 10).

(2) Represents the effect of the commutation of certain retrocession agreements in place with non-affiliates of the Company.

(3) Represents the effect of terminating the Swaps issued to Merrill Lynch and MLI by the Company.

(4) Represents the effect of commuting the Old Master Facultative Reinsurance Agreement and entering into the New Master Facultative Agreement.

(5) Represents the effect of repurchasing the class A preferred shares of Syncora Guarantee Re by Syncora Holdings Ltd. and subsequent cancellation.

(6) Represents the effect of the transfer by XL Capital of its shares of Syncora Holdings to the Company, as well as the amount of cash restricted pursuant to the agreement to hold an aggregate amount of $820.0 million in cash plus interest and premiums for the purpose of commuting, terminating, amending, or otherwise restructuring existing agreements with Counterparties.

5. Description of Continuing Risks and Uncertainties, Assessment of the Company's Ability to Continue as a Going Concern, and Description of the Company's On-Going Strategic Plan

Continuing Risks and Uncertainties

The Company continues to be exposed to certain significant risks and uncertainties that could materially adversely affect its results of operations, financial condition and liquidity, including the following:

- On April 10, 2009, the NYID, pursuant to Section 1310 of the New York Insurance Law, issued an order stating that, without limiting its power to institute rehabilitation or liquidation at an earlier date, the Company shall take such steps as may be necessary to remove the impairment of its capital an return to compliance with its regulatory required minimum surplus to policyholders by no later than May 29, 2009. Additionally, as set forth in the order, the Company shall not write any new business and, as of April 26, 2009, the Company shall suspend payment of any and all claims and otherwise operate only in the ordinary course and as necessary to effectuate a restructuring. On April 27, 2009, pursuant to the aforementioned order, the Company announced that it has suspended the payment of all claims from and after April 26, 2009 and is operating only in the ordinary course and as necessary to complete a successful comprehensive restructuring. As of April 29, 2009, the Company has failed to pay claims aggregating $21.4 million on four insurance policies pursuant to this suspension. The Board of Directors of Syncora Guarantee will continue to monitor the situation on a daily basis and, in the absence of a successful restructuring, may, in the exercise of its fiduciary duties, request the NYID to seek court appointment of a rehabilitator or liquidator of Syncora Guarantee. There can be no assurance that the Company will be successful in remediating its policyholders' surplus deficit and restoring its regulatory required minimum surplus to policyholders.

- Pursuant to section 6903 of the New York Insurance Law, the NYID has granted the Company approval, in connection with the preparation of its statutory basis financial statements as of and for the year ended December 31, 2008, to release contingency reserves on terminated policies and policies on which the Company has established case basis reserves for losses and loss adjustment expenses, however, there can be no assurance that the NYID will continue to approve the Company to apply such accounting practices in the future.

- The Company continues to be materially exposed to risks associated with any continuing deterioration in the credit market sectors discussed above, as well as the spread of such deterioration to other sectors of the economy to which the Company has material business exposure, including commercial mortgage-backed securities ("CMBS") and collateralized loan obligations ("CLOs"). The extent and duration of any continued deterioration of the credit markets is unknown, as is the effect, if any, on potential claim payments and the ultimate amount of losses the Company may incur on obligations it has guaranteed, and potential losses the Company may incur on its invested assets.

- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on the Company's in-force business and assessing the amount of anticipated claims and recoveries on the Company's in-force CDS contracts requires the use and exercise of significant judgment by management, including estimates regarding the likelihood of occurrence and amount of a loss on a guaranteed obligation. Actual experience may differ from estimates and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred and, in certain cases, will occur over many years in the future. Examples of these events include changes in the level of interest rates, credit deterioration of guaranteed obligations, and changes in the value of specific assets supporting guaranteed obligations. Both qualitative and quantitative factors are used in making such estimates. Any estimate of future costs is subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and claims will vary, perhaps materially, from any estimate. The most significant assumption underlying the Company's estimate of ultimate losses on its guarantees of ABS CDOs and first lien RMBS transactions is its assumption regarding the expected cumulative loss on mortgage loan collateral supporting such securities. The most uncertain component of that assumption is the future performance of currently performing (non-delinquent) mortgage loan collateral. If the actual rate at which currently performing loans become delinquent is materially greater than assumed, there will be a material adverse effect on the Company's estimate of ultimate losses on the aforementioned guarantees and, accordingly, its financial position and results of operations. The Company's estimate of ultimate losses on its guarantees of obligations supported by home equity line of credit ("HELOC") and closed end second ("CES") mortgage loan collateral is largely dependent on the Company's default rate assumption. In this regard, the Company assumed that the default rate will begin to improve by early 2010. If actual loan performance improves later than assumed or does not improve as much as expected, there will be a material adverse effect on the Company's ultimate losses on its guarantees of obligations supported by HELOCs and CES mortgage loan collateral and, accordingly, its financial position and results of operations. The Company's default assumptions for first lien RMBS transactions is based on current delinquent loans and analysis of historical defaults for loans with similar characteristics. A loss severity is applied to the first lien RMBS defaults ranging from 41-68% to determine the expected loss on the collateral in those transactions. The Company uses traditional default and prepayment curves to model its unpaid loss. If loss severity is higher than the rates applied, there may be a material adverse effect on our ultimate losses. See Note 15(a) for further information.

- Substantially all of the Company's CDS contracts have mark-to-market termination payments following the occurrence of events that are outside the Company's control, such as the Company being placed into receivership or rehabilitation by the NYID or the NYID taking control of the Company or, in limited cases, the Company's insolvency. Mark-to-market termination payments for deals in which the Company would have to pay a termination payment are generally calculated either based on "market quotation" or "loss" (each as defined in the International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreement). "Market quotation" is calculated as an amount (based on quotations received from dealers in the market) that the counterparty would have to pay another party (other than monoline financial guarantee insurance companies) to have such party takeover the Company's position in the CDS contract. "Loss" is an amount that a counterparty reasonably determines in good faith to be its total losses and costs in connection with the CDS contract, including any loss of bargain, cost of funding or, at the election of such counterparty, but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position. There can be no assurance that counterparties to the Company's CDS contracts, including the Counterparties, will not assert that events have occurred which require the Company to make mark-to-market termination payments. If such events were to occur, the aggregate termination payments that may be asserted against the Company would significantly exceed its ability to make such payments and, accordingly, such events would have a material adverse effect on the Company's financial position and results of operations. The fair value of the Company's CDS contracts recorded in its financial statements at December 31, 2008 does not reflect the effect of mark-to-market termination payments.

- Under a reinsurance agreement between the Company and Syncora Guarantee-UK (the "Treaty"), the Company has agreed to reinsure, on a quota share basis, up to 97% of the financial guarantee business written by Syncora Guarantee-UK. In the event that, among other things, either of the parties becomes insolvent or has a receiver appointed, the other party shall have the right to terminate the Treaty. In the event of such termination, the Company will forego the right to receive any future premiums and Syncora Guarantee-UK may also have a right to claim back all or a proportion of any premiums already paid to the Company under the Treaty in relation to the period after the date the Treaty is terminated. The Financial Services Authority ("FSA UK") also, as the applicable regulator of Syncora Guarantee-UK in the United Kingdom, would have broad and extensive powers under the Financial Services and Markets Act 2000 which could be exercised in the event that either the Company or Syncora Guarantee-UK became insolvent or had a receiver appointed, including to vary or cancel Syncora Guarantee-UK's permission to carry on any of its regulated activities. If any of the aforementioned events should occur, it will have a material adverse effect on the Company's financial position and results of operations, as well as its ability to comply with its minimum policyholders' surplus requirement.

Furthermore, in 2002, Syncora Guarantee-UK agreed with the FSA UK to maintain a minimum solvency margin at the greater of (i) $12.5 million or (ii) 200% of the FSA UK's required minimum margin of solvency. Under a Surplus Maintenance Agreement, the Company agreed to provide Syncora Guarantee-UK with funds sufficient to maintain compliance with this test at all times. Syncora Guarantee-UK was in breach of its capital solvency margin as required by the FSA UK under U.K. GAAP by $4.4 million as of September 30, 2008 and $0.6 million as of December 31, 2008. The Company contributed $4.4 million to Syncora Guarantee-UK and has requested NYID approval to contribute another $1.0 million. The NYID has verbally notified the Company that, until the 2009 MTA is consummated, it will not permit the $1.0 million capital injection to be made. The Company could be required to provide additional contributions to Syncora Guarantee-UK and these amounts could be material. The payment of such funds will be subject to NYID approval. If the NYID does not approve capital contributions to Syncora Guarantee-UK, the FSA UK may take regulatory actions that adversely affect the Company's financial position and results of operations, and may impact its ability to comply with its minimum policyholders' surplus requirement.

- The Company may be unable to enter into or consummate the transactions contemplated by the 2009 MTA or close the tender offer, which would have a material adverse effect on our financial condition and results of operations. In the absence of a successful restructuring that achieves remediation of RMBS exposures and CDS exposures, of the magnitude contemplated by the Letter of Intent and the tender offer, the Company will continue to report a policyholders' deficit and the New York Superintendent may seek court appointment as rehabilitator or liquidator of the Company. Moreover, in the absence of a successful restructuring and in the exercise of its fiduciary duties, the Company's Board of Directors may request the New York Superintendent to seek such court appointment. In such circumstances, it is likely that the New York Superintendent would institute such proceedings. If the Company should become subject to a regulatory proceeding, or, in limited cases, if the Company should become insolvent, the holders of certain of the CDS contracts the Company has insured may assert the right to terminate the contracts and assert claims that Company pay them the termination values, which under current market conditions would be in excess of the Company's financial resources. If the Company were required to pay the termination values, the Company would not have sufficient liquidity to fund its obligations as they become due.
- The suspension of or failure to make claim payments could have a number of material adverse consequences, including but not limited to litigation, potential loss of control rights, the potential assertion of mark-to-market termination payments by counterparties to the Company's CDS contracts and CDS contracts on which the Company fails to pay a claim. There can be no assurance there would not be other material adverse consequences if the Company failed to pay claims.

- The Company's expected financial condition after the consummation of the transactions contemplated by the 2009 MTA and the tender offer is based on various assumptions concerning these transactions, including accounting and tax treatment. There can be no assurance that the assumptions will not differ materially from the ultimate treatment of such transactions and any differences may be material. In addition, while the transactions contemplated by the 2009 MTA and the tender offer were designed to improve our financial condition, the Company will continue to be subject to risks and uncertainties that could materially affect our financial position. Therefore, even if the transactions contemplated by the 2009 MTA and the tender offer are consummated, the Company may continue to report a policyholders' deficit or not comply with the statutory minimum policyholders' surplus, undergo additional restructuring and, in addition, the Company may become insolvent in the future.

The Company's Ability to Continue as a Going Concern

In management's opinion, the principal factors affecting the Company's ability to continue as a going concern are (i) whether the Company is successful in consummating the transactions contemplated by the Letter of Intent and related transactions and the tender offer, as well as the effect on the Company's financial condition from the consummation of such transactions, (ii) non-assertion by certain counterparties to the Company's CDS contracts of a mark-to-market termination event, (iii) the risk of adverse loss development on its remaining in-force business after the successful consummation of the transactions contemplated by the Letter of Intent and related transactions and the tender offer that would cause the Company not to be in compliance with its $65 million minimum policyholders' surplus requirement under New York Insurance Law, (iv) risks associated with the suspension or failure to make claim payments, and (v) the risk of intervention by the NYID as a result of the financial condition of the Company or FSA UK as a result of Syncora Guarantee-UK's financial condition.

As a result of uncertainties associated with the aforementioned factors affecting the Company's ability to continue as a going concern, management has concluded that there is substantial doubt about the ability of the Company to continue as a going concern. The Company's financial statements as of December 31, 2008 and 2007 and for the years ended December 31, 2008, 2007, and 2006 are prepared assuming the Company continues as a going concern and do not include any adjustment that might result from its inability to continue as a going concern.

Ongoing Strategic Plan

Management is principally focused on: (i) seeking to successfully consummate the 2009 MTA and the tender offer, (ii) maintaining or enhancing the Company's liquidity, and (iii) remediating troubled credits to minimize claim payments, maximize recoveries and mitigate ultimate expected losses. The Company currently anticipates that in connection with the 2009 MTA, the Companywill agree, except in certain limited circumstances, not to recommence writing any new business.

In seeking to reduce exposure to CDS contracts and other guaranteed products and otherwise improve the Company's financial position and liquidity, the Company may from time to time, directly or indirectly, seek to purchase (on the open market or otherwise) or commute its guaranteed exposures. The amount of exposure reduced and the nature of any such actions will depend on market conditions, pricing levels, the Company's cash position, and other considerations. On March 11, 2009, the Fund commenced a tender offer to acquire the RMBS Securities insured by the Company (see Note 3).

6. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements present the historical consolidated financial position, results of operations and cash flows of the Company. These Consolidated Financial Statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could, and likely will, differ from those estimates. Accounting policies requiring significant estimates consist of those relating to the Company's credit derivative contracts, deferred acquisition costs, investments, and reserves for losses and loss adjustment expenses, as discussed in this note.

Prior to the IPO, certain expenses reflected in the Consolidated Financial Statements include allocations of corporate expenses incurred by XL Capital related to general and administrative services provided to the Company. These expenses were allocated based on estimates of the cost incurred by XL Capital to provide these services to the Company. Management believes that the methods used to estimate the costs allocated to the company are reasonable. All intercompany accounts and transactions have been eliminated in consolidation. However, these results do not necessarily represent what the historical consolidated financial position, results of operations and cash flows of the Company would have been if the Company had been a separate, stand-alone entity prior to the IPO.

In December 2006, the SEC contacted the Association of Financial Guaranty Insurers ("AFGI"), of which the Company is a member, and instructed the members thereof to recommend a uniform approach for presenting credit derivatives issued by financial guarantee insurance companies in their financial statements. The recommendation of AFGI was developed in consultation with the staff of the Office of the Chief Accountant of the Division of Corporate Finance of the Securities and Exchange Commission (the "SEC") and has been adopted by the Company effective January 1, 2008 in accordance with the transition AFGI discussed with the SEC. The new presentation does not change the Company's reported net income or shareholders' equity, although it does change the presentation of revenues, expenses, assets and liabilities.

As a result of the Company's adoption of this revised presentation, changes in fair value of the Company's credit derivatives are recorded in the line item of the accompanying consolidated statement of operations entitled "Net change in fair value of credit derivatives" which is required to be classified in the revenue section of the statement of operations. This line item consists of two components, which are also separately presented in the statement of operations: (1) "Realized gains and losses and other settlements" and (2) "Unrealized gains and losses". The "Realized gains and losses and other settlements" component includes (i) net premiums received and receivable on issued credit derivatives, (ii) net premiums paid and payable on purchased credit derivatives, (iii) losses paid and payable to credit derivative counterparties due to the occurrence of a credit event and, (iv) losses recovered and recoverable on purchased credit derivatives due to the occurrence of a credit event. The "Unrealized gains and losses" component includes anticipated claims payable and anticipated recoveries, as well as all other changes in fair value. Also included in the aforementioned line items is the change in fair value of the put option relating to the Company's capital facility. See discussion below and in Note 9.

Prior to the adoption of this revised presentation the Company reported (i) premiums received or receivable from the issuance of credit derivative contracts in line item captions in the consolidated statement of operations entitled “Gross premiums written,” “Reinsurance premium assumed,” “Ceded premiums,” “Net premiums written” and “Net premiums earned,” as appropriate, (ii) losses from actual and expected payments to counterparties under such contracts in the line item caption in the consolidated statement of operations entitled “Net losses and loss adjustment expenses” and (iii) all other changes in the fair value of such instruments in the line item caption in the consolidated statement of operations entitled “Net realized and unrealized losses on credit derivatives.” In the consolidated balance sheet, the Company reclassified all credit default swap-related balances previously included in “Unpaid losses and loss adjustment expenses” and “Reinsurance balances recoverable on unpaid losses” to either “Derivative liabilities” or “Derivative assets,” depending on the net position of the credit default swap contract at each balance sheet date.

Certain reclassifications have been made to prior period consolidated financial statement amounts, including that discussed above, to conform to current period presentation. There was no effect on net (loss) income or shareholders’ equity as a result of these reclassifications. The following is a summary of reclassifications made to prior period consolidated financial statement amounts to conform to current year presentation:

	Year Ended December 31, 2007			Year Ended December 31, 2006		
(in thousands)	As Originally Reported	Reclassifications	As Reclassified	As Originally Reported	Reclassifications	As Reclassified
Net premiums earned	$ 215,719	$ (47,059)[1]	$ 168,660	$ 183,115	$ (23,674)[1]	$ 159,441
Change in fair value of derivatives						
Realized gains and losses and other settlements	—	47,059[1]	47,059	—	23,674[1]	23,674
Unrealized losses	(690,917)	(651,382)[2]	(1,342,299)	(8,385)	(2,068)[2]	(10,453)
Net change in fair value of derivatives	(690,917)	(604,323)	(1,295,240)	(8,385)	21,606	13,221
Total revenues	(358,681)	(651,382)	(1,010,063)	236,209	(2,068)	234,141
Net losses and loss adjustment expenses	720,748	(651,382)[2]	69,366	14,958	(2,068)[2]	12,890
Net (loss) income	(1,197,080)	—	(1,197,080)	131,117	—	131,117

(1) Premiums from CDS contracts.

(2) Credit impairment adjustments on CDS contracts.

	As of December 31, 2007		
(in thousands)	As Originally Reported	Reclassifications	As Reclassified
Assets			
Reinsurance balances recoverable on unpaid losses	$ 450,733	$ (183,788)[1][2]	$ 266,945
Derivative assets	168,364	186,232[1]	354,596
Other assets	4,642	(2,444)[2]	2,198
Total assets	3,538,222	—	3,538,222
Liabilities and Shareholders’ Equity			
Unpaid losses and loss adjustment expenses	1,253,088	(850,569)[1]	402,519
Derivative liabilities	850,126	850,569[1]	1,700,695
Total liabilities	3,107,981	—	3,107,981
Total liabilities and shareholders’ equity	3,538,222	—	3,538,222

(1) Credit impairment adjustments on CDS contracts.

(2) Reclassification of subrogation recoverable on paid claims.

