SYNCORA HOLDINGS LTD.

CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

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Independent Auditor's Report

To the Board of Directors and Shareholders of Syncora Holdings Ltd.:

We have audited the accompanying consolidated financial statements of Syncora Holdings Ltd. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations and shareholders' deficit and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Syncora Holdings Ltd. and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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, the

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risk of adverse loss development on the Company's remaining in-force business and the Company's ability to maintain adequate liquidity represent significant uncertainties that raise substantial doubt about the Company’s ability to continue as a going concern. Management’s plans in regard to these matters are described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

PricewaterhouseCoopers LLP

June 11, 2013

SYNCORA HOLDINGS LTD.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2012 and 2011
(U.S. dollars in thousands, except share and per share amounts)

	2012	2011
ASSETS		
Debt securities available for sale, at fair value (amortized cost: $1,300,931 and $984,304)	$ 1,362,797	$ 1,021,524
Other invested assets, at fair value	10,273	5,583
Cash and cash equivalents	115,418	156,607
Total cash and invested assets	1,488,488	1,183,714
Restricted cash and cash equivalents	709	5,518
Accrued investment income	9,236	9,898
Deferred acquisition costs, net	95,270	106,361
Prepaid reinsurance premiums	4,873	5,310
Premiums receivable	227,493	276,637
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	3,715	5,023
Salvage and subrogation recoverable	139,226	209,398
Credit default and other swap contracts, at fair value	212,116	401,082
Receivables on insurance cash flow certificates, net	278,315	91,950
Replacement bank warrants, at fair value (face value: $197,332 and $167,942)	138,132	100,765
Interest rate derivative instrument, at fair value	—	192
Other assets	30,895	28,108
Assets of consolidated variable interest entities, at fair value	473,912	440,117
Total assets	$ 3,102,380	$ 2,864,073
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Liabilities		
Unpaid losses and loss adjustment expenses	$ 1,232,045	$ 1,020,032
Unearned premium revenue	662,014	762,616
Credit default and other swap contracts, at fair value	590,382	1,271,546
Notes payable (par value: $702,553 and $715,801)	292,401	283,045
Payable for securities purchased	1,019	3,538
Reinsurance premiums payable	1,568	1,584
Accounts payable, accrued expenses and other liabilities	52,835	46,272
Liabilities of consolidated variable interest entities, at fair value	333,486	239,398
Total liabilities	3,165,750	3,628,031
Shareholders' deficit		
Non-controlling interest in subsidiary- Series B non-cumulative preferred shares of Syncora Guarantee Inc. (2,000 shares issued and 1,345 shares outstanding); ($200,000 liquidation preference); 655 preferred shares held by Syncora Guarantee Inc	13,453	20,000
Series A perpetual non-cumulative preferred shares (250,000 shares authorized, issued and outstanding, $0.01 par value) and additional paid-in capital ($250,000 liquidation preference)	246,593	246,593
Common shares (500,000,000 shares authorized; 59,336,686 shares issued; $0.01 par value) and additional paid-in capital	2,681,713	2,675,166
Accumulated deficit	(3,122,287)	(3,780,620)
Accumulated other comprehensive income	117,158	74,903
Total Syncora Holdings Ltd. common shareholders' deficit	(323,416)	(1,030,551)
Total Syncora Holdings Ltd. shareholders' deficit	(76,823)	(783,958)
Total shareholders' deficit	(63,370)	(763,958)
Total liabilities and shareholders' deficit	$ 3,102,380	$ 2,864,073

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND SHAREHOLDERS' DEFICIT
YEARS ENDED DECEMBER 31, 2012 and 2011
(U.S. dollars in thousands)

	2012	2011
Revenues		
Net premiums earned	$ 90,243	$ 96,299
Net investment income	37,357	43,063
Net realized gains on investments, net of other-than-temporary impairment losses of $(3,271) and $(2,984)	11,352	15,999
Net earnings on insurance cash flow certificates	458,598	186,528
Fee income and other	27,515	12,018
Gain on extinguishment of notes payable	18,097	—
Change in fair value of credit default and other swap contracts:		
Realized gains and other settlements	21,695	27,572
Net unrealized gains	432,021	276,497
Net change in fair value of credit default and other swap contracts	453,716	304,069
Net change in consolidated variable interest entities	(31,644)	20,345
Total revenues	1,065,234	678,321
Expenses		
Net losses and loss adjustment expenses	292,174	279,725
Amortization of deferred acquisition costs, net	11,091	15,022
Realized loss on interest rate derivative instrument	192	3,610
Foreign currency exchange loss	2,369	3,800
Operating expenses	98,462	132,388
Total expenses	404,288	434,545
Income before income tax expense	660,946	243,776
Income tax expense	2,613	4
Net income	658,333	243,772
Other comprehensive income:		
Net unrealized gains on investments	42,255	7,407
Comprehensive income	700,588	251,179
Receipt of non-controlling interest in subsidiary- Series B non-cumulative preferred shares of Syncora Guarantee Inc.	(6,547)	—
Change in common shares and additional paid-in capital	6,547	—
Change in shareholders' deficit	700,588	251,179
Total shareholders' deficit—beginning of period	(763,958)	(1,015,137)
Total shareholders' deficit—end of period	$ (63,370)	$ (763,958)

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 and 2011
(U.S. dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Premiums collected	$ 36,876	$ 42,550
Investment income collected	37,308	42,969
Fees received on credit default swaps	22,519	32,357
Losses paid on credit default swaps	(1,000)	(20,922)
Fees paid for other derivative swaps	(60,000)	—
Interest collected on Replacement Bank Warrants	13,135	8,699
Reinsurance recoveries collected on paid losses	—	1,308
Cash received for settlements	375,000	—
Claims paid to policyholders	(374,142)	(435,841)
Operating expenses paid	(104,421)	(100,413)
Income taxes paid	(682)	(95)
Cash paid for Insurance Cash Flow Certificates	(29,149)	(15,013)
Cash received on Insurance Cash Flow Certificates	309,547	374,248
Transfers from restricted cash	4,808	96,701
Other cash receipts (disbursements)	2,608	(11,676)
Investment income collected by variable interest entities	20,022	38,675
Interest and other expenses paid by variable interest entities	(15,422)	(29,025)
Net cash provided by operating activities	237,007	24,522
Cash flows from investing activities:		
Net proceeds from sales of debt securities	421,508	432,854
Net proceeds from maturity of debt securities	154,344	122,790
Purchases of debt securities	(864,263)	(894,252)
Net (purchases) proceeds from consolidated variable interest entities' assets	(42,690)	205,037
Net cash used in investing activities	(331,101)	(133,571)
Cash flows from financing activities:		
Net paydowns of consolidated variable interest entities' liabilities	52,905	(147,636)
Net cash provided by (used in) financing activities	52,905	(147,636)
Decrease in cash and cash equivalents	(41,189)	(256,685)
Cash and cash equivalents—beginning of period	156,607	413,292
Cash and cash equivalents—end of period	$ 115,418	$ 156,607
Supplemental non-cash flow information:		
Transfer of short-term and long-term notes	28,409	—
Transfer of non-controlling interest in subsidiary- Series B non-cumulative preferred shares of Syncora Guarantee Inc	6,547	—

See accompanying Notes to Consolidated Financial Statements.