(in thousands)	Year Ended December 31, 2007 As Originally Reported	Reclassifications	As Reclassified
Cash provided by operating activities:			
Net unrealized losses on derivatives	$ 690,917	$ 651,382(1)	$ 1,342,299
Increase in reinsurance balances recoverable on unpaid losses	(351,306)	182,677(1)	(168,629)
Other, net	(10,903)	2,443	(8,460)
Increase in unpaid losses and loss adjustment expenses	1,060,287	(836,286)(1)	224,001
Net cash provided by operating activities	287,688	—	287,688

(in thousands)	Year Ended December 31, 2006 As Originally Reported	Reclassifications	As Reclassified
Cash provided by operating activities:			
Net unrealized losses on derivatives	$ 8,385	$ 2,068(1)	$ 10,453
Increase in reinsurance balances recoverable on unpaid losses	(17,664)	324(1)	(17,340)
Increase in unpaid losses and loss adjustment expenses	33,542	(2,393)(1)	31,149
Net cash provided by operating activities	389,857	—	389,857

(1) Credit impairment adjustments on CDS contracts.

Investments

All of the Company's investments in debt and equity securities are considered available-for-sale and accordingly are carried at fair value. The fair value of investments is based on quoted market prices received from nationally recognized pricing services or, in the absence of quoted market prices, dealer quotes or matrix pricing. Adverse credit market conditions during the second half of 2007 caused some markets to become relatively illiquid, thus reducing the availability of certain data used by the independent pricing services and dealers. The net unrealized appreciation or depreciation on investments, net of deferred income taxes, is included in accumulated other comprehensive income (loss). Any unrealized depreciation in value considered by management to be other-than-temporary is charged to income in the period that such determination is made.

At the end of each accounting period, the Company reviews unrealized losses on its investment securities to identify declines in fair value that are other-than-temporary. This review involves consideration of several factors including: (i) the time period during which the security has been in a continuous unrealized loss position, (ii) an analysis of the liquidity, business prospects and overall financial condition of the issuer, (iii) the significance of the decline, (iv) an analysis of the collateral structure and other credit support, as applicable, of the securities in question and (v) the Company's intent and ability to hold the investment for a sufficient period of time for the value to recover. Where the Company concludes that a decline in fair value is other-than-temporary, the cost of the security is written down to fair value and a corresponding loss is realized in the period such determination is made.

With respect to securities where the decline in value is determined to be temporary and the security's value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of overall risk monitoring, changing information, general market conditions and assessing value relative to other comparable securities.

Bond discounts and premiums are amortized on a level yield basis over the remaining terms of securities acquired. For pre-refunded bonds, the remaining term is determined based on the contractual refunding date. For mortgage-backed securities, and any other holdings for which prepayment risk may be significant, assumptions regarding prepayments are evaluated periodically and revised as necessary. Any adjustments required due to the resulting change in effective yields are recognized in income.

Short-term investments comprise securities with maturities equal to or greater than 90 days but less than one year at time of purchase. Cash equivalents include fixed-interest and money market fund deposits with a maturity of less than 90 days when purchased.

All investment transactions are recorded on a trade date basis. Realized gains and losses on sales of debt securities are determined on the basis of average cost. Investment income is recognized when earned.

The Company’s policy is to not invest in obligations which it insures, and there were no such obligations included in the Company’s investment portfolio as of December 31, 2008 or 2007.

Premium Revenue Recognition

Premiums charged in connection with the issuance of the Company’s guarantees are received either upfront or in installments. Such premiums are recognized as written when due. Installment premiums written are earned ratably over the installment period, generally one to three months, which is consistent with the expiration of the underlying risk or amortization of the underlying insured par. Upfront premiums written are earned in proportion to the expiration of the related risk. The methodology employed to earn upfront premiums requires that such premiums be apportioned to individual sinking fund payments of a bond issue according to the bond issue’s amortization schedule. The apportionment is based on the ratio of the principal amount of each sinking fund payment to the total principal amount of the bond issue. After the premium is allocated to each scheduled sinking fund payment, such allocated premium is earned on a straight-line basis over the period of that sinking fund payment. As a result, for upfront premiums on amortizing insured obligations, premium revenue recognition will tend to be greater in the earlier periods of the transaction when there is a higher amount of risk or principal outstanding. The effect of the Company’s upfront premium earnings policy is that the Company recognizes greater levels of upfront premiums in earlier years of each amortizing insured obligation. Recognizing premium revenue on a straight-line basis over the life of each amortizing insured obligation without allocating premiums to the scheduled principal payments would materially change the amount of premium the Company recognizes in a particular financial reporting period, but not over the life of the applicable policy. For upfront premiums on non-amortizing bullet maturity debt obligations, premium revenue recognition is recognized on a straight-line basis over the life of the underlying insured obligation. Deferred premium revenue represents the portion of premiums written that is applicable to the unexpired risk or principal of insured obligations. For both upfront and installment policies, ceded premium expense is recognized in earnings in proportion to and at the same time the related premium revenue is recognized.

The Company’s accounting policies for the recognition of ceded premiums, ceding commissions and ceded losses and loss adjustment expenses under its ceded reinsurance contracts mirror the policies described herein for premium revenue recognition, deferred ceding commissions, and reserves for losses and loss adjustment expenses.

In addition, when an insured issue is retired early, is called by the issuer or is in substance paid in advance through a refunding accomplished by placing U.S. government securities in escrow (hereafter collectively referred to as a “Refunding”), the remaining deferred premium revenue is earned at that time since there is no longer risk to the Company.

Fee Income and Other

The Company has collected, and may collect in the future, certain fees in connection with its guaranteed transactions. Depending upon the type of fee received, the fee is either earned when services are rendered or deferred and earned over the life of the related transaction. Termination fees are earned when due and are included in the accompanying statements of operations under the caption “Fee Income and Other.” Structuring, waiver and consent, and commitment fees are included in the accompanying consolidated statements of operations as premiums and earned on a straight-line basis over the life of the related transaction.

Losses and Loss Adjustment Expenses

The Company’s financial guarantees insure scheduled payments of principal and interest due on various types of financial obligations against payment default by the issuers of such obligations. The Company establishes reserves for losses and loss adjustment expenses on such business based on its best estimate of the ultimate expected incurred losses. The Company’s estimated ultimate expected incurred losses are comprised of: (i) case basis reserves, (ii) unallocated reserves, and (iii) cumulative paid losses to date. Establishment of such reserves requires the use and exercise of significant judgment by management, including estimates regarding the occurrence and amount of a loss on an insured obligation. Actual experience may differ from estimates and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred. Examples of these events include changes in the level of interest rates, credit deterioration of insured obligations, and changes in the value of specific assets supporting insured obligations. Both qualitative and quantitative factors are used in establishing such reserves. In determining the reserves, management considers all factors in the aggregate, and does not attribute the reserve provisions or any portion thereof to any specific factor. Any estimate of future costs is subject to the inherent limitation on the Company’s ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and loss adjustment expenses will vary, perhaps materially, from any estimate.

Case basis reserves on insured business are established by the Company with respect to a specific policy or contract upon receipt of a claim notice or when management determines that (i) a claim is probable in the future based on specific credit events that have occurred and (ii) the amount of the ultimate loss that the Company will incur can be reasonably estimated. As specific case basis reserves are established management considers whether any changes are required to the assumptions underlying the calculation of unallocated reserves (which are discussed below) as a result of such activity. The amount of the case basis reserve is based on the net present value of the expected ultimate loss and loss adjustment expense payments that the Company expects to make, net of expected recoveries under salvage and subrogation rights. Case basis reserves are generally determined using cash flow models to estimate the net present value of the anticipated shortfall between (i) scheduled payments on the insured obligation plus anticipated loss adjustment expenses and (ii) anticipated cash flow from the collateral supporting the obligation and other anticipated recoveries. A number of quantitative and qualitative factors are considered when determining or assessing the need for a case basis reserve. These factors may include the creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured, the projected cash flow or market value of any assets that collateralize or secure the insured obligation, and the historical and projected loss rates on such assets. Other factors that may affect the actual ultimate loss include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral. Such factors and the Company’s assessment thereof will be subject to the specific facts and circumstances associated with the specific insured transaction being considered for case reserve establishment. Case basis reserves are generally discounted at a rate reflecting the return on the Company's investment portfolio during the period the case basis reserve is established. The Company believes this rate of return is an appropriate rate to discount its reserves because it reflects the rate of return on the assets supporting such business. When a case basis reserve is established for a guaranteed obligation whose premium is paid on an upfront basis, the Company continues to record premium earnings on such policy over its remaining life, unless it has recorded a full limit loss with respect to such policy, in which case the remaining deferred premium revenue relating thereto is immediately reflected in earnings. When a case basis reserve is established for a guaranteed obligation whose premium is paid on an installment basis, those premiums, if expected to be received prospectively, are considered a form of recovery.

Case basis reserves on financial guarantee reinsurance assumed are generally established by the Company upon quarterly current notifications from ceding companies. There historically has been no time lag between the time the Company records an assumed case basis reserve and the time the Company's ceding companies record such reserves. For each notification of a ceded case basis reserve from ceding companies, the Company conducts an examination of the basis of the ceding company's reserve estimate to ensure that the Company concurs with the ceding company's evaluation and conclusions. In certain instances, the Company may develop its own estimates of losses on assumed business. Except as discussed below, in all instances to date where the Company has assumed case basis reserves, it has concurred with the ceding companies' evaluation and conclusions with respect to such reserves and, accordingly, there has been no difference between the amount of case basis reserves reported to the Company by its ceding companies and the amount it has recorded in its financial statements. During the year ended December 31, 2008, the Company, based on its own internal analysis, recorded a provision for losses and loss adjustment expenses of $8.6 million relating to a reinsured guarantee covering a global infrastructure financing (see Note 15 (d)) and, in March 2009, the Company was advised by the ceding company that the Company's share of the estimated reserve that the ceding company had established was approximately $18.0 million. To date, the Company has not completed its assessment of the ceding company's estimated reserve and, therefore, have not adjusted our provision to reflect the ceding company's estimate.

In assessing whether a loss is probable, the Company considers all available qualitative and quantitative evidence. Qualitative evidence may take various forms and the nature of such evidence will depend upon the type of insured obligation and the nature and sources of cash flows to fund the insured obligation's debt service. For example, such evidence with respect to an insured special revenue obligation such as an obligation supported by cash flows from a toll road would consider traffic statistics such as highway volume and related demographic information, whereas an insured mortgage-backed securitization would consider the quality of the mortgage loans supporting the insured obligation including delinquency, default and foreclosure rates, loan to value statistics, market valuation of the mortgaged properties and other pertinent information. In addition, the Company will make qualitative judgments with respect to the amount by which certain other structural protections built into the transaction are expected to limit the Company's loss exposure. Examples of such structural protections may include: (i) rate covenants, which generally stipulate that issuers (i.e., public finance issuers) set rates for services at certain predetermined levels (i.e., water and sewer rates which support debt obligations supported by such revenues), (ii) springing liens, which generally require the issuer to provide additional collateral upon the breach of a covenant or trigger incorporated into the terms of the transaction, (iii) consultant call-in rights, which provide, under certain circumstances, for a consultant to be engaged to make certain binding recommendations, such as raising rates or reducing expenses, (iv) the ability to transfer servicing of collateral assets to another party, and (v) other legal rights and remedies pursuant to representations and warranties made by the issuer and written into the terms of such transactions. Quantitative information may take the form of cash flow projections of the assets supporting the insured debt obligation (which may include, in addition to collateral assets supporting the obligation, structural protections subordinate to the attachment point of the Company's risk, such as cash reserve accounts and letters of credit), as well as (to the extent applicable) other metrics indicative of the performance of such assets and the trends therein. The Company's ability to make a reasonable estimate of its expected loss depends upon its evaluation of the totality of both the available quantitative and qualitative evidence, and no one quantitative or qualitative factor is dispositive.

In addition to case basis reserves, the Company maintains an unallocated loss reserve for expected losses inherent in its in-force business (consisting of both financial guarantee insurance and reinsurance business) that it expects to emerge in the future. The Company's unallocated loss reserves represent its estimated ultimate liability from claims expected to be incurred in the future under its in-force insured and reinsured policies less outstanding case basis reserves and cumulative paid claims to date on such policies. The Company's unallocated reserves are estimated by management based upon an actuarial reserving analysis. The actuarial methodology applied by the Company is in accordance with Actuarial Standards of Practice No. 36, *Determination of Reasonable Provision*. The methodology applied is based on the selection of an expected ultimate loss ratio ("UELR"), as well as an expected loss emergence pattern (i.e., the expected pattern of the expiration of risk on insured and reinsured in-force policies). Salvage and subrogation recoveries are implicit in the Company's selected UELR as such ratio is derived from industry loss experience, which is net of salvage and subrogation recoveries (i.e., from the liquidation of supporting or pledged collateral assets). The implicit inclusion of salvage and subrogation recoveries in the Company's selected UELR is consistent with the Company's explicit consideration of collateral support in the establishment of its case basis reserves. In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 163 ("SFAS 163"), Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60, "Accounting and Reporting by Insurance Enterprises" ("SFAS 60"). SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Upon adoption of SFAS 163, the Company will no longer be able to record unallocated reserves and will be required to de-recognize its existing unallocated reserves. See "Recent Accounting Pronouncements" below.

The Company updates its estimates of losses and loss adjustment expense reserves quarterly and any resulting changes in reserves are recorded as a charge or credit to earnings in the period such estimates are changed. In connection therewith, the Company's unallocated reserves are adjusted each period to reflect (i) any revisions to management's estimated UELR, if any, and (ii) the underlying par risk amortization (or "loss development") of the related insured and reinsured in-force business (i.e., loss emergence pattern). As stated above, the Company's estimated ultimate expected incurred losses are comprised of: (i) case basis reserves, (ii) unallocated reserves, and (iii) cumulative paid losses to date. As the Company establishes case basis reserves and pays claims it may, based on its judgment, reduce or increase the UELR used to determine unallocated reserves to reflect its best estimate of the Company's expected ultimate loss experience. In addition, under the Company's accounting policy the Company may, based on its judgment, reduce unallocated reserves in response to significant case basis reserve and/or paid loss activity. The Company would only expect such reductions to occur in limited instances, such as economic events generating significant loss activity across a broad cross-section of its in-force portfolio. The Company has not viewed its case basis reserve and paid loss activity to date to warrant a reduction of its unallocated reserves. While material case basis reserves were established by the Company in 2007 and 2008, these reserves were concentrated in certain sectors of the Company's financial guarantee portfolio and were associated with unprecedented credit-market events. As such, these events did not alter the Company's perspective of the UELR associated with the remainder of the portfolio and the required level of unallocated reserves. Each quarterly period there is an interplay between case basis reserves, unallocated reserves and cumulative paid losses to date, such that the aggregate thereof represents management's best estimate of the ultimate losses it expects the Company to incur on its in-force business. The process of establishing unallocated reserves and periodically revising such reserves to reflect the underlying par risk amortization and management's current best estimate of ultimate losses will ultimately cause the cumulative loss experience over the life of a particular underwriting year's business to equal the cumulative inception-to-date actual paid losses on such business.

The selection of the Company's UELR (and subsequent periodic updates thereof) is based on management's judgment, which considers: (i) the characteristics of the Company's in-force financial guarantee insurance and reinsurance business (e.g., principally the mix of the Company's in-force financial guarantee insurance and reinsurance business between public finance and structured finance business; however, management also considered the various bond sectors comprising the Company's insured and reinsured in-force business which are discussed in detail in Note 15, as well as the credit profile of the Company's insured and reinsured portfolio of business), (ii) the Company's actual loss experience, (iii) the characteristics, as discussed above in relation to the Company's in-force financial guarantee insurance and reinsurance business, of the insured in-force business of companies comprising the financial guarantee insurance industry, and (iv) the actual loss experience of companies comprising the financial guarantee insurance industry, as discussed below. Other factors impacting market default levels and the assumptions important to the Company's reserving methodology are implicit in the Company's UELR. Such factors may include interest rates, inflation, taxes, industry trends in the valuation of certain asset classes and the overall credit environment. Based on this comparison, the Company adjusts its UELR, as it consider necessary, to ensure that such ratio continues to be appropriate for the risks inherent in the Company's in-force business.

The Company analyzes the actual loss experience of companies comprising the financial guarantee insurance industry annually. The analysis utilizes loss and premium data filed by the three largest companies in the financial guarantee insurance industry in Schedule P of their annual statutory financial statements. These statutory filings provide data for ten calendar years and exclude unallocated reserves. Information on unallocated reserves is obtained from Annual Reports filed with the SEC on Form 10-K and is combined with the Schedule P data to estimate ultimate loss ratios for each of the preceding ten years.

Based on this analysis, the Company selected a UELR in 2006, 2007 and 2008 of 20%. The Company has not changed the UELR in 2008 or 2007 because of its view that the losses recorded by the Company and others in the industry are concentrated in residential mortgage exposures which are not correlated to the rest of the Company's in-force business. The Company's expected loss emergence pattern is determined by underwriting year based on the par amortization schedules of the underlying insured and reinsured debt obligations comprising its in-force business. The Company adjusts or realigns the expected loss emergence pattern each quarter to reflect the underlying changes in its in-force business (for example, changes in the average life of in-force business resulting from changes in the mix of business and risk or par expiration).

The Company's methodology applies the UELR to earned premium during the period from its entire in-force book of business (after exclusion of the effect on earned premiums of Refundings and full limit losses because no more risk exists on these policies). Significant changes to any variables on which the Company's UELR is based, over an extended period of time, will likely result in an increase or decrease in such ratio. For example, a shift in the mix of in-force business to sectors with high default rates would likely increase the Company's UELR, while a shift in the mix of in-force business to sectors with low default rates would likely decrease the Company's UELR. Additionally, increases in default rates relative to the Company's in-force business and in the Company's actual loss experience or decreases in statistical recovery rates and in the Company's actual recovery experience would increase the UELR, while the inverse would likely decrease the UELR.

The Company's unallocated loss reserve is established on an undiscounted basis and represents management's best estimate of losses that the Company will incur in the future as a result of credit deterioration in the Company's in-force business but which have not yet been specifically identified. The Company does not attempt to apportion unallocated reserves by type of product.

The Company believes that its reserves are adequate to cover its expected ultimate losses. However, due to the inherent uncertainties of estimating reserves for losses and loss adjustment expenses, actual experience may differ from the estimates reflected in the Company's financial statements, and the differences may be material. While the Company believes that the underlying principles applied to loss reserving are consistent across the financial guarantee industry, differences may exist with regard to the methodology and measurement of such reserves. While the Company believes that the principles it applies are the most appropriate for the Company's business and have been applied consistently during the years presented, alternate methods may produce different estimates as compared to the current methodology used by the Company.