1. Organization and Business

Syncora Holdings Ltd. ("Syncora Holdings") is a Bermuda holding company, which was formed on March 17, 2006 that provided, through its wholly-owned subsidiaries, financial guarantee insurance and reinsurance. Syncora Holdings collectively with its consolidated subsidiaries is hereafter referred to as the ("Company").

Syncora Holdings principal business operating subsidiaries consist of Syncora Guarantee Inc. ("Syncora Guarantee") and Syncora Guarantee's wholly-owned subsidiaries, Syncora Capital Assurance Inc. ("Syncora Capital Assurance") and Syncora Guarantee (U.K.) Ltd. ("Syncora Guarantee-UK").

Syncora Guarantee is an insurance company domiciled in the State of New York, which is regulated by the New York State Department of Financial Services and at one time was licensed to conduct financial guarantee insurance business throughout all 50 of the United States and other jurisdictions. However, because of the events discussed herein, Syncora Guarantee no longer writes insurance business nor is Syncora Guarantee licensed to do so in certain states and other jurisdictions. Syncora Guarantee ceased writing substantially all new business in January 2008. Syncora Guarantee, however, collects and expects to continue to collect premiums on existing business in such states and jurisdictions. See Note 17 for further discussion.

Syncora Capital Assurance is a New York domiciled financial guarantee insurance company regulated by the New York State Department of Financial Services, which was formed and commenced operations on July 15, 2009, in connection with the restructuring of Syncora Guarantee as discussed in Note 3. Syncora Capital Assurance is prohibited from writing new business and, therefore, does not intend to seek to obtain licenses to transact new insurance business in any other state or jurisdiction.

Syncora Guarantee-UK is a domiciled and licensed financial guarantee insurance company formed in the United Kingdom and is regulated by the Financial Services Authority ("FSA") in the United Kingdom. In 2009, Syncora Guarantee-UK's application to remove its authority to effect new contracts of insurance was approved by the FSA.

Prior to January 2008, the Company was primarily engaged in the business of providing (i) credit enhancement on fixed and variable rate debt obligations through the issuance of financial guarantee insurance policies and (ii) credit protection on specific referenced credits or on pools of specific referenced credits through the issuance of financial guarantee insurance policies covering the obligations under credit default swap ("CDS") contracts issued by trusts established to comply with the New York Insurance Law (the "NYIL"). These trusts are consolidated by the Company.

Financial guarantee insurance policies obligate the insurer to provide an unconditional and irrevocable guarantee to the holder of a debt obligation of full and timely payment of certain principal and interest when due. In the event of a default under the debt obligation, the insurer has recourse against the issuer and/or any related collateral (which is more common in the case of insured asset-backed obligations or other non-municipal debt) for amounts paid under the terms of the policy. CDS contracts are derivative contracts that offer credit protection relating to a particular security or pools of specified securities. Under the terms of a CDS contract, 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 security. Credit derivatives typically provide protection to a buyer rather than credit enhancement of a debt security as in traditional financial guarantee insurance.

2. Countrywide Settlement, Description of Continuing Significant 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

Countrywide Settlement

On July 17, 2012, Syncora Guarantee settled its RMBS-related claims and other claims with Countrywide, Bank of America Corp. ("BAC") and affiliates thereof.

In return for releases of all claims Syncora Guarantee had against Countrywide and BAC arising from its provision of insurance in relation to five second lien transactions that were the subject of litigation and all of the Syncora Guarantee's claims in relation to nine other first and second lien transactions, Syncora Guarantee received a cash payment of $375.0 million.

In addition to the Countrywide settlement and in an effort to terminate other relationships between the parties, Syncora Guarantee transferred certain assets to subsidiaries of BAC and subsidiaries of BAC transferred or agreed to transfer to Syncora Guarantee or its designee certain of Syncora Guarantee's and the Company's preferred shares, notes and other securities. The transfer of the Company's preferred shares and other securities remains subject to the Company's Board approval. As discussed above, on July 17, 2012, Syncora Guarantee transferred to subsidiaries of BAC certain RMBS Uninsured Cash Flow Certificates. Syncora Guarantee recorded a gain of approximately $16.0 million on such sale in the third quarter of 2012. In addition, subsidiaries of BAC transferred to Syncora Guarantee, short-term and long-term notes of Syncora Guarantee, with an aggregate original principal amount

of $40.7 million and preferred stock, with a par value of $65.5 million, issued by Syncora Guarantee, which were held by BAC's subsidiaries. As a result of the transfer of short-term and long-term notes from BAC to Syncora Guarantee, the Company recorded an $18.1 million gain on extinguishment of debt and $10.4 million of other income in the Company's consolidated statements of operations.

Significant Risks and Uncertainties

Given the significant risks and uncertainties discussed below and that the Company has a $323.4 million common shareholders' deficit and its capitalization includes debt, in the form of surplus notes, with a par value of $703 million, as well as preferred stock with an aggregate liquidation value of $450 million, the Company believes that there will likely be very little, if any, residual value available to the common shareholders of Syncora Holdings and cautions investors that an investment in Syncora Holdings common shares is extremely speculative and is likely to result in a loss of substantially all of their investment. Additionally, given the risks outlined below, including those with respect to Syncora Holdings' liquidity position and Syncora Guarantee's liquidity and surplus position, the Company cautions investors that investment in the preferred shares of Syncora Holdings or Syncora Guarantee or an investment in Syncora Guarantee's surplus notes should also be considered speculative.

Syncora Holdings is a holding company with no operations or significant assets other than $10.7 million of debt securities and cash and cash equivalents and its common equity ownership of its subsidiaries. Syncora Holdings only potential sources of funds are dividends and/or reimbursements for certain expenses related to the general services agreement with its subsidiaries to provide funds for its working capital needs and to pay operating expenses. The remainder of its capital is held at Syncora Guarantee and Syncora Capital Assurance, and any dividends and/or distributions from these entities are subject to contractual and regulatory prohibitions and limitations and to the prior claims of Syncora Guarantee's surplus noteholders and preferred shareholders. There can be no assurance that Syncora Holdings will be able maintain adequate capital or have sufficient liquidity in the future to pay its operating expenses. See Note 21 for condensed financial information of Syncora Holdings.

Despite the Company's litigation settlement with Countrywide and all its remediation transactions, the Company's only direct operating subsidiary Syncora Guarantee continues to be exposed to certain significant risks and uncertainties that could materially adversely affect its results of operations, financial condition and liquidity position. These relate to, among other things, (i) a potential liquidity mismatch resulting from the timing of anticipated future claims payments and subsequent cash recoveries related to these claims payments (ii) the potential for future adverse loss and claims development on its insured obligations, (iii) the failure to receive payments on its Insurance Cash Flow Certificates, (iv) the resolution of various litigation matters, including recoveries from the Company's insurance policy litigation claims, and (v) the failure to receive interest payments from Syncora Capital Assurance on its remaining surplus note. These risks, in turn, materially adversely affect the results of operations, financial condition and liquidity of Syncora Holdings. The aforementioned risks and uncertainties are discussed more fully below.

- The Company in connection with its subsidiary, Syncora Guarantee continues to face a potential "liquidity mismatch" between expected future medium to long term claim payments and recoveries relating to such claims. This potential liquidity mismatch results primarily from substantial claims payments that the Company anticipates it will be obligated to make beginning in 2017, followed in later years (in some cases significantly later years) by anticipated recoveries of these claims payments. The amount and timing of the recoveries related to the anticipated future claims payments are subject to greater uncertainty than the amount and timing of such future claims payments themselves. If realized, this liquidity mismatch is projected to have a material adverse effect on the Company, including its expected future liquidity position, and could have a material adverse effect on the Company's ability to satisfy its future medium to long-term obligations, including policyholder claims, interest and principal payments on its surplus notes, and other obligations. Because of the inherent uncertainty in estimating future claim payments and recoveries, no assurance can be given that the actual severity or timing of claims payments, related recoveries, or ultimate losses will not be different than the Company's estimates, and such differences could be material. Further, no assurance can be given that the Company will be successful in further enhancing liquidity or mitigating adverse developments associated with its future claim payments, recoveries, reserves for losses or the aforementioned potential liquidity mismatch. Future adverse loss and claims development also may have a material adverse effect on the Company's financial position and results of operations, potentially causing it to report a policyholders' deficit or not to comply with the statutory minimum policyholders' surplus of $65.0 million. There can be no assurance that, were such adverse loss and claims development to occur, the Company would be able to remediate any such losses or restore such policyholders' surplus in a timely manner or at all. The Company may experience significant adverse development on its insured obligations that may place further demands on the Company's near term liquidity and surplus. The Company cannot provide any assurance that, were it to experience further adverse loss and claims development, the New York State Department of Financial Services ("NYDFS") would not take regulatory action, which may include commencement of rehabilitation or liquidation proceedings.

- The Company is exposed to significant refinancing risks in its insured and reinsured portfolio. The Company had assumed at origination that certain of the debt issuances insured could be refinanced in the market. The Company is exposed to this risk and,

accordingly, may be required to make claims payments and then seek to recover its payments from revenues produced by the transaction. The Company believes it has reserved appropriately to reflect this risk but a more difficult refinancing market at the time of refinancing could lead to the Company facing additional, material claims and losses (see the discussion of the potential "liquidity mismatch" described above). Through its guarantees of certain collateralized debt obligations ("CDOs"), the Company is also indirectly exposed to refinancing risk associated with debt obligations held or referenced in these portfolios. The underlying asset types for which refinancing risk is a factor primarily include US collateralized loan obligations ("CLOs"), European CLOs and commercial mortgage-backed securities ("CMBS") CDOs.

- The Company has direct insurance and reinsurance (including reinsurance ceded by its subsidiary Syncora Guarantee-UK) exposure to certain credits within European countries. The global market and economic conditions have been negatively affected with concerns about the continued sovereign debt crisis within the European region and the possibility that certain European Union member states will default on their debt obligations or leave the European Union. The continued uncertainty over the outcome of the European Union governments' efforts to provide financial support for sovereigns and sub-sovereigns and the possibility of further deteriorating conditions in Europe could have a material adverse effect on the Company's financial and liquidity position. As of December 31, 2012, the Company's in-force guaranteed principal exposure to the European Union was approximately $12.6 billion of which $563.0 million was specifically related to certain credits in higher risk countries, such as Portugal, Italy and Spain. See Note 11.

- In the United States, the unemployment rate remains high and housing markets remain fragile despite some stabilization. The Company and its financial position will continue to be subject to risk of global financial and economic conditions that could materially and adversely affect the amount of losses, (including the timing and amount of claims and subsequent recoveries) incurred on transactions it guarantees, the value of its investment portfolio, and otherwise materially and adversely affect the Company. Issuers or borrowers whose securities or loans the Company insures or holds as well as the Company's counterparties under swaps and other derivative contracts may default on their obligations to the Company due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting securities that the Company has guaranteed may deteriorate further, causing these securities to incur losses.

- The Company is materially exposed to foreign exchange risk as the Company's insured debt obligations are denominated in a number of foreign currencies and the U.S. dollar. The principal currencies creating foreign exchange risk are the British pound sterling, Australian dollar and the European Union euro. At current exchange rates, approximately $14.1 billion of the Company's in-force guaranteed net par outstanding exposure of $66.9 billion at December 31, 2012 was denominated in such currencies. The Company translates foreign currencies into U.S. dollars at the current market exchange rates. Changes in the exchange rates between foreign currencies and U.S. dollars may have an adverse effect on the settlement of potential claims and therefore could have a material adverse effect on the Company's liquidity and surplus position. See Note 11. In addition, the Company is materially exposed to risks associated with its financial guarantees covering foreign denominated inflation indexed-linked bonds in connection with the bonds issued by UK and European utility and project finance issuers.

- The Company continues to be materially exposed (directly and indirectly) to risks associated with any continuing deterioration in the residential mortgage market through its guarantees of RMBS, as well as other bond sectors to which it has material exposure, including the structured single risk, public finance, commercial mortgage, and corporate loan bond sectors. The extent and duration of any continued deterioration of the credit markets is unknown, as is the effect, if any, on: (i) potential claim payments and the ultimate amount of losses the Company may incur on obligations it has guaranteed and (ii) potential losses the Company may incur on its invested assets.

- On November 9, 2011, Jefferson County, Alabama ("Jefferson County") filed for bankruptcy protection under Chapter 9 of the United States Bankruptcy Code. The Company continues to have significant exposure to Jefferson County.

  The Company entered into a plan support agreement ("PSA"), dated as of June 6, 2013, with Jefferson County and other bond insurers that insure Jefferson County sewer obligations. This conditional settlement agreement provides a framework for resolving Jefferson County's overall sewer indebtedness and the Company's exposure thereto through a consensual plan of debt readjustment (the "Plan").

  Notwithstanding this development, the Company remains exposed to event-driven risks, such as adverse outcomes or rulings in Jefferson County's bankruptcy proceedings, which could have a material adverse effect on the Company's liquidity and financial position. The Company also remains exposed to the risks and uncertainties inherent in Jefferson County's ability to consummate the Plan as contemplated or at all, including the approval thereof by the bankruptcy court, the execution of an approximately $2.0 billion refinancing transaction and its inherent interest rate and market risks, and the satisfaction of the other necessary conditions to effectuate the Plan.