The Company's loss reserving policy, described above, is based on guidance provided in FASB Statement No. 60, "Accounting and Reporting by Insurance Enterprises" ("SFAS 60"), SFAS 5, "Accounting for Contingencies" and analogies to Emerging Issues Task Force (EITF) 85-20, "Recognition of Fees for Guaranteeing a Loan." SFAS 60 requires that, for short-duration contracts, a liability for unpaid claim costs relating to insurance contracts, including estimates of costs relating to incurred but not reported claims, be accrued when insured events occur. Additionally, SFAS 5, requires that a loss be recognized when it is probable that one or more future events will occur confirming that a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

Although SFAS 60 provides guidance to insurance enterprises, the Company does not believe SFAS 60 comprehensively addresses the unique attributes of financial guarantee insurance contracts, as the standard was developed prior to the maturity of the financial guarantee industry. SFAS 60 provides guidance with respect to insurance contracts that are either short-duration or long-duration in nature. Financial guarantee contracts typically have attributes of both and, therefore, are difficult to classify as either. For instance, financial guarantee contracts are reported for regulatory purposes as property and liability insurance, normally considered short-duration, but have elements of long-duration contracts in that they are irrevocable and extend over a period that may be in excess of 30 years. The Company does, however, recognize premium revenue and policy acquisition costs in a manner consistent with the guidance provided in SFAS 60 for short-duration contracts. If the Company and the rest of the financial guarantee industry were required to classify its insurance contracts as either short-duration or long-duration or if new specific guidance for financial guarantee insurance emerges, different methods of accounting could apply with respect to loss reserving and liability recognition, and possibly extend to premium revenue and policy acquisition cost recognition. Additionally, there are differences in the methodology and measurement of loss reserves followed by other financial guarantee companies.

Deferred Acquisition Costs ("DAC") and Deferred Ceding Commission

Policy acquisition costs include those expenses that primarily relate to, and vary with, the production of new business. The Company periodically conducts a study to estimate the amount of operating costs that are acquisition costs. These costs include direct and indirect expenses related to underwriting, marketing and policy issuance, rating agency fees and premium taxes, and are reduced by ceding commission income on premiums ceded to reinsurers. Policy acquisition costs are deferred and amortized over the period in which the related premiums are earned.

The Company will recognize a charge to reduce deferred acquisition costs, and establish a liability if necessary, to the extent the sum of expected losses and loss adjustment expenses, maintenance costs and unamortized policy acquisition costs exceeds the related unearned premiums, the anticipated present value of future premiums under installment contracts written, and anticipated investment income. For policies reinsured with third parties the Company receives ceding commissions to compensate for acquisition costs incurred. The Company nets ceding commissions received against deferred acquisition costs and earns these ceding commissions over the period in which the related premiums are earned.

In the event of a Refunding, the remaining net amount of DAC with respect to refunded insured issue is recognized at such time.

Reinsurance

In the normal course of business, the Company purchases reinsurance coverage principally to increase aggregate capacity, manage its risk guidelines and reduce the risk of loss on its in-force business. Reinsurance premiums ceded are earned over the period the reinsurance coverage is provided. Prepaid reinsurance premiums represent the portion of premiums ceded which is applicable to the unexpired term of reinsured policies in-force. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Provision is made for any estimated uncollectible reinsurance.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Deferred federal income taxes are provided for temporary differences between the tax and financial reporting basis of assets and liabilities that will result in deductible or taxable amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. A valuation allowance is recorded when it is more likely than not that all, or some portion, of the benefits related to deferred tax assets will not be realized.

Derivative Instruments

Prior to suspending writing substantially all new business (see Note 2), the Company issued CDS contracts and entered into arrangements with other issuers of CDS contracts to assume, all or a portion, of the risks in the CDS contracts they issued ("back-to-back arrangements") and, in certain cases, which are discussed in more detail below, the Company purchased back-to-back credit protection on all or a portion of the risk from the CDS contracts it issued or assumed. Such back-to-back arrangements were generally structured on a proportional basis. In connection with the transactions comprising the 2008 MTA, the Company terminated substantially all its back-to-back arrangements in the third quarter of 2008 (see Note 4).

CDS contracts are derivative contracts which offer credit protection relating to a particular security or pools of securities which are specifically referenced in the CDS contract. Under the terms of a CDS contract, the seller of credit protection (the issuer of the CDS contract) makes a specified payment to the buyer of such protection (the CDS contract counterparty) upon the occurrence of one or more credit events specified in the CDS contract with respect to a referenced security or securities. The terms of the CDS contracts issued by the Company generally only require the Company to make a payment upon the occurrence of one or more specified credit events after exhaustion of various levels of subordination or first-loss protection. In addition, pursuant to the terms of the Company's CDS contracts, the Company is precluded from transferring such contracts to other market participants without the consent of the counterparty.

Securities or assets referenced in the Company's in-force CDS contracts include structured pools of obligations, such as ABS CDOs, CLOs, corporate CDOs, CDOs of CDOs and CMBS. Such pools were rated investment-grade or better at the issuance of the CDS contract.

The Company's policy has been to hold its CDS contracts to maturity and not to manage such contracts to realize gains or losses from periodic market fluctuations. However, in certain circumstances, the Company may enter into an off-setting position or back-to-back arrangement, commute, terminate or restructure a CDS contract prior to maturity for risk management purposes (for example, upon a deterioration in underlying credit quality or for the purposes of managing its capital). In connection with the 2008 MTA, the Company commuted several of its CDS contracts and back-to-back arrangements. In addition, the transactions contemplated by the Letter of Intent also include commutation of CDS contracts. See Notes 3 and 4.

As derivative financial instruments, CDS contracts are required under GAAP to be reported at fair value in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" and, effective January 1, 2008, measured in accordance with Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), with changes in fair value during the period included in earnings. SFAS 157 specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. This hierarchy requires the use of observable market data when available. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect assumptions about market data based on management's judgment. In accordance with SFAS 157, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

Level 1—Quoted prices for identical instruments in active markets.

Level 2—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 valuation drivers are observable in active markets.

Level 3—Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable.

The principal drivers of the fair value of the Company's CDS contracts include: (i) general market credit spreads for the type(s) of assets referenced in CDS contracts, (ii) the specific quality and performance of the actual assets referenced in the contracts, (iii) the amount of subordination in the transaction before the Company's liability attaches, (iv) other customized structural features of such contracts (e.g. terms, conditions, covenants), (v) supply and demand factors, including the volume of new issuance and financial guarantee market penetration, as well as the level of competition in the marketplace, and (vi) the market perception of the Company's ability to meet its obligations under its CDS contracts which may be implied by the cost of buying credit protection on the Company.

The fair value of the Company's in-force portfolio of CDS contracts other than CDS on ABS CDOs, which are discussed below, represents the net present value of the difference between the remaining unearned premiums that the Company originally charged for credit protection and management's best estimate of what a financial guarantor of a comparable credit worthiness would hypothetically charge to provide the same protection as of the measurement date. The hypothetical nature of this exit value is representative of the lack of a principal market for the Company's CDS contracts. In the absence of such a principal market, the Company believes other financial guarantors of comparable credit quality to the Company best represent the hypothetical exit market for the Company's CDS contracts. Fair value is defined as the price at which an asset or a liability could be bought or transferred in a current transaction between willing parties. Fair value is determined based on quoted market prices, if available. Quoted market prices are available only on a limited portion of the Company's in-force portfolio of CDS contracts. If quoted market prices are not available, fair value is estimated based on valuation techniques involving management's judgment. In determining the fair value of its CDS contracts, the Company uses various valuation approaches with priority given to observable market prices when they are available. Market prices are generally available for traded securities and market standard CDS contracts but are less available or unavailable for highly-customized CDS contracts. Most of the Company's CDS contracts are highly customized structured credit derivative transactions that are not traded and do not have observable market prices. Due to the significance of unobservable inputs required to value such CDS contracts, they are considered to be Level 3 under the SFAS 157 fair value hierarchy.

Typical market CDS contracts are standardized, liquid instruments that reference tradeable securities such as corporate bonds that also have observable prices. These market standard CDS contracts also involve collateral posting, and upon a default of the referenced bond obligation, can be settled in cash. In contrast, the Company's CDS contracts do not contain the typical CDS market standard features as described above but have been customized to replicate the Company's financial guarantee insurance. The Company's CDS contracts provide protection on specified obligations, such as those described above and, generally contain some form of subordination prior to the attachment of the Company's liability. The Company is not required to post collateral, and upon default, the Company generally makes payments on a "pay-as-you-go" basis after the subordination in a transaction is exhausted.

The Company's payment obligations after a default vary by deal type. There are three primary types of policy payment requirements:

(i) timely interest and ultimate principal;

(ii) ultimate principal only at final maturity; and

(iii) payments upon settlement of individual collateral losses as they occur upon erosion of subordination.

The Company's CDS contracts are structured to prevent large one-time claims upon a specified credit event and generally allow for payments over time (i.e. "pay as you go" basis) or at final maturity. Also, the Company's CDS contracts are generally governed by a single transaction ISDA Master Agreement relating only to that particular transaction/contract. Under most monoline financial guarantee standard termination provisions, there is no requirement for mark-to-market termination payments upon the early termination of a guaranteed CDS contract. However, substantially all of the Company's CDS contracts provide for mark-to-market termination payments following the occurrence of events that are outside the Company's control, such as the Company being placed into receivership or rehabilitation or a regulator taking control of the Company or the Company's insolvency. Under current market conditions such termination payments would result in a substantial liability to the Company which would be substantially in excess of that currently recorded by the Company in accordance with SFAS 157 and its ability to pay (see Note 5). An additional difference between the Company's CDS contracts and the typical market standard CDS contracts is that, except in the circumstances noted above, there is no acceleration of the payment to be made under the Company's CDS contracts unless the Company, at its option, elects to accelerate. Furthermore, by law, the Company's guarantees are unconditional and irrevocable, and cannot be transferred to most other capital market participants as they are not licensed to write such business. However, through the purchase of back-to-back credit protection, the risk of loss (but not counterparty risk) on these contracts can be transferred to other financial guarantee insurance and reinsurance companies.

Description of Valuation Methodology Used by the Company at December 31, 2008

Key variables used in the Company's valuation of substantially all of its CDS contracts at December 31, 2008 include the balance of unpaid notional, expected term, fair values of the underlying reference obligations, reference obligation credit ratings, assumptions about current financial guarantee CDS fee levels relative to reference obligation spreads, the Company's Non-Performance Risk, as defined and described below, and other factors. Fair values of the underlying reference obligations are obtained from broker quotes when available, or are derived from other market indications such as new issuance and secondary spreads and quoted values for similar transactions and indices, such as ABX or CDX. The Company's valuation of such CDS contracts does not generally provide for any adjustment to broker quotes. While such broker quotes are non-binding, the brokers from whom the Company obtains such quotes actively monitor and participate in the markets where such collateral is traded. Accordingly, the Company believes that such brokers rely on observable market information to the greatest extent possible when determining such quotes; however, such brokers may also rely on their internal models and unobservable inputs in making such determinations.

Implicit in the fair values obtained by the Company on the underlying reference obligations are the market's assumptions about default probabilities, default timing, correlation, recovery rates and collateral values. In general, the Company is using a percentage of the credit spread over LIBOR (the "premium percentage") that management believes is consistent with (i) levels attainable in the market just prior to the collapse of the market for CDS from financial guarantors and (ii) historical premium pricing for high credit spread transactions. Management believes that the premium percentage available in the market has dropped significantly as the credit spreads for the underlying reference securities have widened to levels not seen historically. These credit spreads reflect the lack of liquidity in the market and this liquidity premium historically has flowed directly to the CDS counterparty as the funding institution. Though management believes the actual premium percentage would be far below those seen in previous markets, with no observable market transactions to use as a benchmark, management has decided to set a floor on the premium percentage of 30%. This level is consistent with the bottom range of our historical premium pricing for CDS transactions. Under this approach, the financial guarantee CDS fee used for a particular contract in the Company's fair value calculations represent a consistent percentage, period to period, of the credit spread determinable from the reference index value as of the measurement date. This results in a CDS fair value (before adjustment for Non-Performance Risk, as defined below) that fluctuates in proportion with the reference index value.

For example, assuming that at the end of the previous reporting period the credit spread of a reference index was 100 basis points and the current market premium for a transaction that is priced off of that reference index was set at 30 basis points (30% of the reference index), if at the end of the current reporting period the reference index moved to 150 basis points (a 50% increase), the current market premium for such a transaction would be set at 45 basis points (also a 50% increase). Thus, the model indicates that the Company would need to receive an additional 15 basis points (45 bps currently less the 30 bps reported last period) for issuing a CDS on the reference obligation in the current reporting period. To compute the current period change in fair value we discount the product of the outstanding notional amount of the CDS and the contractual premium over the life of the reference obligation, using a counterparty discount rate and subtract from that, the discounted product of the outstanding notional amount of the CDS and calculated current market premium, over the life of the reference obligation using a Company-specific discount rate.

For CDS contracts issued on ABS CDOs, the Company utilizes non-binding broker quotes on the underlying obligations to project principal and interest shortfalls and the timing of such shortfalls. The Company then discounts the shortfalls using a Company-specific discount rate and nets from this the discounted expected premium using a counterparty discount rate (based on the published credit spreads of the counterparty), to arrive at the fair value of the CDS. No adjustments have been made to third party broker quotes as these are intended to capture all elements of the fair value of the underlying securities.

The basis of management's estimate of the fair value of the Company's CDS contracts at December 31, 2008 described above reflects the absence of observable transactions in the Company's principal market. Should such transactions occur in the future, it may significantly affect the Company's estimate of the fair value of its CDS contracts.

In addition to that discussed above, the fair value of the Company's CDS contracts reflects the risk that the Company will not be able to honor its obligations under its CDS contracts (its "Non-Performance Risk") as implied by the market price of buying credit protection on the Company. Non-Performance Risk is reflected in the fair value of the Company's CDS contracts by incorporating the spread on CDS contracts traded on the Company into the discount rate used. The Company estimates a discount rate for each CDS contract based on the swap rate and the Company's credit spread for the duration that is the closest to the remaining weighted average life ("WAL") of the obligation referenced in the CDS contract. Reflecting Non-Performance Risk in the Company's estimate of the fair value of its CDS contracts was the only change in its valuation methodology caused by the adoption of SFAS 157. At December 31, 2008, the effect of reflecting Non-Performance Risk in the Company's estimate of the fair value of its CDS contracts was a reduction in the Company's net derivative liability of approximately $14.2 billion. The spread on 10-year CDS contracts traded on the Company at December 31, 2008 was 60.16%. If the transactions contemplated by the Letter of Intent are consummated, specifically the commutations of CDS contracts with Counterparties as discussed in Note 3, the uncertainty associated with future adverse loss development on the Company's guarantees will be reduced and management believes that, as a result, the cost of buying credit protection on the Company should decline. The effect of a decline in the cost of buying credit protection on the Company will increase the Company's derivative liability on the remaining in-force CDS contracts; however, the Company believes that any such increase should be offset in part by the effect on its derivative liability from the aforementioned commutations. However, there can be no assurance that material adverse loss development will not occur in the future or that the aforementioned commutations with will offset the increase in the Company's derivative liability. At December 31, 2008 and 2007, the notional amount outstanding of the Company's in-force CDS contracts was $57.8 billion and $65.3 billion, respectively. The remaining WAL of such CDS contracts at December 31, 2008 was 10.2 years. In addition, based on such notional amount as of December 31, 2008 and 2007, approximately 60% and 93%, respectively, of referenced assets underlying such in-force CDS contracts were rated (based on S&P's ratings) "AAA", 18% and 7%, respectively, were rated at or above investment-grade, and 22% and less than 1%, respectively, were rated below investment-grade at such dates, respectively.

The following table sets forth the Company's financial assets and liabilities related to credit derivatives that were accounted for at fair value as of December 31, 2008 by level within the fair value hierarchy of SFAS 157. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

(in thousands)	Level 1	Level 2	Level 3	Total
Financial assets:				
Derivative assets	$ —	$ —	$ 54,832	$ 54,832
Total assets	$ —	$ —	$ 54,832	$ 54,832
Financial liabilities:				
Derivative liabilities	$ —	$ —	$ 787,221	$ 787,221
Total liabilities	$ —	$ —	$ 787,221	$ 787,221

The following table presents the changes in the net derivative asset (liability) balance for the year ended December 31, 2008:

	Level 3 Financial Assets and Liabilities Accounted for at Fair Value Year Ended December 31, 2008			
(in thousands)	CDS Contracts, net	Other Derivatives, net[1]	Other Level 3 Financial Assets and Liabilities	Total
Balance, beginning of period	$ (1,453,144)	$ 107,045	$ —	$ (1,346,099)
Total realized and unrealized gains/(losses) included in earnings	422,050	72,514	—	494,564
Purchases, issuances, and settlements	306,205[2]	(179,559)	—	126,646
Transfers in and/or out of Level 3	(7,500)	—	—	(7,500)
Balance, end of period	$ (732,389)	$ —	$ —	$ (732,389)
The amount of total gains and losses for the period included in earnings which are attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ 639,455	$ —	$ —	$ 639,455

(1) Represents the change in fair value of the put option on the Company's capital facility (see Note 9). The fair value of the option was determined principally based on an independent broker quote.

(2) See Note 4 for details of settlements.

The following table provides the components of the income statement line item entitled, "Change in fair value of derivatives" related to derivative contracts for the year ended December 31, 2008:

(in thousands)	Realized Gains and Losses and Other Settlements	Unrealized Gains and Losses
Realized and unrealized gains and losses included in earnings for the period are reported as follows:		
Total gains or losses included in earnings for the period	$ (126,646)[(1)]	$ 621,210[(2)]
Change in realized/unrealized gains or losses relating to the assets still held at the reporting date	$ (61,625)	$ 639,455

(1) Includes premiums received and receivable on CDS contracts issued net of premiums paid or payable on purchased contracts.

(2) Includes losses paid and payable on issued CDS contracts net of losses recovered and recoverable on purchased contracts.

The following table provides the components of the income statement line item entitled, "Change in fair value of derivatives" related to derivative contracts for the years ended December 31, 2008, 2007 and 2006:

	For the Year Ended December 31,		
(in thousands)	2008	2007	2006
Change in fair value of derivatives:			
Realized gains and losses and other settlements:			
Net derivative premiums received and receivable	$ 61,625	$ 47,059	$ 23,674
Net derivative losses paid and payable	(188,271)	—	—
Total realized gains and losses and other settlements	(126,646)	47,059	23,674
Unrealized losses:			
Change in fair value of derivatives	621,210	(1,342,299)	(10,453)
Net change in fair value of derivatives	$ 494,564	$ (1,295,240)	$ 13,221

Description of Valuation Methodology Used by the Company at December 31, 2007

As of December 31, 2007, the Company's estimate of the fair value of its in-force CDS contracts was based on the use of valuation techniques involving management judgment in regard to a number of factors, including:

(i) estimates of rates of return which would be required by market participants to assume the risks in the Company's CDS contracts in the current market environment,

(ii) the amount of subordination in the Company's CDS contracts before liability attaches that would be required by a market participant in order for it to assume the risks in the Company's contracts,

(iii) the actual amount of subordination in the Company's CDS contracts before liability attaches,

(iv) the quality of the specific assets referenced in the Company's CDS contracts at the measurement date,

(v) the market perception of risk associated with asset classes referenced in the Company's CDS contracts,

(vi) the remaining average life of the CDS contract,

(vii) credit price indices, published by non-affiliated financial institutions, for the type(s), or similar types, of assets referenced in the Company's CDS contracts (both in terms of type of assets and their credit rating),

(viii) price discovery resulting from discussions and negotiations with market participants or counterparties to the Company's CDS contracts to transfer or commute the risks in any of the Company's CDS contracts, and

(ix) prices of guarantees issued in the Company's retail market or commutations of contracts the Company has executed in proximity to the measurement date.

With respect to items (viii) and (ix) above, in any price discovery involving a commutation of a CDS contract with its counterparty to the transaction, the Company considered its performance risk as implied by the market price of buying credit protection on the Company, when assessing the estimated fair value of its obligations to the counterparty under the contract.

The weight ascribed by management to the aforementioned factors in forming its best estimate of the fair value of the Company's CDS contracts may vary under changing circumstances. In periods prior to July 1, 2007, management principally considered price indices published by nonaffiliated financial institutions in forming its best estimate of the fair value of the Company's CDS contracts. The fair value of the guarantee was determined by multiplying the percentage change in the applicable credit price index or indices applicable to the assets referenced in the CDS contracts by the present value of the remaining expected future premiums to be received under the contract. Management concluded that results from this calculation represented a reasonable estimate of the fair value of the Company's CDS contracts at that time.

In forming management's best estimate of the fair value of the Company's CDS contracts subsequent to June 30, 2007, however, management concluded that limited reliance could be placed on price indices because events and conditions in the credit markets associated with subprime mortgage collateral and corporate loans resulted in limited or no transaction activity in many financial instruments since June 30, 2007 (including ABS CDOs, CLOs, RMBS, and other CDOs), causing financial institutions which publish the indices that management historically relied upon to estimate the fair value of the Company's credit derivatives either to refrain from updating such indices or base changes in the indices partly on judgments in regard to estimated price levels and not actual executed trades. In addition, evidence suggested that the limited price information available in the marketplace in regard to such instruments was influenced by trades resulting from margin calls and liquidity issues that are generally not part of the risks associated with the Company's business model or CDS contracts. As a result of the factors discussed above, the fair value of the Company's credit defaults swaps at September 30, 2007 and December 31, 2007 were estimated by management primarily as follows:

- in instances where the Company was in substantive discussions with market participants to transfer the risk in specific CDS contracts, management's estimate of the fair value of such contracts was largely based on the price discovery it obtained from such discussions,

- in instances where current market indices were reliable and available, management's estimate of fair value was based on applying the percentage change in the applicable credit price index or indices applicable to the assets referenced in the CDS contracts by the present value of the remaining expected future premiums to be received under the contract, and

- in substantially all other instances management's estimate of the fair value of the Company's CDS contracts ascribed significant weight to management's judgments regarding rates of return required by market participants in the current market environment and the amount of subordination required by market participants before their liability would attach under the CDS contracts. Management's judgment in regard to the appropriate rate of return that would be required by a market participant considered all of the other factors discussed above. Management's judgment in regard to the amount of subordination required by market participants before the liability would attach under the CDS contracts generally assumed that, in the current market environment at December 31, 2007, to transfer the risk in an existing contract it would need subordination sufficient to qualify for a triple-A rating from Moody's and S&P. Accordingly, for any contract rated below triple-A by the Company or the rating agencies (which consisted only of ABS CDO contracts), the estimated fair value was calculated by adding additional subordination sufficient to meet S&P standards for a triple-A rating based on S&P requirements at December 31, 2007 to the amount of additional premium required to be paid to transfer the risk to achieve the selected rate of return. Such premium was calculated by adjusting the present value of the expected remaining future net cash flows under such contracts (which are comprised of the remaining expected future premiums to be received under the contract, less estimated maintenance expenses and a provision for expected losses that will manifest in the future) to reflect management's best estimate of the rates of return that would be required by a market participant to assume the risks on such contracts.

Variable Interest Entities

The Company insured obligations issued by variable interest entities ("VIEs") in the ordinary course of the Company's business. The Company provided financial guarantee insurance of structured transactions backed by pools of assets of specified types, municipal obligations supported by the issuers' ability to charge fees for specified services or projects, and corporate risk obligations including essential infrastructure projects and obligations backed by receivables from future sales of commodities and other specified services. The obligations related to these transactions were often securitized through VIEs. In synthetic transactions, the Company guaranteed payment obligations of counterparties, including VIEs, through CDS contracts referencing asset portfolios. The Company only provided financial guarantee insurance of these VIEs for premiums at market rates but did not hold any equity positions or subordinated debt in these off-balance sheet arrangements. These financial guarantee contracts represent variable interests held by the Company in VIEs.

In underwriting financial guarantees, the Company generally required that guaranteed obligations be investment-grade prior to the provision of credit enhancement. Typically, in the case of ABS and other structured obligations, such investment grade ratings were based upon subordination, cash reserves and other structural protections. Consequently, the Company determined that it is not the primary beneficiary of any VIEs in which it holds a variable interest. Accordingly, these VIEs are not consolidated by the Company.

.***Recent Accounting Pronouncements***

Statement of Financial Accounting Standards ("SFAS") No. 163, Accounting for Financial Guarantee Insurance Contracts—An interpretation of FASB Statement No. 60

In May 2008, the FASB issued SFAS 163, Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60, "Accounting and Reporting by Insurance Enterprises" ("SFAS 60"). SFAS 163 clarifies how SFAS 60 applies to financial guarantee insurance contracts. SFAS 163, among other things, changes current industry practices with respect to the recognition of premium revenue and claim liabilities. Under SFAS 163, a claim liability on a financial guarantee insurance contract is recognized when the insurance enterprise expects that a claim loss will exceed the deferred premium revenue (liability) for that contract based on expected cash flows. The discount rate used to measure the claim liability is based on the risk-free market rate and must be updated each quarter. Premium revenue recognition, under SFAS 163 is based on applying a fixed percentage of the premium to the amount of outstanding exposure at each reporting date (referred to as the level-yield approach). In addition, in regard to financial guarantee insurance contracts where premiums are received in installments SFAS 163 requires that an insurance enterprise recognize an asset for the premium receivable and a liability for the unearned premium revenue at inception of a financial guarantee insurance contract and, that such recognition should be based on the following:

- The expected term of the financial guarantee insurance contract if (1) prepayments on the insured financial obligation are probable, (2) the timing and amount of prepayments can be reasonably estimated, and (3) the pool of assets underlying the insured financial obligation are homogeneous and are contractually prepayable. Any adjustments for subsequent changes in those prepayment assumptions would be made on a prospective basis. In all other instances, contractual terms would be used, and

- The discount rate used to measure the premium receivable (asset) and the deferred premium revenue (liability) should be the risk-free rate.

The Company expects that the initial effect of applying SFAS 163 will be material to the Company's financial statements. In particular, the Company expects that implementation of SFAS 163 will cause the Company to de-recognize its reserves for unallocated losses and loss adjustment expenses, and preclude it from providing such reserves in the future (see Note 6 and 15).

SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and for interim periods within those fiscal years. In addition, beginning in the third quarter of 2008, the Company was required to make certain disclosures describing the Company's guarantees that were being closely monitored as a result of deterioration or other adverse developments (see Note 15).

SFAS No. 157, "Fair Value Measurements"

In September 2006, the FASB issued SFAS 157 "Fair Value Measurements" ("SFAS 157") which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement is applicable in conjunction with other accounting pronouncements that require or permit fair value measurements, where the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within these fiscal years. The Company adopted the provisions of SFAS 157 on January 1, 2008. See Note 6 for disclosure of the effect on our financial position and results of operations of the adoption of SFAS 157 and Note 7 for certain other disclosures required under SFAS 157.

FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active: An Amendment of FASB Statement No. 157"

In October 2008, the FASB issued FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active: An Amendment of FASB Statement No. 157" ("FSP No. FAS 157-3"). FSP No. FAS 157-3 applies to financial assets within the scope of SFAS 157 for which other accounting pronouncements require or permit fair value measurements. FSP No. FAS 157-3 clarifies the application of SFAS 157 in an inactive market and provides an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is not active. The provisions are effective upon issuance, including prior periods for which financial statements have not been issued. The provisions of this FSP need not be applied to immaterial items. Since FSP No. FAS 157-3 only illustrates additional guidance in determining the fair value of a financial asset when the market for that financial asset is not active, FSP No. The Company adopted FAS 157-3 upon its issuance and if did not have any effect on the Company's financial condition, results of operations or cash flows.

FSP No. FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161"

In September 2008, the FASB issued FSP No. FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161" ("FSP No. FAS 133-1 and FIN 45-4"). FSP No. FAS 133-1 and FIN 45-4 require enhanced disclosures about credit derivatives and guarantees and amends FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" to exclude derivative instruments accounted for at fair value under SFAS No. 133. The Company adopted FSP No. FAS 133-1 and FIN 45-4 for its financial statements prepared as of and for the year ended December 31, 2008. Since FSP No. FAS 133-1 and FIN 45-4 only requires additional disclosures concerning credit derivatives and guarantees, adoption of FSP No. FAS 133-1 and FIN 45-4 did not affect the Company's financial condition, results of operations or cash flows.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities"

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 provides the Company an irrevocable option to report selected financial assets and liabilities at fair value with changes in fair value recorded in earnings. The option is applied, on a contract-by-contract basis, to an entire contract and not only to specific risks, specific cash flows or other portions of that contract. Upfront costs and fees related to a contract for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. SFAS 159 was effective for the Company on January 1, 2008. The Company did not elect to report any financial assets or liabilities at fair value under SFAS 159.

SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities—An Amendment of FASB Statement No. 133"

In March 2008, the FASB issued SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities—An Amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 establishes the disclosure requirements for derivative instruments and for hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Early application is encouraged. SFAS 161 is not expected to have any effect on the Company's results of operations or financial position.

7. Investments

The Company's primary investment objective is the preservation of capital through maintenance of high-quality investments with adequate liquidity. A secondary objective is optimizing long-term, after-tax returns.

The amortized cost and fair value of investments as of December 31, 2008 and 2007 are as follows:

	December 31, 2008			
(in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
Mortgage- and asset-backed securities	$ 1,045,944	$ 13,595	$ (831)	$ 1,058,708
U.S. Government and government agencies	268,981	33,409	—	302,390
Corporate	608,556	9,242	(377)	617,421
Non-U.S. sovereign government	5,955	398	—	6,353
U.S. states and political subdivisions of the states	815	—	(113)	702
Total debt securities	$ 1,930,251	$ 56,644	$ (1,321)	$ 1,985,574

	December 31, 2007			
(in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
Mortgage- and asset-backed securities	$ 1,379,631	$ 13,586	$ (8,082)	$ 1,385,135
U.S. Government and government agencies	306,787	8,143	(9)	314,921
Corporate	709,108	7,449	(2,686)	713,871
Non-U.S. sovereign government	15,826	235	(37)	16,024
U.S. states and political subdivisions of the states	823	5	(7)	821
Total debt securities	$ 2,412,175	$ 29,418	$ (10,821)	$ 2,430,772

The change in net unrealized gains consists of changes in the valuation of debt securities of $36.7 million, $38.3 million and $0.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Proceeds from sales of debt securities for the years ended December 31, 2008, 2007 and 2006 were $100.5 million, $91.5 million and $384.5 million, respectively.

The amortized cost and fair value of bonds at December 31, 2008 and 2007 by contractual maturity are shown below. Actual maturity may differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2008	
(U.S. Dollars in thousands)	Amortized Cost	Fair Value
Due within one year	$ 98,649	$ 99,718
Due after one through five years	445,643	456,069
Due after five through ten years	303,792	328,508
Due after ten years	36,223	42,571
Subtotal	884,307	926,866
Mortgage- and asset-backed securities	1,045,944	1,058,708
Total	$ 1,930,251	$ 1,985,574

	December 31, 2007	
(in thousands)	Amortized Cost	Fair Value
Due within one year	$ 49,882	$ 49,760
Due after one through five years	579,748	586,886
Due after five through ten years	362,952	367,371
Due after ten years	39,962	41,620
Subtotal	1,032,544	1,045,637
Mortgage- and asset-backed securities	1,379,631	1,385,135
Total	$ 2,412,175	$ 2,430,772

Net investment income is derived from the following sources:

(in thousands)	2008	2007	2006
Debt securities, short-term investments and cash and cash equivalents	$ 134,299	$ 121,288	$ 77,679
Less: Investment expenses	(2,853)	(2,437)	(2,184)
Net investment income	$ 131,446	$ 118,851	$ 75,495

The gross realized gains and gross realized (losses) for the years ended December 31, 2008, 2007 and 2006 were $2.1 million and ($242.4) million; $0.9 million and ($3.4) million; and $1.9 million and ($18.2) million, respectively.

The Company has gross unrealized losses on securities which it considers to be temporary impairments. Such individual security positions have been evaluated by management, based on specific criteria, to determine if these impairments should be considered other-than-temporary. These criteria include assessment of the severity and length of time securities have been impaired, along with management's ability and intent to hold the securities to recovery (which considers the Company's liquidity position), among other factors. For the years ended December 31, 2008 and December 31, 2007, the Company recorded other-than-temporary impairment charges of $238.9 million and $1.2 million, respectively. The Company did not record any other-than-temporary declines in the fair value of debt securities or short-term investments for the year ended December 31, 2006.

The other-than-temporary impairment charge recorded during the year ended December 31, 2008, was due to fact that the Company was not able to assert that it had the intent and ability to hold securities in an unrealized loss position until they mature or recover in value. The Company's inability to make such assertion is due to its expectation that it will need to sell a significant amount of its invested assets to fund the transactions contemplated by the Letter of Intent if they are consummated. See Note 3.

The following tables present the aggregate gross unrealized losses and fair value by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007, respectively:

	December 31, 2008								
	Less than 12 months			12 months or more			Total		
(in thousands)	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Description of securities									
Mortgage- and asset-backed securities ...	$ 5,043	$ 800	12	$ 1,006	$ 31	4	$ 6,049	$ 831	16
U.S. Government and government agencies	—	—	—	—	—	—	—	—	—
Corporate	9,787	377	23	—	—		9,787	377	23
U.S. states and political subdivisions	340	27	1	361	86	1	701	113	2
Non-U.S. sovereign government	—	—	—	—	—	—	—	—	—
Total debt securities and short-term investments	$ 15,170	$ 1,204	36	$ 1,367	$ 117	5	$ 16,537	$ 1,321	41

	December 31, 2007								
	Less than 12 months			12 months or more			Total		
(in thousands)	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Description of securities									
Mortgage- and asset-backed securities ...	$ 94,598	$ 831	7	$ 384,020	$ 7,251	153	$ 478,618	$ 8,082	160
U.S. Government and government agencies	—	—	—	7,666	9	2	7,666	9	2
Corporate	40,683	403	12	208,696	2,283	88	249,379	2,686	100
U.S. states and political subdivisions	445	7	1	—	—	—	445	7	1
Non-U.S. sovereign government	—	—	—	8,530	37	2	8,530	37	2
Total debt securities and short-term investments	$ 135,726	$ 1,241	20	$ 608,912	$ 9,580	245	$ 744,638	$ 10,821	265

The following table presents the fair value of the Company's investments at December 31, 2008 based on the fair value hierarchy level of the inputs used to determine the fair value of such investments as prescribed under SFAS 157. See Note 6 for a description of the fair value hierarchy requirements of SFAS 157.

(in thousands)	As of December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Debt securities available for sale	$ 1,985,574	$ 190,836	$ 1,792,640	$ 2,098
Equity securities(1)	22,720	—	22,720	—

(1) Represents 8 million class A ordinary shares of XL Capital received by the Company in connection with the transactions comprising the 2008 MTA. See Note 4.

Debt securities with an amortized cost and fair value of $6.5 million and $7.3 million and $7.1 million and $7.6 million at December 31, 2008 and 2007, respectively, were on deposit with various regulatory authorities as required by insurance laws.

8. Series A Redeemable Preferred Shares

Syncora Guarantee Re was originally formed in 1998 as part of an investment venture between XL Capital and FSA and was initially capitalized through a series of transactions resulting in the issuance by Syncora Guarantee Re of its common shares to XLI, an indirect wholly owned subsidiary of XL Capital, for consideration of $221.0 million and the issuance by Syncora Guarantee Re of its Series A Redeemable Preferred Shares to FSA for consideration of $39.0 million. On December 7, 2004, Syncora Guarantee Re issued additional common shares to XLI in exchange for $125.0 million and on July 1, 2006 all of XL Capital’s direct and indirect ownership interest in Syncora Guarantee Re was contributed to Syncora Holdings. See Note 1. In addition, during 2006, Syncora Holdings contributed $298.1 million to Syncora Guarantee Re from the net proceeds of its IPO and in 2007, Syncora Holdings contributed $225.0 million to Syncora Guarantee Re from the net proceeds of its issuance of Series A Perpetual Non-Cumulative Preference Shares. There were no common or other shares of equity capital issued by Syncora Guarantee Re to Syncora Holdings in exchange for such contributions. Pursuant to Syncora Guarantee Re’s corporate bye-laws each share of common stock of Syncora Guarantee Re was entitled to three votes with respect to matters requiring a vote of shareholders and each share of the Series A Redeemable Preferred Shares were entitled to one vote. Accordingly, at December 31, 2007 and 2006 holders of Syncora Guarantee Re’s Series A Redeemable Preferred Shares as a group had approximately a 5% voting interest in Syncora Guarantee Re, respectively, whereas holders of Syncora Guarantee Re’s common shares had an approximate 95% voting interest, respectively.