No assurances can be given that the Plan will be approved or consummated on the terms contemplated or at all. If the Plan is implemented as contemplated, the Company's losses with respect to Jefferson County are currently estimated to be within its established loss reserves. Likewise, while consummation of the Plan would be expected to positively affect the Company's cash position, it is not expected to mitigate the potential "liquidity mismatch" between the Company's expected future medium to long-term claim payments and recoveries relating to such claims and the other significant risks and uncertainties described herein.

- The Company also continues to have significant exposure to a number of large structured single risk transactions with material risk of adverse development, including to event driven risks, such as political, operational, bankruptcy, legal and regulatory actions. Such adverse events could have a material adverse effect on the Company's liquidity and financial position.

- Any payment of principal or interest on the long-term surplus note issued by Syncora Capital Assurance, which is held by Syncora Guarantee, is subject to the satisfaction of conditions precedent, including, without limitation, prior regulatory approval by the NYDFS and compliance with contractual restrictions in the 2009 MTA. On November 8, 2012, the NYDFS approved the payment due on December 28, 2012 by Syncora Capital Assurance to Syncora Guarantee on its long-term surplus note. No assurance can be given as to whether and when the NYDFS will approve future payments on Syncora Capital Assurance's long-term surplus note. The failure of Syncora Guarantee to receive all future payments due from Syncora Capital Assurance could have a material adverse effect on Syncora Guarantee's anticipated liquidity position.

- Any payment of principal or interest on the short-term and long-term surplus notes issued by Syncora Guarantee is subject to the satisfaction of conditions precedent, including, without limitation, prior regulatory approval by the NYDFS. Syncora Guarantee was obligated by the terms of its short-term surplus notes to pay the outstanding principal balance of $150 million, together with paid-in-kind interest of approximately $15.4 million and accrued and unpaid interest of $4.2 million, totaling approximately $169.6 million, on December 28, 2011, however, the NYDFS did not approve the payment, and accordingly, the payment was not made. Further, in November 2012, Syncora Guarantee again sought approval for payment on its short-term surplus notes, and on November 8, 2012 the NYDFS did not approve such payment. Notwithstanding the Company's litigation settlement with Countrywide and its remediation transactions, Syncora Guarantee remains exposed to significant risks and uncertainties that may materially and adversely affect its financial condition, liquidity position and ability to make payments on its surplus notes. Consequently, there is significant uncertainty and there can be no assurance as to whether and when the NYDFS will approve any future payments on the short-term or long-term surplus notes. Any payment by Syncora Guarantee of principal or interest on its short-term or long-term surplus notes could have a potential material adverse effect on Syncora Guarantee's prospective policyholders' surplus and liquidity position.

- Syncora Guarantee also holds 100% of the common shares issued by Syncora Capital Assurance. Syncora Capital Assurance's ability to pay dividends on such common shares is subject to risks and uncertainties, including, without limitation, prior regulatory approval by the NYDFS and compliance with certain contractual restrictions. No assurance can be given as to whether or when Syncora Guarantee or Syncora Capital Assurance may be able to pay any dividends on its preferred and/or common shares.

- As discussed in more detail in Note 10, Syncora Guarantee has exercised rights available to it in connection with certain RMBS it insures and has issued put-back notices to certain sponsors of such securities to require the repurchase of mortgage loans which back the securities and has recorded a reduction in its statutory reserves for losses of $85.3 million at December 31, 2012, reflecting an estimate of its ultimate recovery from such repurchases. Certain sponsors have disputed Syncora Guarantee's right to require them to repurchase the aforementioned mortgages and Syncora Guarantee is involved in litigation with the sponsors to enforce its rights. If Syncora Guarantee is unsuccessful in enforcing its rights and does not realize the benefit it recorded through the aforementioned reduction in its reserves as and when expected, it may have a material effect on Syncora Guarantee's anticipated liquidity position and material adverse effect on Syncora Guarantee's policyholders' surplus, which Syncora Guarantee would have to report to the NYDFS. Likewise, if Syncora Guarantee is successful in enforcing its rights in an amount greater than the benefit it recorded through the aforementioned reduction in reserves, it may have a materially positive effect on Syncora Guarantee's liquidity position and policyholder surplus. The aforementioned benefit recorded as a reduction in statutory reserves of $85.3 million compares to Syncora Guarantee's policyholders' surplus at December 31, 2012 of $510.7 million. Syncora Guarantee periodically engages in discussions with the sponsors aimed at attempting to resolve these claims before trial. While a negotiated resolution with one or more of the sponsors could result in an amount below that recorded in the aforementioned reserve reductions, it could also result in an amount greater than such reductions.

- As a result of the RMBS Fund (as defined in Note 3), alternative transactions effectively replicating such RMBS and direct purchases of insured securities the Company has effectively defeased or, in substance, commuted its exposure to certain insured transactions. The effectiveness of these structures is dependent upon the ability of the Company to receive payments on its Insurance Cash Flow Certificates. Failure of the Company to receive these payments would have a material adverse effect on the Company.

- The Company's estimate of reserves for losses on its exposures is based on certain assumptions. Changes in such assumptions could materially adversely affect such reserves estimates, including the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company, these exposures may result in significant increases in claims beyond that assumed in the Company's reserve estimate (that may or may not result in an increase in such loss reserves) against the Company in the near to medium term.

- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on the Company's in-force business requires the use and exercise of significant judgment by management, including estimates regarding the likelihood of occurrence, timing and amount of a loss on a guaranteed obligation. A material portion of the Company's case basis reserves reflect certain assumptions with respect to recoveries on rights available to the Company in connection with certain RMBS it insures that require the sponsors of such securities to repurchase mortgage loans that breached certain representations and warranties (see Note 10). Similarly, a material portion of the Company's case basis reserves reflects certain assumptions that affect reimbursements in the remainder of its insured and reinsured portfolio. Actual experience may, and likely will, differ from those 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, changes in the value of specific assets supporting guaranteed obligations, changes in the level of investment yield and changes in the timing, level of success and collectability of the aforementioned mortgage loan repurchases. Both qualitative and quantitative factors are used in making such estimates. From time to time the Company reevaluates all such estimates. Changes in these estimates may be material. 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 risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed (see Note 11).

- Failure to make claim payments by Syncora Guarantee and Syncora Capital Assurance in the future (see discussion of regulatory and legal matters below) 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 CDS contracts guaranteed by Syncora Guarantee on which Syncora Guarantee fails to pay a claim, and policyholders potentially withholding premium payments. There can be no assurance that there would not be other material adverse consequences of Syncora Guarantee's and Syncora Capital Assurance's failure to make claim payments.