Under Syncora Guarantee Re’s corporate bye-laws the Series A Redeemable Preferred Shares were originally structured to provide for: (i) a 5% fixed annual dividend, (ii) an annual participating dividend according to certain criteria including a formula based on the financial guarantee company industry average for dividends paid, and (iii) a payment upon redemption. Under Syncora Guarantee Re’s amended corporate bye-laws the Series A Preferred Shares may be redeemed by Syncora Guarantee Re: (i) at any time, in whole or in part, at its sole option; subject to certain limitations; or (ii) in whole but not in part, at any time after the tenth anniversary of the date of their initial issue. Dividends under the Series A Preferred Shares are cumulative. At any time after November 3, 2008, the holders may require Syncora Guarantee Re to redeem the Series A Preferred Shares. The Series A Preferred Shares may also be required to be redeemed upon the occurrence of a change of control.

Prior to April, 2006 the redemption price of the Series A Preferred Shares was estimated at the end of each reporting period and changes in the redemption value were accreted over the period from the date of issuance to the earliest redemption date using the interest method. Pursuant to resolution of Syncora Guarantee Re’s shareholders on April 2006, Syncora Guarantee Re restructured the terms of its Series A Redeemable Preferred Shares and changed its bye-laws accordingly. In accordance with the resolution, the participating dividend of the preference shares was eliminated, the stated value of the preferred shares held by FSA was increased to $54.0 million, and the fixed dividend rate was increased from 5% to 8.25%.

For the year ended December 31, 2006, the Company recorded $8.0 million of dividends on redeemable preferred shares which reflects the effect of the restructured terms of the Series A Preferred Shares referred to above.

On February 27, 2007, the board of directors of Syncora Guarantee Re approved: (i) an extraordinary dividend of $15.0 million on its Series A Redeemable Preferred Shares, and (ii) a reduction in the stated value of the remaining outstanding Series A Redeemable Preferred Shares by a corresponding amount. Payment of the extraordinary dividend and the reduction in the stated value of the Series A Redeemable Preferred Shares occurred on March 30, 2007. Also, as a result of the reduction in stated value, dividends on the redeemable preferred shares were $0.8 million quarterly subsequent to March 31, 2007.

In connection with the 2008 MTA, Syncora Holdings purchased all the outstanding Syncora Guarantee Re Series A Preferred Shares in exchange for $2.9 million and contributed them to the Company. In connection with the merger of Syncora Guarantee Re with and into the Company, such shares were cancelled. See Note 4.

9. Syncora Guarantee Capital Facility

On February 11, 2008, Syncora Guarantee Re issued $200 million of non-cumulative perpetual Series B preferred shares (the "Series B Preferred Shares") pursuant to the exercise of a put option under its capital facility. After the merger of Syncora Guarantee Re with and into the Company on September 4, 2008, the Series B Preferred Shares became preferred shares of the Company (see Notes 1 and 4). The Series B Preferred Shares have a par value of $120 per share and a liquidation preference of $100,000 per share. Holders of outstanding Series B Preferred Shares are entitled to receive, in preference to the holders of the Company's common shares, cash dividends at a percentage rate per Series B Preferred Share as follows:

(1) for any dividend period ending on or prior to December 9, 2009, one-month LIBOR plus 1.00% per annum, calculated on an actual/360 day basis; and

(2) for any subsequent dividend period, one-month LIBOR plus 2.00% per annum, calculated on an actual/360 day basis.

The holders of the Series B Preferred Shares are not entitled to any voting rights as shareholders of the Company and their consent is not required for taking any corporate action. Subject to certain requirements, the Series B Preferred Shares may be redeemed, in whole or in part, at the option of the Company at any time or from time to time after December 9, 2009 for cash at a redemption price equal to the liquidation preference per share plus any accrued and unpaid dividends thereon to the date of redemption without interest on such unpaid dividends. On February 26, 2008, Syncora Guarantee Re elected to declare dividends on the Series B Preferred Shares at the required rate for the next three monthly periods and on May 6, 2008, Syncora Guarantee Re elected to declare dividends on the Series B Preferred Shares at the required rate for the succeeding month. On July 25, 2008, Syncora Guarantee Re elected to declare dividends on the Series B Preferred Shares at the required rate for the July 2008 and August 2008 periods. The Company did not declare dividends on the Series B Preferred Shares for any period after August 2008 through the date hereof.

In accordance with GAAP, the aforementioned put option is required to be reported at fair value with changes in the fair value thereof reflected in the unrealized gains (losses) component of the "Net change in fair value of derivatives" line item of the Company's statements of operations. For the year ended December 31, 2008, the Company recorded a net realized gain of $179.6 million and for the years ended December 31, 2007 and 2006, the Company recorded net unrealized gains (losses) of $104.6 million and $(2.3) million, respectively, relating to the put option. The increase in the value of the put option recorded at December 31, 2008 and 2007 reflects the trading value at such dates of the aforementioned pass-through securities which, in turn, reflects the market perception of credit risk associated with the Series B Preferred Shares.

At December 31, 2007, the fair value of the put option was $107.1 million, which is reflected in the Company's consolidated balance sheet at such date in the line item entitled, "Derivative assets". During the period from January 1, 2008 through to the effective date of the exercise of the put option, the Company recorded an incremental unrealized gain on the put option of $72.5 million and the corresponding derivative asset at such date was $179.6 million. Upon the exercise of the put option, the Company reversed the derivative asset and correspondingly reduced the paid in capital of the Series B Preferred Shares that were issued pursuant to the exercise of the put option. The effect of these entries is to report the Series B Preferred Shares at their estimated fair value at the date of issuance. Accordingly, the carrying value of the Series B Preferred Shares at December 31, 2008 of $20.0 million represents the net proceeds received upon the issuance thereof less the reversal of the fair value of the put option on the date of exercise.

10. Information Concerning Parent and Affiliate Capital Transactions

Services Agreements with Affiliates

Prior to the IPO, the Company purchased various services from affiliates of XL Capital under various agreements and continued to purchase such services under new agreements that became effective at the date of the IPO. Such services principally included: (i) information technology support, (ii) reinsurance and retrocessional consulting and management services and (iii) actuarial, finance, legal, internal audit services and certain investment management services. Since the IPO, the Company has undertaken to perform certain of the services itself or to outsource such services to other vendors and has, accordingly, discontinued the purchase of all the services that were provided by XL Capital. For the years ended December 31, 2008, 2007 and 2006, the Company incurred costs under the aforementioned agreements aggregating $1.4 million, $72.6 million and $61.5 million, respectively, which are reflected in “Operating expenses” in the accompanying consolidated statements of operations.

Reinsurance Agreements and Other Guarantees with Affiliates

The Company has the following reinsurance agreements with affiliates. Certain of the agreements discussed below may be terminated under certain conditions, as defined in the agreements. As noted below, many of these agreements were terminated or commuted on the Closing Date in connection with the 2008 MTA (see Note 4).

- Effective July 1, 2007, Syncora Guarantee Re ceded certain business to XLI, aggregating approximately $3.7 billion of guaranteed par/notional exposure, under an existing facultative quota share reinsurance agreement. As a result of this transaction, on such date, Syncora Guarantee Re ceded premiums of $16.3 million to XLI, received a ceding commission allowance of $6.6 million from XLI, and recorded a liability to XLI of $9.7 million. In connection with the 2008 MTA discussed in Note 4, the aforementioned reinsurance agreement was commuted.

- Effective August 4, 2006, certain subsidiaries of XL Capital indemnified the Company for all losses and loss adjustment expenses incurred in excess of its retained reserves at the effective date of the agreement relating to an insured project financing described in Note 15 (c). In consideration for the aforementioned indemnifications the Company was obligated to pay such affiliates approximately $9.8 million on an installment basis over the life of the aforementioned project financing. As the premium was due irrespective of any early termination of the underlying insurance transaction, the Company recorded a liability of approximately $7.0 million at the effective date of the indemnifications (representing the present value of the obligation discounted at 5.0%, which reflects the rate on Treasury obligations at that time with a term to maturity commensurate with that of the liability) and a corresponding deferred cost, which are reflected in the accompanying consolidated balance sheet as of December 31, 2007 in “reinsurance premiums payable” and “prepaid reinsurance premiums”, respectively. In connection with the 2008 MTA discussed in Note 4, the aforementioned indemnities were cancelled.

- Effective August 4, 2006, XLA has undertaken to indemnify the Company for any diminution in value below their carrying value at June 30, 2006 of the notes and preferred shares described in Note 15, which notes and preferred shares were acquired in connection with the satisfaction of a claim under a financial guarantee insurance policy issued by Syncora Guarantee. In addition, pursuant to the aforementioned indemnity, XLA agreed to indemnify the Company for any costs arising out of any litigation or future claim in connection with the aforementioned insurance policy. See Note 15 for further information regarding amounts recovered or recoverable by the Company under the indemnity.

- On August 4, 2006, Syncora Guarantee Re terminated a facultative quota share reinsurance treaty with XLI that had been effective since 2001. As a result of the termination, XLI returned $26.5 million of premiums to Syncora Guarantee Re, Syncora Guarantee Re returned ceding commissions of $7.8 million to XLI, and XLI paid Syncora Guarantee Re $18.7 million.

- On August 4, 2006, Syncora Guarantee Re and XLI agreed to cancel from inception the reinsurance of certain business ceded under a facultative quota share reinsurance treaty that was effective since 1999. As a result of this cancellation, Syncora Guarantee Re paid XLI $0.2 million, XLI assumed Syncora Guarantee Re’s obligation for $1.2 million of reserves for losses and loss adjustment expenses, and Syncora Guarantee Re recorded a capital contribution of $1.0 million. In addition, on such date, Syncora Guarantee Re assumed certain business from XLI pursuant to the aforementioned reinsurance treaty. As a result thereof, Syncora Guarantee Re recorded assumed premiums of approximately $8.0 million, ceding commissions of approximately $1.0 million and received cash from XLI of approximately $7.0 million.

- Effective October 1, 2001, Syncora Guarantee Re entered into an excess of loss reinsurance agreement with XLI. This agreement covered a portion of Syncora Guarantee Re’s liability arising as a result of losses on policies it reinsured and credit derivatives it issued that were in excess of certain limits and were not covered by Syncora Guarantee Re’s other reinsurance agreements. Syncora Guarantee Re was charged a premium of $0.5 million per annum for this coverage. This agreement provided indemnification only for the portion of any loss covered by the agreement in excess of 10% of Syncora Guarantee Re’s Bermuda statutory surplus, up to an aggregate amount of $500 million, and excluded coverage for liabilities arising other than pursuant to the terms of an underlying policy.

  In connection with the 2008 MTA discussed in Note 4, the Company and XLI terminated and settled the excess of loss agreement for a payment by XL Capital to the Company of $100.0 million. As a result, the Company recorded a loss during the year ended December 31, 2008 of $106.1 million, which represented the excess net carrying value of amounts owed by XLI to the Company under the agreement over the aforementioned settlement payment.

  There were no losses ceded by Syncora Guarantee Re under this agreement prior to 2007. At December 31, 2007, the Company had a recoverable from XLI under this agreement of $259.4 million, which is reflected in “reinsurance balances recoverable on unpaid losses” in the accompanying consolidated balance sheet for the year then ended. The ceded losses of $259.4 million represent the present value (discounted at 5.1%) of the full limit loss of $500 million under this agreement. The Company incurred expense under the excess of loss reinsurance agreement of $8.2 million and $0.5 million for the years ended December 31, 2007 and 2006, respectively. The expense recorded in 2007 reflects all future ceded premium that the Company would have been required to pay under the reinsurance agreement over the remaining average life of the loss payments and recoveries noted above, in order for the agreement to remain in-force and the Company recover the aforementioned ceded losses.

- Effective November 1, 2002 and as amended and restated as of March 1, 2007, Syncora Guarantee was party to a facultative reinsurance arrangement (the "XL Re Treaty") with XL Reinsurance America, Inc. ("XL RE AM"). Under the terms of the XL Re Treaty, XL RE AM agreed to reinsure risks insured by Syncora Guarantee under financial guarantee insurance policies up to the amount necessary for Syncora Guarantee to comply with single risk limitations set forth in Section 6904(d) of the New York Insurance Law. Such reinsurance was on an automatic basis prior to the effective date of the IPO and was on a facultative basis on and after the effective date of the IPO. The reinsurance provided by XL RE AM was on an excess of loss or quota share basis. The Company was allowed up to a 30% ceding commission (or such other percentage on an arm's-length basis) on ceded premiums written under the terms of this agreement. In connection with the 2008 MTA described in Note 4, the XL RE Treaty was commuted.

- Syncora Guarantee Re entered into the Old Master Facultative Agreement (see Note 4) to reinsure certain policies issued by FSA which guarantee the timely payment of the principal of and interest on various types of debt obligations. Syncora Guarantee Re's obligations under certain of these arrangements were guaranteed by XLI. Effective upon the IPO, the guarantee was terminated with respect to all new business assumed by Syncora Guarantee Re under such arrangement, but the guarantee remained in effect with respect to cessions under the agreement prior to the IPO. In connection with the 2008 MTA discussed in Note 4, Syncora Guarantee Re commuted the Old Master Facultative Agreement and Syncora Guarantee entered into the New Facultative Master Agreement to reinsure a portion of the protection previously provided to FSA by Syncora Guarantee Re. To effect the commutation of the Old Master Facultative Agreement, Syncora Guarantee Re paid FSA $165.4 million and in connection with the reassumption of a portion of such business by Syncora Guarantee under the New Master Facultative Agreement, Syncora Guarantee received a payment from FSA of $88.6 million. In addition, in connection with the 2008 MTA described in Note 4, XLI's guarantee of Syncora Guarantee Re's obligations to FSA, relating to cessions under reinsurance agreements prior to the IPO, was terminated. Subsequent to the Closing Date, FSA commuted a portion of the business assumed by Syncora Guarantee under the New Facultative Master Agreement.

- Syncora Guarantee Re guaranteed certain of XLI's obligations in connection with certain transactions where XLI's customer required such credit enhancement. Each of these transactions has a "double trigger" structure, meaning that Syncora Guarantee Re does not have to pay a claim unless both the underlying transaction and XLI default. For each of these transactions, Syncora Guarantee Re entered into a reimbursement agreement with XLI, pursuant to which XLI pays Syncora Guarantee Re a fee for providing its guarantee and XLI grants Syncora Guarantee Re a security interest in a portion of the payments received by it from its client. Pursuant to the merger of Syncora Guarantee Re with and into Syncora Guarantee, these guarantees are now the guarantees of Syncora Guarantee. As of December 31, 2008 and 2007, Syncora Guarantee Re's aggregate net par outstanding relating to such guarantees was $365.5 million and $511.1 million, respectively.

- Effective May 1, 2004, XLI entered into an agreement with the Company which unconditionally and irrevocably guaranteed to the Company the full and complete payment when due of all of Syncora Guarantee Re's obligations under its facultative quota share reinsurance agreement with the Company, under which agreement Syncora Guarantee Re has assumed business from the Company since December 19, 2000.

  The XLI guarantee agreement terminated with respect to any new business produced by Syncora Guarantee and ceded to Syncora Guarantee Re pursuant to the facultative quota share reinsurance agreement after the effective date of the IPO, but the guarantee remained in effect with respect to cessions under the agreement prior to the IPO. In connection with the 2008 MTA discussed in Note 4, the facultative quota share reinsurance agreement was commuted and XLI's guarantee of Syncora Guarantee Re's obligations to the Company, relating to cessions under reinsurance agreements prior to the IPO, was eliminated in consideration of a payment by XLI to Syncora Guarantee Re of approximately $1.6 billion, which was recorded by the Company as a capital contribution (see Note 4).

- The Company previously provided financial guarantee insurance policies insuring timely payment of investment agreements issued by XL Asset Funding Company I LLC ("XLAF"), a wholly-owned subsidiary of XL Capital. These investment agreements contained ratings triggers based on the rating of the Company, which were triggered upon the Company's ratings downgrades by Moody's, S&P and Fitch. As a result, XLAF repaid these investment agreements prior to June 30, 2008. As of December 31, 2008 and 2007, the aggregate face amount of such investment agreements guaranteed by the Company was zero and $4.0 billion, respectively. Notwithstanding the repayment of all outstanding investment agreements, XLAF remains obligated to the Company to indemnify it for certain losses, costs and expenses.

  In addition, the Company insures XLAF's obligations under certain derivative contracts issued and purchased by XLAF. As of December 31, 2008 and 2007, the total notional value of such contracts insured was $150.0 million and $162.9 million, respectively. In March 2009, XL Capital settled all such contracts which terminated the Company's insurance of such obligations without any loss to the Company.

11. Net Premiums Earned

Net premiums earned are comprised of:

	Year Ended December 31,		
(in thousands)	**2008**	**2007**	**2006**
Gross premiums written	$ 79,404	$ 254,223	$ 329,328
Reinsurance premiums assumed	(29,401)	56,246	54,221
Total premiums written	50,003	310,469	383,549
Change in direct deferred premium revenue	186,289	(98,673)	(175,208)
Change in assumed deferred premium revenue	50,529	(17,360)	(27,719)
Gross premiums earned	286,821	194,436	180,622
Reinsurance premiums ceded	(398)	(66,913)	(11,291)
Change in prepaid reinsurance premiums	(7,052)	41,137	(9,890)
Ceded premiums earned	(7,450)	(25,776)	(21,181)
Net premiums earned	$ 279,371	$ 168,660	$ 159,441

Premiums earned for the years ended December 31, 2008, 2007, and 2006 include $130.6 million, $14.7 million and $27.4 million, respectively, related to refunded and called bonds and other accelerations.

12. Deferred Acquisition Costs and Deferred Ceding Commissions

Deferred acquisition costs, net of deferred ceding commission revenue, as well as related amortization, as of and for the years ended December 31, 2008, 2007 and 2006 are as follows:

	Year Ended December 31,		
(in thousands)	**2008**	**2007**	**2006**
Deferred acquisition costs, net—beginning of year	$ 108,117	$ 93,809	$ 59,592
Costs and revenues deferred:			
Acquisition costs deferred during the year	—	54,858	51,214
Ceding commission revenue deferred during the year	—	(20,579)	(8,566)
Net costs and revenues deferred	—	34,279	42,648
Commutation with affiliate	19,046	—	7,809
Acquisition costs and ceding commission revenue amortized:			
Acquisition costs amortized	(19,127)	(27,284)	(22,422)
Ceding commission revenue amortized	2,026	7,313	6,182
Net acquisition costs amortized	(17,101)	(19,971)	(16,240)
Deferred acquisition costs, net—end of year	$ 110,062	$ 108,117	$ 93,809

During the year ended December 31, 2007, the Company recorded a charge of $3.1 million to reduce deferred acquisition costs in regard to certain of its guarantees of obligations supported by HELOC and CES mortgage loan collateral to reflect the fact that the sum of expected losses and loss adjustment expenses, maintenance costs and unamortized policy acquisition costs on such guaranteed obligations exceeded the related unearned premiums, the anticipated present value of future premiums under installment contracts written, and anticipated investment income.

Accelerated amortization of deferred acquisition costs due to Refundings was $8.3 million, $2.7 million and $2.2 million for the years ended December 31, 2008, 2007 and 2006, respectively.

13. Reinsurance

The Company enters into ceded reinsurance arrangements principally to increase aggregate capacity, manage its risk guidelines and to reduce the risk of loss on business written or assumed. This reinsurance includes the reinsurance arrangements with affiliates that are discussed in Note 10, as well as reinsurance arrangements with non-affiliated reinsurers. Reinsurance does not relieve the Company of its obligations under its guarantees. Accordingly, the Company is still liable under its guarantees in the event reinsuring companies do not meet their obligations to the Company under reinsurance agreements. The Company regularly monitors the financial condition of its reinsurers. For the years ended December 31, 2008, 2007, and 2006 there were no amounts provided by the Company for uncollectible reinsurance recoverable. The following tables set forth certain amounts ceded to affiliate and non-affiliate reinsurers as of and for the years ended December 31, 2008, 2007, and 2006.

	2008		
(in thousands)	**Affiliate**	**Non-Affiliate**	**Total**
Year Ended December 31			
Ceded premiums written	$ (4,902)	$ 5,300	$ 398
Ceded premiums earned	(2,696)	10,146	7,450
Ceding commission revenue	1,893	3,527	5,420
Ceded losses and loss adjustment expenses	2,835	52,224	55,059
As of December 31			
Par exposure ceded	$ —	$ 1,401,463	$ 1,401,463
Reinsurance balances recoverable on unpaid losses	—	6,011	6,011

	2007		
(in thousands)	**Affiliate**	**Non-Affiliate**	**Total**
Year Ended December 31			
Ceded premiums written	$ 31,086	$ 35,827	$ 66,913
Ceded premiums earned	13,737	12,039	25,776
Ceding commission revenue	2,947	4,367	7,314
Ceded losses and loss adjustment expenses	49,026	1,310	50,336
As of December 31			
Par exposure ceded	$ 7,738,617	$ 10,921,965	$ 18,660,582
Reinsurance balances recoverable on unpaid losses	225,743	41,202	266,945

	2006		
(in thousands)	**Affiliate**	**Non-Affiliate**	**Total**
Year Ended December 31			
Ceded premiums written	$ (4,837)	$ 16,128	$ 11,291
Ceded premiums earned	9,841	11,340	21,181
Ceding commission revenue	2,809	3,373	6,182
Ceded losses and loss adjustment expenses	14,647	487	15,134
As of December 31			
Par exposure ceded	$ 1,581,107	$ 5,745,370	$ 7,326,477
Reinsurance balances recoverable on unpaid losses	79,615	9,001	88,616

14. Outstanding Exposure and Collateral

The Company provides financial guarantee insurance and reinsurance to support public and private borrowing arrangements. Financial guarantee insurance guarantees the timely payment of principal and interest on insured obligations to third party holders of such obligations in the event of default by an issuer. The Company's potential liability in the event of non-payment by the issuer of a guaranteed obligation represents the aggregate outstanding principal guaranteed under its policies and contracts and related interest payable at the date of default. In addition, the Company provides credit protection on specific assets referenced in its CDS contracts which consist of structured pools of corporate obligations (see Note 6). Under the terms of its CDS contracts, the seller of credit protection makes a specified payment to the buyer of credit protection upon the occurrence of one or more specified credit events with respect to a referenced obligation. The Company's potential liability under its CDS contracts represents the notional amount of such swaps that it guarantees.

As of December 31, 2008 and 2007, the Company's net outstanding par exposure under its in-force financial guarantee insurance and reinsurance policies and contracts aggregated to $133.7 billion and $165.0 billion, respectively, including the Company's notional exposure under CDS contracts aggregating to $56.2 billion and $59.6 billion, respectively.

The following tables present certain information with respect to the par amounts insured and notional amounts guaranteed by the Company at December 31, 2008 and 2007, before and after reinsurance (or on a "gross" and "net" basis, respectively):

	2008			2007		
(in billions)	Gross	Net	% of Net	Gross	Net	% of Net
Risk Classes—Par Exposure						
U.S. Public finance	$ 53.5	$ 52.4	39.2%	$ 74.3	$ 69.3	42.0%
Non-U.S. Public finance:						
U.S. Structured finance	58.1	58.1	43.5%	76.9	70.2	42.5%
International finance	23.5	23.2	17.3%	32.5	25.5	15.5%
Total	$ 135.1	$ 133.7	100.0%	$ 183.7	$ 165.0	100.0%

The par amounts insured as of December 31, 2008 and 2007 and the terms of maturity are as follows:

	2008			
	U.S. Public Finance		Non-U.S. Public Finance	
(in billions)	Gross	Net	Gross	Net
Years to Maturity—Par Exposure				
0 to 5 years	$ 1.5	$ 1.5	$ 8.0	$ 8.0
5 to 10 years	12.0	11.2	11.3	11.3
10 to 15 years	5.6	5.6	10.8	10.8
15 to 20 years	11.4	11.4	5.1	5.1
20 years and beyond	23.0	22.7	46.4	46.1
Total	$ 53.5	$ 52.4	$ 81.6	$ 81.3

	2007			
	U.S. Public Finance		Non-U.S. Public Finance	
(in billions)	Gross	Net	Gross	Net
Years to Maturity—Par Exposure				
0 to 5 years	$ 1.2	$ 1.2	$ 13.9	$ 10.4
5 to 10 years	12.8	11.4	17.9	16.6
10 to 15 years	6.9	6.7	12.2	11.3
15 to 20 years	14.8	14.1	7.0	6.4
20 years and beyond	38.6	35.9	58.4	51.0
Total	$ 74.3	$ 69.3	$ 109.4	$ 95.7

The Company seeks to limit its exposure to losses by maintaining a surveillance function which monitors such transactions throughout their lives. Additionally, the Company historically sought to mitigate credit risk by only underwriting investment-grade transactions, diversifying its portfolio and maintaining collateral requirements on asset-backed obligations, as well as through reinsurance.

As of December 31, 2008 and 2007, par and notional amounts of the Company's guaranteed asset-backed obligations were supported by the following types of collateral:

	2008			2007		
(in billions)	Gross	Net	% of Net	Gross	Net	% of Net
Asset-Backed Collateral Type—Par Exposure						
Consumer ABS	$ 10.3	$ 10.3	78.0%	$ 16.1	$ 13.9	82.3%
Commercial ABS	2.9	2.9	22.0	4.3	3.0	17.7
Total	$ 13.2	$ 13.2	100.0%	$ 20.4	$ 16.9	100.0%

As of December 31, 2008 and 2007, the Company's in-force portfolio of guaranteed risks was diversified by type of obligation as shown in the following table:

	2008			2007		
(in billions)	Gross	Net	% of Net	Gross	Net	% of Net
Type of Insured Obligation—Par Exposure[1]						
Pooled Debt Obligation	$ 42.7	$ 42.7	31.9%	$ 48.0	$ 45.5	27.6%
General Obligation	29.8	29.1	21.7	35.7	33.7	20.4
Utilities	17.6	17.4	13.0	13.4	12.3	7.5
Transportation	11.5	11.2	8.4	17.0	12.5	7.6
Consumer ABS	10.3	10.3	7.7	16.1	13.9	8.4
Non-Ad Valorem	5.0	5.0	3.7	7.1	6.9	4.2
Housing and Public Buildings	4.9	4.8	3.6	2.6	2.5	1.5
Higher Education	3.8	3.8	2.9	6.7	6.6	4.0
Commercial ABS	2.9	2.9	2.2	4.3	3.0	1.8
Financial Product	1.8	1.8	1.4	8.6	7.7	4.7
Future Flow	1.5	1.5	1.1	2.3	2.0	1.2
Power & Utilities	1.2	1.2	0.9	14.8	12.7	7.7
Municipal—Other	1.2	1.1	0.8	1.4	1.0	0.6
Infrastructure	0.4	0.4	0.3	4.0	3.3	2.0
Specialized Risk—Other	0.3	0.3	0.2	—	—	0.0
Sovereign	0.1	0.1	0.1	1.0	0.7	0.4
Whole Business Secured	0.1	0.1	0.1	0.4	0.4	0.2
Specialized Risk	—	—	0.0	0.3	0.3	0.2
Pre-Insured	—	—	0.0	—	—	0.0
Revenue Secured	—	—	0.0	—	—	0.0
Total	$135.1	$133.7	100.0%	$ 183.7	$ 165.0	100.0%

(1) Includes policies in all segments: U.S. Public Finance, U.S. Structured Finance and International Finance.

In addition, the Company seeks to maintain a diversified portfolio of guaranteed obligations designed to spread its risk across a number of geographic areas. Set forth below is the distribution of the Company's par and notional exposures by geographic location as of December 31, 2008 and 2007:

	2008			2007		
(in billions)	Gross	Net	% of Net	Gross	Net	% of Net
Geographic Distribution—Par Exposure						
New York	$ 16.9	$ 16.9	12.6%	$ 20.7	$ 19.2	11.6%
California	8.3	8.3	6.2	15.5	14.2	8.6
Illinois	3.9	3.9	2.9	5.4	5.1	3.1
Texas	3.9	3.7	2.8	5.0	4.5	2.7
Alabama	3.6	3.5	2.6	3.6	2.9	1.7
Florida	3.4	2.7	2.0	4.9	4.1	2.5
Delaware	3.1	3.1	2.3	4.7	4.0	2.5
Pennsylvania	2.9	2.9	2.2	3.5	3.4	2.1
New Jersey	2.3	2.3	1.7	3.4	3.3	2.0
Massachusetts	1.6	1.6	1.2	3.6	3.5	2.1
Michigan	1.5	1.5	1.1	2.0	2.0	1.2
Georgia	1.5	1.5	1.1	2.0	1.9	1.2
Colorado	1.4	1.4	1.0	1.5	1.5	0.9
Wisconsin	0.9	0.9	0.7	2.1	1.8	1.1
District of Columbia	0.7	0.7	0.5	1.1	1.1	0.7
Other U.S. Jurisdictions	17.4	17.4	13.0	24.5	23.0	13.9
U.S. Diversified	38.4	38.4	28.8	47.7	43.9	26.6
International	23.4	23.0	17.3	32.5	25.6	15.5
Total	$ 135.1	$ 133.7	100.0%	$ 183.7	$ 165.0	100.0%

In its asset-backed business, the Company historically considered geographic concentration as a factor in its underwriting process. However, the existence of first-loss protection in a typical asset-backed securitization, in addition to other factors, makes it difficult to attribute geographic exposure to deals collateralized by diversified pools of obligations. For asset-backed transactions, the Company considers the seller/servicer, industry and type of collateral to be more relevant measures of diversification.

Set forth below is the Company's par exposure from the issuance of financial guarantee insurance policies and its notional exposure from the issuance of CDS contracts as of December 31, 2008 and 2007:

	2008			2007		
(in billions)	Gross	Net	% of Net	Gross	Net	% of Net
Credit Enhancement—Par Exposure						
Financial guarantee insurance policy	$ 78.0	$ 77.5	58.0%	$ 118.4	$ 105.4	63.9%
CDS contracts	57.1	56.2	42.0	65.3	59.6	36.1
Total	$ 135.1	$ 133.7	100.0%	$ 183.7	$ 165.0	100.0%

During 2008, the Company recorded a provision for losses before reinsurance of approximately $1,850.6 million ($1,789.8 million after reinsurance) relating to its exposure to guarantees of obligations supported by residential mortgages due to unprecedented credit-market events. See Note 15.

The Company is exposed to residential mortgages directly, through its guarantees of RMBS and indirectly, through its guarantees of ABS CDOs.

As of December 31, 2008, the Company's total net direct exposure to RMBS aggregated approximately $8.7 billion, representing approximately 6.5% of its total in-force guaranteed net par outstanding at such date. The RMBS exposure consisted of various collateral types, including prime and Alt-A 1st lien, subprime 1st lien, HELOC and CES mortgage collateral. During the year ended December 31, 2008, the Company recorded a provision for losses and loss adjustment expenses of $1,850.6 million before reinsurance ($1,789.8 million after reinsurance) on certain guarantees supported by HELOC and CES mortgage collateral (see Note 15).

As of December 31, 2008, the Company had insured 17 ABS CDO transactions, with total net par outstanding of $14.2 billion. All of its indirect exposure to residential mortgages arises from CDOs in which its guarantees are with respect to securities having the benefit of higher than the minimum amount of subordination required under rating agency criteria, in effect at the time of issue for a rating of "AAA," based on S&P ratings. However, as a result of the actual levels of delinquencies, defaults and foreclosures on subprime mortgages substantially exceeding forecast levels, the Company anticipates losses from these policies. As of December 31, 2008, the Company's indirect subprime net exposure was approximately $4.4 billion based on the RMBS holdings within the ABS CDO collateral pools. The Company's indirect net exposure to other ABS CDOs was approximately $1.7 billion as of December 31, 2008, and a significant portion of the underlying collateral supporting these transactions consists of subprime RMBS. In addition, the collateral pools of most of the Company's ABS CDO transactions contain securities issued by other ABS CDOs (also known as CDOs of CDOs or CDOs squared).

Exposure to CDOs

The following table presents the net notional exposure of the Company's guaranteed CDOs by rating as of December 31, 2008:

(in billions, except percentages)[(1)]	**Net Par Outstanding as of December 31, 2008**	**% of Total**
AAA[(2)]	$27.9	65.3%
AA	2.5	5.9
A	0.3	0.7
BBB and lower	12.0	28.1
Total	$42.7	100.0%

(1) Ratings represent the lower of S&P or the Company's internal rating by deal as of February 25, 2009.

(2) Also includes exposure considered to be "super senior" where the underlying credit support exceeds the "AAA" guidelines set by S&P.

The following table presents the net notional exposure of the referenced assets underlying the Company's CDO of ABS portfolio by rating as of December 31, 2008:

(in billions except percentages)	Net Notional Outstanding as of December 31, 2008	% of Total
Ratings[1]		
AAA	$ 1.9	13.4%
AA	2.3	16.2
A	1.1	7.7
BBB & lower	8.9	62.7
Total	$ 14.2	100.0%

(1) Ratings represent the lower of ratings by S&P or Moody's as of February 2, 2009.

15. Liability for Losses and Loss Adjustment Expenses

The Company's liability for losses and loss adjustment expenses consists of case basis reserves and unallocated reserves. The provision for losses and loss adjustment expenses represents the expense recorded to establish the total reserve (case basis and unallocated reserves) at a level determined by management to be adequate for losses inherent in the financial guarantee portfolio as of the reporting date. Activity in the liability for losses and loss adjustment expenses is summarized as follows:

(in thousands)	2008	2007	2006
Gross unpaid losses and loss expenses at beginning of year	$ 402,519	$ 164,235	$ 135,478
Unpaid losses and loss expenses recoverable	(266,945)	(87,505)	(68,430)
Net unpaid losses and loss expenses at beginning of year	135,574	76,730	67,048
Increase in net losses and loss adjustment expenses incurred in respect of losses occurring in current year	606,151	73,019	12,239
Prior years	1,191,726	(3,653)	651
Effect of commuting certain reinsurance agreements	112,746	(2,444)	(1,177)
Less net losses and loss expenses paid	(366,021)	(8,078)	(2,031)
Net unpaid losses and loss adjustment expenses at end of year	1,680,176	135,574	76,730
Unpaid losses and loss adjustment expenses recoverable	6,011	266,945	87,505
Gross unpaid losses and loss expenses at end of year	$ 1,686,187	$ 402,519	$ 164,235

Case Basis Reserves for Losses and Loss Adjustment Expenses

Set forth below is a discussion of certain case basis reserves established by the Company during the years ended December 31, 2008, 2007, and 2006.

(a) For the years ended December 31, 2008, 2007 and 2006, the Company recorded a provision for losses and loss adjustment expenses, after giving effect to reinsurance, of approximately $1,789.8 million, $37.2 million and $0, respectively, representing the net present value loss expected to be incurred in the future with respect to certain of its guarantees of obligations supported by HELOC and CES (second lien loans) mortgage loan collateral, as well as Alt-A (first lien) mortgage loan collateral in 2008. At December 31, 2008 and 2007, reserves for unpaid losses and loss adjustment expenses on such business, after giving effect to reinsurance, were $1,557.9 million and $37.2 million, respectively ($1,558.4 million and $216.7 million, respectively before giving effect to reinsurance).

The 2008 activity for losses and loss adjustment expenses reflects the recapture of previously ceded reserves as a result of the commutation of reinsurance agreements. In connection with the 2008 MTA discussed in Note 4, the Company commuted substantially all of its ceded reinsurance arrangements.

The loss amounts discussed above, before giving effect to reinsurance, represent: (i) all claims paid through the measurement date, plus the net present value of claims expected to be paid subsequent thereto, less (ii) recoveries received through the measurement date, the net present value of expected recoveries subsequent thereto, and the net present value of installment premiums due by the counterparties to such guarantees subsequent to the measurement date.

The total remaining par guaranteed by the Company with respect to the aforementioned guarantees supported by HELOC, CES and Alt-A collateral, net of carried case basis reserves but before reinsurance, aggregated approximately $3.7 billion ($3.7 billion after reinsurance) at December 31, 2008 and $2.4 billion ($2.2 billion after reinsurance) at December 31, 2007.