- The Company is involved in a number of legal proceedings, both as plaintiff and defendant. Management cannot predict the outcomes of these legal proceedings and other contingencies with certainty. The outcome of some of these legal proceedings and other contingencies could require the Company to take or refrain from taking actions which could adversely affect its business or could require the Company to pay (or fail to receive) substantial amounts of money. Similarly, a favorable outcome of the suits where the Company is the plaintiff, could entitle the Company to receive (directly or indirectly) substantial recoveries. A favorable or unfavorable outcome could have a material effect on the Company's policyholders' surplus and liquidity position. Prosecuting and defending these lawsuits and proceedings involves significant expense and diversion of management's attention and resources from other matters. See Note 17.

- The Company continues to be materially exposed (directly and indirectly) to risks associated with the financial condition of other financial guarantors, including the placement of a financial guarantor into rehabilitation or liquidation. Such exposure may arise as a result of (i) direct contractual dealings with a financial guarantor such as reinsurance (whether as ceding company or reinsurer), or (ii) indirectly by means of (a) "wrapping over" another financial guarantor (which exposes Syncora Guarantee to the credit risks of the insured transaction directly) or (b) participating in an insured transaction with such other financial guarantor (where such rehabilitation or liquidation could have an effect on the insured transaction or the rights and remedies available to the Company). The ultimate effects of the financial condition of other financial guarantors or any such rehabilitation or liquidation are 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 such effects may be materially adverse to the Company's financial position.

- In addition to exposure to general economic factors, the Company is exposed to the specific risks faced by the particular businesses, municipalities or pools of assets covered by its financial guarantee products. Recently, in light of the economic and financial crisis, the U.S. "fiscal cliff", unemployment challenges and the continuing European solvency crisis, various businesses and municipalities are facing financial difficulties. In addition, catastrophic events or terrorist acts could adversely affect the ability of public sector issuers to meet their obligations with respect to securities insured by the Company and the Company may incur material losses due to these exposures if the economic stress caused by these or other events is more severe than the

Company currently foresees. Other events, such as interest rate changes or volatility, could, in certain instances, also materially affect the Company or its insured obligations.

- The economic crisis caused many state and local governments that issue some of the obligations the Company insures to experience significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations. If the issuers of the obligations in the Company's public finance portfolio do not have sufficient funds to cover their expenses and are unable or unwilling to raise taxes, decrease spending or receive federal assistance, the Company may experience increased levels of losses or impairments on its public finance obligations, which could materially and adversely affect its business, financial condition and results of operations.

- In addition, obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, may be adversely affected by revenue declines resulting from reduced demand, changing demographics or other factors associated with an economy in which unemployment remains high, housing markets have not yet stabilized and growth is slow. These obligations, which may not necessarily benefit from financial support from other tax revenues or governmental authorities, may also experience increased losses if the revenue streams are insufficient to pay scheduled interest and principal payments.

- Changes in laws and regulations affecting insurance companies, the municipal and structured securities markets, the financial guarantee insurance and reinsurance markets and the credit derivatives markets, as well as other governmental regulations, may subject the Company, its affiliates and subsidiaries to additional legal liability and regulatory requirements, affect the credit performance of the securities that the Company insures and otherwise affect the Company’s financial condition.

- Syncora Capital Assurance has significant exposure to public finance transactions. Certain of these exposures, including the City of Detroit, have a risk of material adverse development to event driven risks such as political, operational, legal and regulatory actions. Such adverse events could have a material adverse effect on the Company's liquidity and financial position.

- Syncora Capital Assurance believes conditions exist, which would allow a limited number of beneficiaries of insured interest rate swaps the opportunity to declare termination events under the applicable insured interest rate swaps, and should the financially-weak obligors thereunder fail to pay, to submit claims for such termination events to Syncora Capital Assurance under its policies for an aggregate amount up to $27 million. It is uncertain if such termination events will be declared (and therefore whether claims will be made on Syncora Capital Assurance), and if made, whether they would ultimately result in any losses to Syncora Capital Assurance.

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) signed into law on July 21, 2010 may result in requirements for the Company to maintain a certain mandated amount of capital on its existing insured derivatives portfolio. The Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC”) jointly released final rules regarding the definitions of “swap dealers,” “security-based swap dealers,” “major swap participants,” and “major security-based swap participants” (“MSSPs”) under the Dodd-Frank Act. Under those rules, the swap and security-based swap positions in the Company's existing insured derivatives portfolio are expected to count towards the positions required to be included in calculations for purposes of determining whether the Company or any of its affiliates will meet any of those definitions, even if such portfolio is in run-off. The SEC and the CFTC have also released joint final rules defining the terms “swap,” “security-based swap,” and “mixed swap,” an important step in finalizing the regulatory framework applicable to derivatives activities. Although the Company is still assessing its status under these and other rules, both proposed and final, the Company estimates that it is below the calculation thresholds that would require it to so register and accordingly it believes that the Company would not be required to register as an MSSP. Should the Company be required to so register, MSSP designation and registration may expose the Company to increased compliance costs. The magnitude of the related GAAP-based capital requirements resulting from MSSP designation and registration, and the extent to which such requirements would apply to the Company's legacy insured derivatives portfolio, will depend in part on the release of final capital rules by the SEC, which has not yet occurred. However, the proposed rules released by the SEC regarding capital requirements suggests that if the Company is required to register as an MSSP, it may be subject to GAAP-based capital requirements in excess of its current GAAP-based capital position. With limited or no access to sources of external capital, in the event the Company is subject to the MSSP GAAP-based capital requirements, it is unlikely that the Company would be able to comply with such requirements. The consequences of non-compliance are not known. Current information suggests that the earliest that these requirements could apply to the Company is in late 2013, and the Company continues to consider its options.

- The Company's UK subsidiary, Syncora Guarantee-UK is regulated by the FSA in the United Kingdom. The Solvency II Directive (2009/138/EC) was adopted by the European Union on November 25, 2009 and is currently expected to become effective for UK insurance companies in January 2015 (“Solvency II”). The Solvency II directive reforms the European insurance industry’s solvency framework, including minimum capital and solvency capital requirements, governance requirements, risk

management and public reporting standards. The currently proposed Solvency II-imposed minimum solvency and capitalization requirements may exceed Syncora Guarantee-UK's own capital resources. It is unknown what actions, if any, the FSA may take for companies that fail to meet these requirements. Any such actions may have material and adverse effects on Syncora Guarantee-UK and the Company and its financial and liquidity position.

- As described above, the Company's subsidiary, Syncora Guarantee-UK is exposed to certain risks and uncertainties, whether as a result of the continuing European sovereign debt crisis, foreign currency risk, the application of Solvency II or other regulatory risk or otherwise. Accordingly, the Company's investment in its subsidiary, Syncora Guarantee-UK, and its interest in the reinsurance premiums from Syncora Guarantee-UK, is subject to certain risks and uncertainties. Any reduction in the carrying value of the Company's investment in its subsidiaries or the cessation or material limitation of reinsurance premiums from Syncora Guarantee-UK would have a material adverse effect on the Company's financial and liquidity position.