The Company's estimates of losses on the aforementioned guarantees are based on assumptions and estimates extending over many years into the future. Such estimates are subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should therefore be expected that the actual emergence of losses and loss adjustment expenses will vary, perhaps materially, from any estimate. Among other things, the assumptions could be affected by an increase in unemployment, further decreases in house prices, increase in consumer costs, lower advance rates by lenders or other parties, lower than expected revenues or other events or trends. The Company's estimates are determined based on an analysis of results of a cash flow model.

The cash flow model projects expected cash flows from the underlying mortgage notes. The model output is dependent on, and sensitive to, key input assumptions, including assumptions regarding default rates, draw rates, recoveries and prepayment rates. The cash flow from the mortgages is then run through the "waterfall" as set forth in the indenture for each transaction. Claims in respect of principal result when the outstanding principal balance of the mortgages is less than the outstanding principal balance of the insured notes. Recoveries result when cash flow from the mortgages is available for repayment, typically after the insured notes are paid off in full.

The Company bases its default assumptions for the second lien transactions (HELOCs and CESs) in large part on recent observed default rates and the current pipeline of delinquent loans. At December 31, 2007, the Company had assumed that the peak defaults would occur at the end of 2008 and decline to a steady-state by mid-2009. At December 31, 2008, the Company's assumption is that the peak will occur in mid-2009 and continue until early 2010 with a return to steady-state by the end of 2010. Net losses will be greater if the time it takes the mortgage performance to stabilize is longer than currently anticipated.

The losses for the second lien transactions (HELOCs and CESs) are estimated based on a model using a constant default rate ("CDR") curve. The model anticipates a CDR which would reflect the "rolling" of delinquent loans to loss over a four to seven month time horizon and then assumes a peak CDR plateau through March 2010 followed by a ramping down of CDR over 9 months. After the ramp down, the Company assumes a steady state CDR at a CDR rate well above historical norms until approximately year seven of the deal. By year seven of the deal, the Company assumes another step down to 0% CDR to reflect lower default rates due to seasoning offset by recoveries on previously charged-off loans, based on shape of the CDR curve for a similar product. The CDR is a function of several factors, one of which is the state of the economy and unemployment. If economic conditions remain depressed for longer than expected, the plateau of peak CDR could be longer than modeled. If the plateau were one-quarter longer it would result in an increase in expected unpaid loss of $123 million. If the plateau were one-year longer the expected loss would increase by $410 million.

The Company's default assumptions for 1st lien transactions are based on current delinquent loans and analysis of historical defaults for loans with similar characteristics. A loss severity is applied to the 1st lien defaults ranging from 41-68% based upon actual loss severity observances and collateral characteristics to determine the expected loss on the collateral in those transactions. The Company uses traditional default and prepayment curves to model its unpaid loss.

Through December 31, 2008, the Company has paid claims (net of reimbursements from the transactions) aggregating $513.5 million on its guarantees of obligations discussed above.

The Company has exercised rights available to it in connection with certain RMBS it insured to require the sponsors of such securities to repurchase mortgage loans backing the securities that breached certain representations and warranties. In all or most instances the Company has recorded reserves for unpaid losses and loss adjustment expense on such insured RMBS. While the sponsors have, and may in the future, dispute the repurchase of all or a portion of these mortgages, if the Company is successful in enforcing its rights, whether through litigation or otherwise, it will reduce the ultimate losses expected by the Company on the aforementioned insured securities. As of December 31, 2008 and 2007, the amount of mortgages that the Company is seeking sponsors to repurchase aggregated approximately $771.0 million and $0, respectively. No assurance can be given: (i) that the Company will be successful in enforcing its rights to require sponsors to repurchase the mortgages discussed above, and (ii) in regard to the amount of the potential decrease in reserves for unpaid losses that the Company may be able to record if it is successful. Potential benefit associated with successfully requiring the sponsor to repurchase mortgages, as discussed above, has not been reflected in the Company financial statements.

(b) The Company insured payment of scheduled debt service on sewer revenue warrants issued by Jefferson County, Alabama (the "County") in 2002 and 2003 and, in addition, has provided a surety bond policy in connection therewith. As of December 31, 2008, the outstanding principal amount of such obligations, and the Company's exposure thereto before giving effect to reinsurance and the Company's reserves for losses thereon discussed below, was $1.1 billion (after giving effect to reinsurance and the Company reserves for losses thereon, the Company's exposure was $1.0 billion). Such obligations are secured by a pledge of the net revenues of the County's sewer system. However, the County's sewer system is experiencing severe financial difficulties and in a filing dated February 27, 2008 pursuant to SEC Rule 15c2-12, the County stated it can provide no assurance that net revenues from the sewer system will be sufficient to enable the County to pay, on a timely basis, the scheduled principal and interest obligations of the sewer revenue warrants.

During the year ended December 31, 2008, the Company recorded a provision for losses and loss adjustment expenses, after giving effect to reinsurance, of $26.6 million relating to the warrants, which reflects its best estimate of its ultimate loss thereon. At December 31, 2008, the Company's reserve for unpaid losses and loss adjustment expenses, after giving effect to reinsurance, on the warrants was $22.4 million ($25.6 million before giving effect to reinsurance).

The Company continues to monitor the aforementioned exposure and, as new information becomes available, it may be required to adjust its provision for loss reserves thereon in the future. Through March 30, 2009, the Company has paid gross claims in an aggregate amount of approximately $165.5 million relating to the warrants. In addition, the Company estimates that it may be required to pay claims relating to the warrants over the remainder of calendar year 2009 of approximately $138.0 million. The actual amount of claims the Company may be required to pay in the future may differ from such estimates and the differences could be material.

See Note 17 for information regarding litigation related to the Company's insurance of the warrants.

(c) As of December 31, 2008 and 2007, the Company carried a reserve for unpaid losses and loss adjustment expenses of $41.3 million and $8.7 million after giving effect to reinsurance, respectively, ($41.3 million and $74.0 million, respectively, before giving effect to reinsurance, which was all provided by affiliates of XL Capital), representing the net present value loss expected to be incurred in the future with respect to an insured project financing. Such reserves were based on assumptions and estimates extending over many years into the future. There is currently no payment default with respect to this transaction. Management continues to monitor the exposure and will revise its loss estimate if necessary, as new information becomes available.

In connection with the 2008 MTA (see Note 4), the Company and XL Capital canceled the aforementioned indemnities and commuted the aforementioned reinsurance provided by affiliates of XL Capital in exchange for consideration payable to the Company by affiliates of XL Capital equal to the ceded reserves for unpaid losses and loss adjustment expenses. Also, during the year ended December 31, 2008, the Company decreased the aforementioned reserves from $74.0 million to $41.3 million. The total remaining par insured by the Company in connection with this transaction (net of applicable carried case reserves before reinsurance), which amortizes over the next 10 years, aggregated approximately $224.8 million at December 31, 2008 and $204.6 million at December 31, 2007.

(d) During the year ended December 31, 2008, the Company recorded a provision for losses and loss adjustment expenses of $8.6 million after giving effect to reinsurance relating to a global infrastructure financing that it had reinsured and carried a reserve for unpaid losses and loss adjustment expenses on such reinsured transaction of the same amounts at December 31, 2008. Such reserves were based on assumptions and estimates extending over many years into the future. A claim of $0.9 million was paid on this reinsured transaction in December 2008. Management continues to monitor the exposure and will revise its loss estimate if necessary, as new information becomes available. The total remaining par insured by the Company in connection with this transaction (net of applicable carried case reserves before reinsurance), which amortizes over the next 20 years, aggregated approximately $105.0 million at December 31, 2008. In March 2009, the Company was advised by the ceding company that its share of the estimated reserve they had established on this transaction was approximately $18.0 million. To date, the Company has not completed its assessment of the ceding company's estimated reserve and, therefore, the Company has not adjusted its provision to reflect the ceding company's estimate. See Note 6.

(e) In December 2005, certain notes that were insured by the Company and collateralized by loans to medical providers (the "Insured Notes") defaulted upon their maturity. In satisfaction of the resulting claim, the Company purchased the Insured Notes for $20.2 million, which represented the remaining outstanding principal and accrued interest on the Insured Notes. The Insured Notes were recorded as an investment at their estimated fair value of $19.5 million at the date of acquisition. The difference between the estimated fair value of the Insured Notes at the date they were acquired and the consideration paid to acquire the notes was recorded as a paid loss of $0.7 million. The estimate of fair value of the Insured Notes was based on the Company's estimate of the fair value of the underlying collateral. During 2006, the Company recognized an impairment charge of $15.1 million relating to the Insured Notes and the balance of the Insured Notes was paid down. In addition, during 2006 the Company recorded a charge for $5.0 million relating to other exposures under this transaction. With respect to the aforementioned charges, the Company was indemnified for $6.1 million by XLA pursuant to an indemnification discussed above and in Note 10.

During 2006, the Company also recorded a charge and carried a liability at December 31, 2006 of $5.0 million relating to a dispute in regard to certain claims made by parties associated with the transaction discussed above. Because the Company's liability in regard to this dispute was fully indemnified by XLA pursuant to the indemnification discussed above and in Note 10, the Company also recorded a benefit during 2006 and carried a recoverable from XLA at December 31, 2006 of $5.0 million. During 2007, the Company settled the dispute for $3.9 million and, accordingly, reduced the liability and corresponding recoverable to zero.

(f) During the year ended December 31, 2005, the Company recorded a provision for loss of $5.2 million ($3.4 million after reinsurance) representing the net present value of the loss expected to be incurred in the future with respect to two related insured residential mortgage securitizations.

During 2006, the reinsurance of the aforementioned two residential mortgage transactions was cancelled in settlement of a dispute with the reinsurer. As a result of the cancellation, all ceded premium (which was on an installment basis and consequently fully earned) aggregating $0.4 million, was returned to the Company and the Company's net reserve increased by approximately $1.7 million. Also, during 2006, one of the insured debt obligations was retired early as a result of the exercise of a clean-up call by the entity which transferred the underlying mortgages to the special purpose issuer. As a result of the aforementioned retirement, the Company reduced the related case reserve by approximately $1.9 million. The Company's earnings for 2006 were increased by approximately $0.6 million as a result of the aforementioned returned premium, cancellation, and early retirement. As of December 31, 2006, the Company carried a case basis reserve for this transaction of $3.3 million (none of which was reinsured). During 2007, the insured obligation was retired as a result of the exercise of a clean-up call by the sponsor of the securitization thereby eliminating the Company's exposure without loss. Accordingly, the Company recorded a reduction in its provision for losses and loss adjustment expenses during 2007 of $3.3 million resulting from the elimination of the aforementioned reserve.

(g) During 2007, the Company recorded a provision for loss of $9.5 million representing the net present value of claims expected to be incurred with respect to two related reinsured international transportation project financings. Because this loss represented a full limit loss, the remaining deferred premium revenue pertaining to the transactions, which aggregated approximately $5.5 million, was fully earned resulting in a net loss of approximately $4.0 million.

Unallocated Reserves

While material case basis reserves were established by the Company during the fourth quarter of 2007 and during the year ended December 31, 2008, these reserves were concentrated in certain sectors of its financial guarantee portfolio and were associated with unprecedented credit-market events. As such, these events did not alter management's estimate of the UELR associated with the remainder of the portfolio and, accordingly, the required level of unallocated reserves. For the years ended December 31, 2008, 2007 and 2006, the Company recorded a net provision for unallocated reserves of $4.2 million, $17.5 million and $14.3 million, respectively. The reduction in the

Company's provision for unallocated reserves during the year ended December 31, 2008 was attributable to a significant increase in refunded bonds and other accelerations during such periods. At December 31, 2008 and 2007, the Company's unallocated reserves were $71.6 million and $90.7 million, respectively.

Schedule of Insured Financial Obligations with Credit Deterioration

The Company's surveillance department is responsible for monitoring the performance of its in-force portfolio. The surveillance department maintains a list of credits that it has determined need to be closely monitored and, for certain of those credits, the department undertakes remediation activities it determines to be appropriate in order to mitigate the likelihood and/or amount of any loss that it could incur with respect to such credits.

The Company's surveillance department focuses its review on monitoring the lower rated bond sectors and potentially troubled sectors, which have included RMBS, CMBS, CDOs and CLOs. It tracks performance monthly to try to ensure that covenants have not been breached. If a covenant is breached, the Company may have the right to put the transaction into rapid amortization so that all cash flow generated from that transaction is used to pay down principal and stay current with interest. Typically, the surveillance department reviews periodic servicing and trustee reports to track coverage levels, enhancement levels, delinquency levels, loss frequency, loss severity and total losses and compares such performance metrics with the metrics that were made available at the time the transaction was closed. If losses are above projections, the surveillance department will analyze the reasons for the deviation. In some cases, it may be an indication of servicing problems, where loans are delinquent and are not put into foreclosure in time to maximize recovery. Typically, once per year, the surveillance department will review servicers of loans and other assets supporting the Company's insured obligations to better understand their servicing practices and to identify potential servicing problems, if any. The Company believes that this is an important safeguard, as servicers are required to indemnify the Company against failure to adhere to the servicing standards set forth in the servicing agreements.

The Company's surveillance department also analyzes whether claims on the Company's policies are probable. In some cases, the surveillance department will engage an outside consultant with appropriate expertise in the underlying collateral assets and respective industries to assist management in examining the underlying collateral and determining the projected loss frequency and loss severity. In such case, the surveillance department will use that information to run a cash flow model that includes enhancement levels and debt service to determine whether a claim is probable, possible or not likely.

The activities of the Company's surveillance department are integral to the identification of specific credits that have experienced deterioration in credit quality and the assessment of whether losses on such credits are probable, as well as any estimation of the amount of loss expected to be incurred with respect to such credits. Closely monitored credits are divided into four categories: (i) Special Monitoring List—low investment grade credits where a material covenant or trigger may be breached and closer monitoring is warranted; (ii) Yellow Flag List—credits that the Company determines to be non-investment grade but a loss is unlikely, including credits where claims may have been paid or may be paid but reimbursement is likely; (iii) Red Flag List—credits where a loss is possible but not probable or reasonably estimable, including credits where claims may have been paid or may be paid but full recovery is in doubt; and (iv) Loss List—credits where a loss is probable and reasonably estimable. In general, credits not in the Flag List are considered fundamentally sound, normal risk. These credits are tracked according to a frequency of review schedule. All ABS and CDO credits are reviewed monthly at a minimum. Higher rated municipal credits are reviewed on an exception basis only frequency. Random audit checks are completed annually.

The following table sets forth certain information in regard to the Company's closely monitored credits as of December 31, 2008:

(in millions)	Special Monitoring List	Yellow Flag List	Red Flag List	Loss List	Total
Number of policies	27	8	2	45	82
Remaining weighted-average contract period (in years)	8.6	12.8	3.0	7.2	7.9
Insured contractual payments outstanding:					
Principal	$ 2,911.8	$ 562.2	$ 12.8	$ 6,884.7	$ 10,371.6
Interest	1,319.5	437.6	1.0	1,740.3	3,498.3
Total	$ 4,231.3	$ 999.8	$ 13.8	$ 8,625.0	$ 13,869.9
Gross claim liability	$ —	$ —	$ —	$ 2,949.5	$ 2,949.5
Less:					
Gross potential recoveries	—	—	—	605.5	605.5
PVFIP	—	—	—	19.1	19.1
Discount, net	—		—	674.6	674.6
Claim liability reported in the balance sheet	$ —	$ —	$ —	$ 1,650.3	$ 1,616.2
Unearned premium reserve	$ 3.8	$ 15.8	$ —	$ 32.1	$ 51.7
Reinsurance recoverable	$ —	$ —	$ —	$ 3.1	$ —

16. Income Taxes

Syncora Guarantee Re, prior to the Closing Date, was not subject to any taxes in Bermuda on either income or capital gains under applicable Bermuda law. Effective on the Closing Date, Syncora Guarantee Re redomesticated from Bermuda to the State of Delaware and all the ownership interests in Syncora Guarantee Re, which were owned by Syncora Holdings, were contributed by Syncora Holdings to the Company, and on September 4, 2008 Syncora Guarantee Re merged with and into the Company, with the Company being the surviving company.

The Company is subject to federal, state and local corporate income taxes and other taxes applicable to U.S. corporations, and effective on the Closing Date through September 4, 2008, Syncora Guarantee Re was subject to federal, state and local corporate income taxes and other taxes applicable to U.S. corporations. The U.S. federal income tax liability is determined in accordance with the principles of the consolidated tax provisions of the Internal Revenue Code and Regulations. The Company has subsidiary and branch operations in certain international jurisdictions that are subject to relevant taxes in those jurisdictions. The Company files, and for the period it remained in existence Syncora Guarantee Re will file, a consolidated tax return with Syncora Holdings US Inc. (the U.S. common parent of the Syncora Holdings group) and its subsidiaries (which consists of the Company and Syncora Holdings US Inc.'s other U.S. based subsidiaries). Syncora Guarantee US Inc. maintains a tax sharing agreement with its subsidiaries, whereby the consolidated income tax liability is allocated among affiliates in the ratio that each affiliate's separate return liability bears to the sum of the separate return liabilities of all affiliates that are members of the consolidated group. In addition, a complementary method is used which results in reimbursement by profitable affiliates to loss affiliates for tax benefits generated by loss affiliates.

On the effective date of the merger discussed above, Syncora Guarantee Re's separate existence ceased and from that point forward it was no longer a member of the U.S. consolidated return group.

Management has concluded that results from operations forecasted to be generated in the future is more likely than not insufficient to offset net operating loss carry forwards and cause the realization of the deferred tax assets within a reasonable period, thus a valuation allowance has been established against the entire deferred tax assets of the Company at December 31, 2008 and December 31, 2007. The valuation allowance was calculated in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109") which places primary importance on the Company's operating results in recent periods when assessing the need for a valuation allowance. The Company's cumulative loss in recent periods represents negative evidence sufficient to require a full valuation allowance under the provisions of SFAS 109. The Company intends to maintain a full valuation allowance for its net deferred tax assets until sufficient positive evidence exists to support reversal of all or a portion of the valuation allowance. Until such time, except for state, local and foreign tax provisions, the Company will have no net deferred tax assets.

Section 382 of the Internal Revenue Code ("Section 382") contains rules that limit the ability of a corporation that experiences an "ownership change" to utilize its net operating loss carryforwards ("NOLs") and certain built-in losses recognized in periods following the ownership change. An ownership change is generally any change in ownership of more than 50 percentage points of a corporation's stock over a 3-year period. These rules generally operate by focusing on ownership changes among stockholders owning directly or indirectly 5% or more of the stock of a corporation or any change in ownership arising from a new issuance of stock by the corporation.