- Syncora Guarantee and Syncora Capital Assurance have sought, and may in the future seek, the NYDFS's approval of permitted accounting practices and other regulatory relief which have, and if granted may have, a material effect on Syncora Guarantee's and Syncora Capital Assurance's policyholders' surplus. Once granted, these permitted accounting practices have been subject to an annual approval or confirmation. No assurance can be given that the NYDFS will continue to grant approval of Syncora Guarantee's and Syncora Capital Assurance's past or any future permitted accounting practices or requested regulatory relief. Failure to obtain continuing approval of the past or future permitted accounting practices or requested regulatory relief could have a material adverse effect on Syncora Guarantee's and Syncora Capital Assurance's policyholders' surplus.

- Should the Company experience an "ownership change" for purposes of Section 382 of the Internal Revenue Code, the Company's ability to utilize its net operating loss carryforwards could be subject to an annual limitation in the future, which would be expected to result in a material increase in the Company's U.S. federal income tax liability, reduce reimbursements from profitable affiliates under its tax sharing agreement and therefore materially adversely affect the Company's financial and liquidity position. While the Syncora Holdings Ltd. bye-laws contain restrictions intended to reduce the likelihood of such an "ownership change," it remains possible that an "ownership change" could nonetheless occur. See Note 15 for more information.

Assessment of the Company's Ability to Continue as a Going Concern

In management's opinion, the principal remaining factors affecting Syncora Holdings Ltd. and its consolidated subsidiaries' ability to continue as a going concern are the Company's risk of significant adverse loss and claims development on its remaining in-force business and its ability to maintain adequate liquidity.

As a result of uncertainties associated with the aforementioned factors affecting Syncora Holdings Ltd. and its consolidated subsidiaries' ability to continue as a going concern, management has concluded that there is substantial doubt about the ability of Syncora Holdings Ltd. and its consolidated subsidiaries to continue as a going concern. The Company's consolidated financial statements as of and for the years ended December 31, 2012 and December 31, 2011, presented herein, are prepared assuming Syncora Holdings Ltd. and its consolidated subsidiaries continue as a going concern and do not include any adjustments that might result from their inability to continue as a going concern.

As of December 31, 2012, absent any significant future adverse developments associated with its future claim payments, recoveries, reserves for losses, or the assumptions regarding surplus notes, the Company expects to be able to satisfy its anticipated liquidity needs over the next twelve months.

Description of the Company's On-Going Strategic Plan

Management is actively seeking to (i) remediate insured exposures (through their purchase on the open market or otherwise, commutation, defeasance or other restructuring) to minimize potential claim payments, maximize recoveries and mitigate potential losses, (ii) increase Syncora Guarantee's and Syncora Capital Assurance's capital, surplus, liquidity and claims paying resources (including through additional third-party capital), (iii) realize maximum value from its illiquid assets and various legal proceedings described in Note 17 and from any other rights and remedies the Company may have, whether through litigation or settlement and (iv) take other actions to enhance its financial position (hereafter collectively referred to as "Strategic Actions").

In regard to the Strategic Actions, the Company, working with its external advisors and counsel, is actively pursuing or exploring a number of options available to it which, individually or in the aggregate, may materially affect (favorably or adversely) the Company's policyholders' surplus, liquidity position or address other challenges that the Company faces. No assurances can be given that the Company will be successful in completing any of the aforementioned actions. Furthermore, certain of the Strategic Actions contemplated by the Company may be outside the ordinary course of the Company's operations or its control and may require consents or approvals of parties outside of the Company, including the NYDFS.

3. Description of the Transactions Comprising the 2009 MTA and Related Transactions

On July 15, 2009, the Company consummated a master transaction agreement with certain financial institutions that were counterparties to CDS contracts (the "Counterparties") insured by its financial guarantee insurance policies, as well as certain related transactions (hereafter referred to collectively as the "2009 MTA") which, along with approval of the NYDFS to apply certain accounting practices in connection with the preparation of Syncora Guarantee's statutory financial statements to certain of the transactions comprising the 2009 MTA, resulted in Syncora Guarantee's return to compliance with its regulatory minimum surplus to policyholders. The approval by the NYDFS allowed Syncora Guarantee to among other things: (i) immediately recognize the effect of transactions which economically defeased or, in-substance, commuted certain of Syncora Guarantee's obligations, whereas such recognition would otherwise have been made over the life of the underlying guarantees, and (ii) de-recognize statutory mandated contingency reserves on guarantees which were terminated or where such reserves were redundant with case basis reserves carried by Syncora Guarantee.

The 2009 MTA consisted of the following primary components:

(1) the restructuring, effective defeasance or, in-substance, commutation (in whole or in part) of substantially all of Syncora Guarantee's exposure to CDS contracts, in exchange for which Syncora Guarantee paid the Counterparties consideration comprised of approximately $1.2 billion in cash, the issuance of $625.0 million surplus notes by Syncora Guarantee and the transfer of approximately 40% of the total outstanding common shares of Syncora Holdings Ltd.;

(2) the reinsurance or novation of certain of Syncora Guarantee's business to Syncora Capital Assurance, a newly formed, wholly-owned insurance subsidiary of Syncora Guarantee, in which Syncora Guarantee also issued back-up guarantees on such novated guarantees;

(3) the effective defeasance or, in-substance, commutation of certain of Syncora Guarantee's exposure to insured RMBS securities (see below for further discussion); and

(4) certain other transactions to remediate loss exposure, which primarily consisted of certain commutations of its other guarantees and assumed reinsurance, and terminated its office lease agreement.

Effective Defeasance or In-Substance Commutation of Syncora Guarantee's Exposure to Insured RMBS Securities

In connection with the 2009 MTA, Syncora Guarantee invested in a fund (the "RMBS Fund") that executed certain transactions designed to effectively defease or, in-substance, commute its exposure on certain of its financial guarantee insurance policies written on RMBS. The RMBS Fund purchased certain of such RMBS in return for a trust certificate of an owner trust representing the uninsured cash flows of such RMBS ("Uninsured Cash Flow Certificate") plus a cash payment. In general, the RMBS Fund contributed any such Purchased RMBS (and certain of Syncora Guarantee's reimbursement rights) to separate owner trusts in return for certificates representing the cash flows consisting of insurance payments made on the policies insuring such RMBS ("Insurance Cash Flow Certificates"). In return for such investments, the Insurance Cash Flow Certificates were distributed to Syncora Guarantee. The Insurance Cash Flow Certificates represent the right to receive the payments on Syncora Guarantee's financial guarantee insurance policies covering such RMBS. Syncora Guarantee will, should the cash flows from the underlying RMBS transaction be sufficient, receive certain reimbursement payments in respect of insurance payments previously made by Syncora Guarantee on such RMBS. Syncora Guarantee also entered into several alternative transactions effectively replicating the economics of the RMBS Fund.

As part of its on-going strategic plan, the Company directly purchased certain RMBS and other securities that it had insured. Such directly purchased RMBS and other securities were generally exchanged by the Company for Insurance Cash Flow Certificates and Uninsured Cash Flow Certificates using the mechanics described above. The Uninsured Cash Flow Certificates may either be held or resold by the Company. The Company continues to purchase certain of its insured RMBS and other securities.

During the year ended December 31, 2012, the Company purchased additional RMBS and other securities with an aggregate principal exposure of approximately $75.2 million for consideration of approximately $13.3 million (excludes VIE activity). During the year ended December 31, 2011, the Company purchased additional RMBS and other securities with an aggregate principal exposure of approximately $50.0 million for consideration of approximately $10.4 million (excludes VIE activity).

In addition, while the insurance policies to which the Insurance Cash Flow Certificates relate have been effectively defeased or, in-substance, commuted by virtue of the Company's ownership of the certificates, such policies have not actually been

extinguished. Accordingly, reserves for unpaid losses related to such policies may not be de-recognized and the remaining unearned premium revenue relating thereto may not be earned immediately. Instead, the Company will continue to recognize reserve development and earn premiums on these policies as it would any other in-force policy.

As the Insurance Cash Flow Certificates do not legally extinguish the RMBS or other insured securities, the Company regards the effective purchase of the Insurance Cash Flow Certificates as providing protection on the underlying securities upon the occurrence of an event of default and consequently follows reinsurance accounting principles. Upon the indirect or direct purchase of insured securities a deferred gain is recorded that represents the excess of the estimated ultimate claim payments relating to the insured securities at the time of the transaction over the cost the Company paid for those Insurance Cash Flow Certificates. The deferred gain is recognized in the consolidated statements of operations in "Net earnings on Insurance Cash Flow Certificates" based on the anticipated claim payments at the time of the transaction. The assumptions used in estimating the receivables on the Insurance Cash Flow Certificates for any given period are recognized in a manner consistent with the measurement and recognition of the loss reserves associated with the insured securities.

The following table illustrates the components of the Net Receivable on Insurance Cash Flow Certificates on the accompanying consolidated balance sheets at December 31, 2012 and 2011:

(U.S. dollars in thousands)

	2012	2011
Receivables on Insurance Cash Flow Certificates	$ 419,667	$ 342,846
Deferred gain	(141,352)	(250,896)
Receivables on Insurance Cash Flow Certificates, net	$ 278,315	$ 91,950

The following table illustrates the components of the Net earnings on Insurance Cash Flow Certificates in the accompanying consolidated statements of operations for the years ended December 31, 2012 and 2011:

(U.S. dollars in thousands)

	2012	2011
Amortization of deferred gain, net	$ 109,500	$ 165,185
Change in loss reserves, net of reimbursements	349,098	21,343
Net earnings on Insurance Cash Flow Certificates(1)	$ 458,598	$ 186,528

(1) Net earnings on insurance cash flow certificates during 2011 include an immaterial amount of $6.3 million which was not reflected in 2010.

4. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("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 may, and likely will, differ from those estimates and such differences may be material. Accounting policies requiring significant estimates consist of those relating to the Company's CDS contracts, variable interest entities' assets and liabilities, deferred acquisition costs, investments, and reserves for losses and loss adjustment expenses, as discussed in this note.

Consolidation

The consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and all other entities in which the Company has a controlling financial interest, including variable interest entities ("VIEs") for which the Company is deemed to be the primary beneficiary. All intercompany accounts and transactions have been eliminated.

Reclassifications

Certain reclassifications have been made to prior period consolidated financial statement amounts to conform to the current period presentation. There was no effect on net income or shareholders' (deficit) equity as a result of these reclassifications.

Investments

All of the Company's investments in debt (including Uninsured Cash Flow Certificates) 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 determined using the Company's own internal model estimates. The net unrealized gains or losses on investments, net of deferred income taxes, is included in accumulated other comprehensive income (loss). Any unrealized loss in value considered by management to be other-than-temporary is charged to income in the period that such determination is made. See Note 5 for the criteria used by management in assessing whether an other-than-temporary impairment has occurred.

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.

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.

Cash and Cash Equivalents

The Company's cash and cash equivalents include cash on hand, interest bearing bank deposits and money market funds. The Company defines cash equivalents as short-term, highly liquid securities and interest earning deposits with maturities at time of purchase of 90 days or less.

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents are restricted as to withdrawal and use by the Company. Restricted cash and cash equivalents primarily include deposits held in escrow accounts and cash deposits or allowable securities held to satisfy regulatory requirements.

Unearned Premium Revenue and Receivable for Future Premiums

The Company recognizes a liability for unearned premium revenue at the inception of financial guarantee insurance and reinsurance contracts on a contract-by-contract basis. Unearned premium revenue recognized at inception of a contract is measured at the present value of the premium due or expected to be collected. For certain financial guarantee insurance contracts, the Company receives the entire premium due at the inception of the contract, and recognizes unearned premium revenue liability at that time. For other financial guarantee contracts, the Company receives premiums in installments over the term of the contract at stipulated due dates. Unearned premium revenue and a receivable for future premiums are recognized at the inception of an installment contract, and measured at the present value of premiums expected to be collected over the contract period or expected period using a risk-free discount rate. The expected period is used in the present value determination of unearned premium revenue and receivable for future premiums for contracts where (a) the insured obligation is contractually prepayable, (b) prepayments are probable, (c) the amount and timing of prepayments are reasonably estimable, and (d) a homogenous pool of assets is the underlying collateral for the insured obligation. The Company has determined that substantially all of its installment contracts are required to be measured based on contract period. The receivable for future premiums is reduced as installment premiums are collected. The Company reports the accretion of the discount on installment premiums receivable as premium revenue. The Company assesses the receivable for future premiums for collectability each reporting period, adjusts the receivable for uncollectible amounts and recognizes any write-off as operating expense.

Premium Revenue Recognition

Financial guarantee insurance and reinsurance enterprises recognize the premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the amount of insurance protection provided. As premium revenue

is recognized, a corresponding decrease in the unearned premium revenue occurs. The amount of insurance protection provided is a function of the insured exposure outstanding. Therefore, the proportionate share of premium revenue to be recognized in a given reporting period is a constant rate calculated based on the relationship between the insured exposure outstanding in a given reporting period compared with the sum of each of the insured exposure amounts outstanding for all periods.

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.

An issuer of an insured financial obligation may retire the obligation prior to its scheduled maturity through an outright extinguishment, which terminates the Company's obligation under its insurance policy. Accordingly, any retirement which results in the extinguishment of the Company's obligation under the financial guarantee contract will cause the Company to recognize any remaining unearned premium revenue on the insured obligation as premium revenue in the period the contract is extinguished to the extent the unearned premium revenue has been collected (such retirements are hereafter referred to as "Refundings").

Fee Income and Other

In connection with certain of its insured transactions, the Company may collect waiver, consent, termination and other fees. Depending upon the type of fee received, the fee is either earned when services are rendered and the fee is due, or deferred and earned over a stipulated period or the life of the related transaction.