On August 5, 2008, Syncora Holdings experienced an ownership change for purposes of Section 382. As a result of this ownership change, the Company's ability to utilize NOLs and certain built-in losses existing as of August 5, 2008 will be subject to an annual limitation in the future. This limitation is generally determined by multiplying the value of Syncora Holdings as of the ownership change date by the applicable long-term tax-exempt rate.

Following the August 5, 2008 ownership change, the Company has generated significant additional NOLs, and depending upon the Company's operating performance in future periods, and may continue to generate additional NOLs. If Syncora Holdings undergoes an ownership change for purposes of Section 382 as a result of future transactions involving its common shares, including purchases or sales of shares between five-percent shareholders, the Company's ability to utilize our NOLs and recognize certain built-in losses would be subject to further limitations under Section 382.

On October 21, 2008, Syncora Holding's Board of Directors approved changes to Syncora Holdings' bye-laws which were subsequently approved by the shareholders on February 9, 2009 to limit the transfer of shares prior to the expiration of certain time periods specified in the such bye-laws to preserve shareholder value and the value of certain tax assets primarily associated with net operating losses (NOLs) and built in losses under Section 382 of the Internal Revenue Code. The Company's ability to use its NOLs and built in losses would be limited, if there was an "ownership change" under Section 382. This would occur if shareholders owning (or deemed under Section 382 to own) 5% or more of Syncora Holdings's stock increased their collective ownership of the aggregate amount of outstanding shares of Syncora Holdings by more than 50% over a defined period of time. The transfer restrictions in the bye-laws reduce the likelihood of an "ownership change" occurring as defined by Section 382.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ("Fin 48"), on January 1, 2007. As of December 31, 2008 and 2007, respectively, the Company had no material unrecognized tax benefit and no adjustments to liabilities or operations were required.

The Company recognizes interest and penalties related to uncertain tax provisions in income tax expense which were zero for the years ended 2008, 2007 and 2006.

Tax years 2005 through 2008 are subject to examination by federal authorities. There are no federal, state or local tax audits underway for the Company as of December 31, 2008.

The Company's income tax provisions for the years ended December 31, 2008, 2007, and 2006 are as follows:

	Year Ended December 31,		
(in thousands)	2008	2007	2006
Current (Benefit) Expense:			
U.S.	$ (2,695)	$ (758)	$ 3,567
Non-U.S.	—	—	—
Total current (benefit) expense	(2,695)	(758)	3,567
Deferred Expense (Benefit):			
U.S.	—	16,756	1,083
Non-U.S.	—	391	(1,517)
Total deferred expense (benefit)	—	17,147	(434)
Total tax (benefit) expense	$ (2,695)	$ 16,389	$ 3,133

Reconciliation of the difference between the provision for income taxes and the expected tax provision at the weighted average tax rate for the years ended December 31, 2008, 2007 and 2006 is provided below:

	Year Ended December 31,		
	2008	2007	2006
(in thousands)			
Expected tax (benefit) expense	$ (1,710,037)	$ (118,395)	$ 984
Adjustments			
Transfer pricing adjustments	—	(1,355)	528
Prior year adjustments	(2,695)	(1,376)	568
Valuation allowance	1,710,037	136,804	700
Non deductible expenses	—	651	263
Foreign taxes	—	21	65
Other	—	39	25
Income tax (benefit) expense	$ (2,695)	$ 16,389	$ 3,133

The weighted average expected tax provision or benefit has been calculated using the pre-tax accounting income or loss in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. The difference between the expected and actual tax benefit or expense for each of the years ending December 31, is primarily attributable to the taxable income or loss in the United States. Prior to the Closing Date, the Company had a facultative quota share reinsurance treaty with Syncora Guarantee Re. Under the terms of this treaty, Syncora Guarantee Re reinsured up to 75% of the guaranty business written by the Company. The pre-tax income earned by Syncora Guarantee Re, which was a Bermuda company, was not subject to U.S. income tax. The components of the net deferred income tax position of the Company as of December 31, 2008 and 2007 are as follows:

(in thousands)	2008	2007
Deferred tax assets		
Deferred ceding commissions, net	$ —	$ 17,363
Unpaid loss reserve discount, net	10,577	2,564
Deferred premium revenue	27,126	2,917
Non-deductible losses incurred	1,385,398	—
Foreign losses	1,904	726
AMT credit	91	—
Unrealized losses on credit derivatives	—	51,978
Net operating losses	529,758	61,816
Capital loss carry forward	54,158	824
Other—net	—	902
Total deferred tax assets	2,009,012	139,090
Deferred tax liabilities		
Unrealized appreciation of investments	659	659
Unrealized gains on credit derivatives	158,116	—
Accretion of discount	2,109	339
Other—net	534	534
Total deferred tax liabilities	161,418	1,532
Net deferred tax asset, gross of valuation allowance	1,847,594	137,558
Valuation allowance	(1,847,594)	(137,558)
Net deferred tax asset	$ —	$ —

17. Commitments and Contingencies

a. Litigation

In the ordinary course of business, the Company is subject to litigation or other legal proceedings. It is the opinion of management, after consultation with legal counsel and based upon the information available, that the expected outcome of any outstanding litigation, individually or in the aggregate, will not have a material adverse effect on the Company's financial position, results of operations or liquidity. The Company intends to vigorously defend itself against all such actions.

In the ordinary course of business, the Company also receives subpoenas and other information requests from regulatory agencies or other governmental authorities. Although no action has been initiated against the Company, it is possible that one or more regulatory agencies or other governmental authorities may pursue action against it. As of March 30, 2009, the Company has had its license suspended, has had an order of impairment issued against it or has voluntarily agreed to cease writing business in ten states. If such an action is brought, it could materially adversely affect the Company's business, results of operations and financial condition.

Set forth below is a description of certain legal proceedings to which the Company's a party.

Municipal Derivatives Antitrust Litigation:

The Company is named as a defendant in related lawsuits, filed from April 2008 through October 2008, which have been consolidated for coordinated preliminary and pretrial proceedings under the caption *In re Municipal Derivatives Antitrust Litigation,* MDL No. 1950, currently pending in the United States District Court for the Southern District of New York. The Company was not named as a defendant in the consolidated amended complaint filed on August 22, 2008. The Company is named as a defendant in a number of complaints filed by California municipal entities against several providers and brokers of municipal derivatives. These complaints allege a conspiracy among the defendants to fix, raise, maintain or stabilize the price of, and to rig bids and allocate customers and market for, municipal derivatives in violation of Federal and/or California State antitrust law and California State common law. The complaints seek unspecified damages and other relief.

Bond Insurers Conspiracy Litigation:

In July 2008 through January 2009, lawsuits were filed by a number of California municipal entities in California state court against several bond insurers, including the Company, and two individual defendants. The complaints include allegations that defendants failed to fully disclose their investments in subprime mortgage-backed securities and insurance of subprime instruments and that the defendants conspired to perpetuate and maintain a dual system of bond rating in violation of California State antitrust laws and California State common law. The complaints seek unspecified damages and other relief.

Jefferson County Litigation:

On June 17, 2008, Charles Wilson, on behalf of himself and a class consisting of every Jefferson County, Alabama taxpayer and sewer ratepayer since January 1, 1993, filed suit against the Company and numerous other defendants. The suit alleges that through the wrongful conduct of the members of the Jefferson County Commission, most notably Larry Langford, the County incurred a bonded indebtedness of approximately $3.2 billion relating to improvements to its sewer system. The complaint alleges that the commissioners, in a conspiracy with several individuals, financial companies, law firms, and bond insurers, completed several swap transactions whereby the bonds, which were primarily fixed interest securities, were swapped to variable rate and auction rate securities. These swaps, the complaint alleges, were done primarily to facilitate the inappropriate payment of exorbitant fees to several bond brokers and financial advisors. With respect to the bond insurers, including the Company, the complaint alleges that the insurers negligently insured the bonds while allowing themselves to become undercapitalized and downgraded by the rating services, which in turn downgraded the bonds. The plaintiffs allege damages on the ground that their sewer rates are much higher than they otherwise would have been without the wrongdoing of all parties. We have filed a motion to dismiss which is currently pending before the court. Plaintiffs have also voluntarily dismissed Jefferson County taxpayers as members of the putative class, leaving only the sewer system ratepayers. Several of the defendants have filed motion seeking recusal of the Judge based on his daughter being a Jefferson County ratepayer, and thus a member of the putative class of plaintiffs.

On August 28, 2008, a complaint was filed by Carnell E. Fowler, William Young, and Citizens for Sewer Accountability, on behalf of the State of Alabama, against the Company and many of the same defendants in the Wilson case above. This complaint asserts claims under Alabama's *quo warranto* statutes, Ala. Code §§ 6-6-590, et seq. *Quo warranto* is an ancient and extraordinary remedy available to annul a corporation's charter and/or preclude it from operating as a corporation in Alabama where the corporation has engaged in such actions as to warrant a forfeiture of its corporate rights and existence. The factual allegations of the complaint virtually mirror those in the Wilson case. The Company has filed a motion to dismiss. Prior to the court's ruling on the motion, the plaintiffs voluntarily dismissed the Company, without prejudice, as a defendant. The court subsequently granted the motions to dismiss filed by several of the remaining defendants, but has granted leave for plaintiffs to file an amended complaint. The amended complaint has yet to be filed, and currently the Company is no longer a defendant to this lawsuit. See Note 15(b) for additional information.

On or around September 16, 2008, the Company, together with the trustee under the indenture for the Jefferson County, Alabama sewer warrants as well as Financial Guaranty Insurance Company, who also insures a portion of the warrants, commenced a lawsuit against the County and its current commissioners in the United States District Court for the Northern District of Alabama seeking, among other things, the appointment of a receiver over the County's sewer system. A hearing on the plaintiff's request for a receiver occurred on March 26, 2009. A decision on the emergency motion for the appointment of a receiver is currently pending. On September 25, 2008, the county filed a counterclaim against the Company and Financial Guaranty Insurance Company alleging negligence, breach of contract, fraud and fraudulent suppression. On March 31, 2009, the Company filed suit against EMC Mortgage Corporation ("EMC") in the United States District Court of the Southern District of New York, alleging that EMC made misrepresentations in connection with a securitization of home-equity loans for which EMC acted as sponsor, and for which the Company acted as credit enhancer, and seeking damages and other relief for breach of contract. See Note 15 (b) for additional information.

Other Litigation:

On or around June 27, 2008, the Company filed suit against IndyMac Bank, F.S.B. in the United States District Court for the Southern District of New York seeking to specifically enforce the terms of a certain insurance and indemnity agreement to which they are parties. Subsequent to the filing of this suit, the Federal Deposit Insurance Corporation ("FDIC") placed IndyMac Bank, F.S.B into conservatorship. We filed a proof of claim with the FDIC on October 10, 2008. This litigation has been stayed until June 2009 to allow the FDIC 180 days to determine whether to allow the proof of claim.

On January 29, 2009, the Company filed suit in the Supreme Court of the State of New York, New York County, against Countrywide Home Loans, Inc., Countrywide Securities Corp., and Countrywide Financial Corp. (collectively referred to as "Countrywide"), alleging that Countrywide made misrepresentations in connection with several securitizations of home equity mortgage loans originated and serviced by Countrywide, and for which the Company acted as credit enhancer, and seeking damages and other relief for fraud and breach of contract.

On February 5, 2009, the Company, together with co-plaintiffs U.S. Bank National Association and CIFG Assurance North America, Inc., filed suit in the Supreme Court of the State of New York, New York County, against GreenPoint Mortgage Funding, Inc. ("GreenPoint"), alleging that GreenPoint made misrepresentations and warranties in connection with a securitization of primarily home-equity mortgage loans originated by GreenPoint, and for which the Company acted as credit enhancer, and seeking damages and other relief for breach of contract.

On April 15, 2009, the Company and Financial Guaranty Insurance Company filed a Notice of Claim indicating their intention to sue the County for fraud.

b. Lease and Other Commitments

The Company's lease commitments are primarily comprised of its office premise leases at 1221 Avenue of the Americas, New York, New York, 25 Copthall Ave—London, Merritt 7 Corporate Park, Norwalk, Connecticut and office space lease commitments with respect to 250 Park Avenue, New York, New York and 595 Market Street, San Francisco, California. In addition, the Company is liable under an information technology outsourcing agreement that it entered into with International Business Machines Corporation ("IBM") on October 1, 2006. Pursuant to the agreement IBM will: (i) provide the Company with all its information technology hardware, (ii) provide all support services to maintain such hardware and provide for efficient disaster recovery, (iii) develop a transition plan for the Company's systems from its existing hardware to new hardware, and (iv) maintain the Company's technology at a level that allows the Company to take advantage of technological advances. In consideration for these services the Company is obligated to pay IBM approximately $4.0 million per annum for the five year term of the contract. The Company incurred expenses of $5.3 million, $4.6 million and $0 under this agreement for the years ended December 31, 2008, 2007 and 2006, respectively.

The table below presents the Company's minimum lease payment obligations under the aforementioned lease commitments and outsourcing agreement, as well as estimated sub-lease income from the sub-lease of space at the aforementioned locations. Net rent expense was $9.5 million, $9.3 million and $6.2 million for the years ended December 31, 2008, 2007, and 2006, respectively.

(in thousands)	Minimum Lease Payments	Sub-lease Income
2009	$ 11,681	$ 882
2010	15,845	889
2011	7,690	891
2012	7,349	931
2013	7,530	854
Later years	60,249	493
Total	$ 110,344	$ 4,940

c. Other Contingencies

See also Note 5 for a description of continuing risks and uncertainties affecting the Company and other information.

18. Disclosures About Fair Values of Financial Instruments

The following estimated fair values have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessary to interpret the data used to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amount the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Debt securities and equity investments: The fair values of the Company's investments are based upon quoted market prices from nationally recognized pricing services or, in the absence of quoted market prices, dealer quotes or matrix pricing.

Cash and cash equivalents: The carrying amount of these items is a reasonable estimate of their fair value due to the short maturity of these instruments.

Deferred premium revenue, net of prepaid reinsurance premiums: The carrying amount of deferred premium revenue, net of prepaid reinsurance premiums, represents the Company's future premium revenue, net of reinsurance, on policies where the premium was received at the inception of the insurance contract. The fair value of deferred premium revenue, net of prepaid reinsurance premiums, is an estimate of the premiums that would be paid under a reinsurance agreement with a third party to transfer the Company's financial guarantee risk, net of that portion of the premiums retained by the Company to compensate it for originating and servicing the insurance contract.

Losses and loss adjustment expenses, net of reinsurance balances recoverable: The carrying value is assumed to be fair value, because the provision is established for non-specific expected levels of losses resulting from credit failures.

Installment premiums: The fair value of installment premiums is estimated based on the present value of the future contractual premium revenues, net of reinsurance, that would be paid under a reinsurance agreement with a third party to transfer the Company's financial guarantee risk, net of that portion of the premium retained by the Company to compensate it for originating and servicing the insurance contract. The fair value is derived by calculating the present value of the estimated future cash flow stream (net premium and ceding commissions) discounted at 7.0% at December 31, 2008 and 2007.

	2008		2007	
(in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Debt securities, short-term investments and other invested assets	$ 2,008,294	$ 2,008,294	$ 2,430,772	$ 2,430,772
Cash and cash equivalents	526,759	526,759	217,426	217,426
Liabilities				
Deferred premium revenue, net of prepaid reinsurance premiums	648,137	525,692	826,263	586,066
Loss and loss adjustment expenses, net of reinsurance recoverable on unpaid losses	1,680,176	1,680,176	135,574	135,574
Off-Balance Sheet Instruments				
Installment premiums	—	706,403[1]	—	839,209

[1] Includes $129.6 million which is netted against certain of the Company's case basis reserves for losses and loss adjustment expenses at December 31, 2008. See Note 15.

19. Dividend Restrictions and Certain Regulatory Information

The ability of the Company to declare and pay Syncora Holdings a dividend is governed by the Insurance Law of the State of New York (the "Insurance Law"). Under the Insurance Law, the Company is permitted to pay dividends each calendar year, without the prior approval of the New York Superintendent in an amount equal to the lesser of ten percent of its policyholders' surplus as of the end of the preceding calendar year or its net investment income for the preceding calendar year, as determined in accordance with Statutory Accounting Practices prescribed or permitted by the NYID. The Insurance Law also provides that the Company may distribute dividends to its shareholders in excess of the aforementioned amount only upon giving notice of its intention to declare such dividend, and the amount thereof, to the New York Superintendent. Moreover, a New York-domiciled insurer may not declare or distribute any dividends except out of earned surplus. The New York Superintendent may disapprove such distribution if he finds that the financial condition of the Company does not warrant such distribution.

In connection with the 2008 MTA discussed in Note 4, the Company entered into an undertaking with the NYID pursuant to which it agreed not to make any dividends or distributions without the NYID's express written consent until November 18, 2010 (two years after the shares of Syncora Holdings were placed into trust for the benefit of the Company and the Counterparties).

Among other requirements, Article 69 of the Insurance Law provides that financial guarantee insurance companies maintain minimum policyholders' surplus of $65 million. As of December 31, 2008, the Company reported a policyholders' deficit of $2.4 billion and, accordingly, was not in compliance with its minimum policyholders' surplus requirement. As discussed in Note 2, failure to maintain positive statutory policyholders' surplus or non-compliance with the statutory minimum policyholders' surplus requirement permits the NYID to intervene in the Company's operations. For example, under these or certain other circumstances, the New York Superintendent could seek court appointment as rehabilitator or liquidator of the Company.

For the years ended December 31, 2008 and 2007, the Company reported, in accordance with accounting practices prescribed or permitted by the NYID (see Note 2), net loss of $4.8 billion and $522.3 million, respectively, and a policyholders' deficit of $2.4 billion as of December 31, 2008, as compared to a policyholders' surplus of $138.9 million at December 31, 2007.

20. Other Matters

To reduce long-term operating costs and align resources with its current needs (see Note 2), effective March 31, 2008 the Company reduced its workforce by approximately 60 positions, which consisted primarily of insurance business origination staff. Subsequently, the Company made certain further reductions in its workforce. As a result of these workforce reductions the Company recorded a charge of approximately $19.5 million during the year ended December 31, 2008.