Loss and Loss Adjustment Expenses

A claim liability (loss reserve) is recognized at the measurement date on a contract-by-contract basis based on the weighted average probability of net cash outflows to be paid under the contract, on a present value basis, to the extent that the claim liability so determined exceeds the unearned premium revenue attributable to such contract at the measurement date (see Note 10).

Establishment of reserves for unpaid losses and loss adjustment expenses 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.

The present value of net cash outflows is determined based on a risk free rate of interest commensurate with the expected duration of the related contract. For this purpose, the Company uses the rate on U.S. Treasury obligations with a duration consistent with the duration of the underlying insured obligation for U.S. dollar denominated insured obligations or the comparable risk free rate on foreign government obligations relating to insured obligations denominated in foreign currencies. The weighted average risk free rate at December 31, 2012 was 1.1%. A claim liability is subsequently remeasured each reporting period for increases or decreases due to changes in the magnitude and likelihood of default and potential recoveries, as well as changes in the risk free rate of interest. Subsequent changes to the measurement of claim liability are recognized as loss expense in the period of change. Measurement and recognition of loss liability is reported gross of any reinsurance. The Company estimates the likelihood of possible claims payments and possible recoveries using probability-weighted expected cash flows based on information available as of the measurement date, including market information. Accretion of the discount on a claim liability, as well as any changes in the risk free rate of interest, are included in loss expense.

Loss reserves represent the Company's: (i) probability weighted average estimate of the net present value of claims to be paid subsequent to the balance sheet date, less (ii) its probability weighted average estimate of the net present value of recoveries subsequent to the balance sheet date and (iii) any unearned premium revenue relating to such guarantees at the end of the reporting period.

Loss 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 loss reserve establishment.

Loss 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 loss 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. In general, when the Company has assumed loss 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 loss reserves reported to the Company by its ceding companies and the amount it has recorded in its financial statements.

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.

Deferred Acquisition Costs and Deferred Ceding Commission

Policy acquisition costs include those expenses that primarily relate to, and vary with, the production of new business. 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 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 deferred acquisition costs with respect to refunded insured issue is recognized at such time.

Salvage and Subrogation Recoverable

The Company recognizes a salvage and subrogation recoverable based on net discounted anticipated recoveries in excess of net discounted anticipated paid claims on its financial guaranty insurance contracts up to the amount of previously paid claims or when the Company becomes entitled to the net cash inflows from the underlying collateral of an insured obligation under salvage and subrogation rights as a result of a claim payment or estimated future claim payments. Such recoverable amounts are included in salvage and subrogation recoverable on the accompanying consolidated balance sheets.

Credit Default Swap Contracts

Credit default swap contracts are derivative financial instruments and are recorded at fair value. Changes in fair value are recorded in "net change in fair value of credit default and other swap contracts" on the consolidated statements of operations. Realized

gains (losses) and other settlements on credit default swap contracts include credit swap derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, contractual claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions expense or income and realized gains or losses related to their early termination. Net unrealized gains (losses) on credit default swaps contracts represent the adjustments for changes in fair value in excess of realized gains and other settlements that are recorded in each reporting period. Fair value of credit default swap contracts is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 8 for a discussion on the fair value methodology for credit default swap contracts.

Reinsurance

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.

Basic earnings per share amounts are calculated by dividing net income by the weighted average number of common shares outstanding during the year, excluding the effect of dilutive securities. Diluted earnings per share amounts are calculated by dividing net income by the sum of the weighted average number of common shares outstanding during the year plus additional shares potentially issued from all dilutive securities. There were no dilutive securities outstanding at December 31, 2012 and 2011, respectively.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements: In May 2011, the FASB issued updated guidance to amend the fair value measurements and disclosure requirements. These amendments clarify existing guidance related to the application of fair value measurement requirements and disclosures. The Company adopted this guidance effective January 1, 2012. Since this guidance only affects the Company's disclosures related to fair value, the adoption of this standard did not affect the Company’s financial position, results of operations, or cash flows. Refer to Note 8 for these disclosures.

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts: In October 2010, the FASB issued amended accounting guidance which modifies the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal insurance contracts. The accounting guidance requires only incremental costs or costs directly related to the successful acquisition of new or renewal contracts to be capitalized as a deferred acquisition cost. The Company adopted the guidance effective January 1, 2012 on a prospective basis. As the Company is currently not writing any new insurance policies, the adoption of this standard did not have a material effect on the Company's financial position, results of operations, or cash flows.

Presentation of Comprehensive Income: In June 2011, the FASB issued guidance to amend the presentation of comprehensive income. This amendment eliminates the current option under GAAP to report other comprehensive income and its components in the statement of changes in equity. The amendment does not change what currently constitutes net income and other comprehensive income. The Company adopted this guidance effective January 1, 2012. Since the standard modifies the presentation of comprehensive income only, the adoption of this standard will not affect the Company’s financial position, results of operations, or cash flows.

Accounting Pronouncements Pending Adoption

Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income: In February 2013, the FASB issued updated guidance regarding the presentation of comprehensive income. Under the guidance, an entity would separately present information about significant items reclassified out of accumulated other comprehensive income by component as well as changes in accumulated other comprehensive income balances by component in either the financial statements or the notes to the consolidated financial statements. The guidance will only affect the Company's disclosures and will not affect the Company's financial position, results of operations, or cash flows. The guidance is effective for the first interim or annual reporting period beginning after December 15, 2013 and should be applied prospectively.

Disclosures about Offsetting Assets and Liabilities: In December 2011, the FASB issued guidance to amend the disclosure requirements about offsetting assets and liabilities. Entities will be required to disclose gross and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions when those activities are subject to an agreement similar to a master netting arrangement. In January 2013, the FASB clarified and revised the

guidance to only include derivatives, repurchase agreements, reverse repurchase agreements, securities borrowing and securities lending arrangements. The new disclosure guidance is effective for annual reporting periods beginning on or after January 1, 2013. Since the standard only affects the Company's disclosures, the adoption of this standard will not affect the Company's financial position, results of operations, or cash flows.

5. Investments

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

The amortized cost and fair value of investments as of December 31, 2012 and 2011 are as follows:

	December 31, 2012			
(U.S. dollars in thousands)	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Debt securities				
Mortgage-backed securities:				
RMBS [1]…	$ 250,012	$ 14,188	$ (268)	$ 263,932
CMBS…	112,327	6,674	(332)	118,669
Asset-backed securities	118,885	1,073	(4)	119,954
U.S. Government and government agencies	315,732	5,690	(70)	321,352
Corporate and other	458,392	28,121	(180)	486,333
U.S. states and political subdivisions of the states	100	1	—	101
Non-U.S. sovereign government	45,483	6,977	(4)	52,456
Total debt securities	$ 1,300,931	$ 62,724	$ (858)	$ 1,362,797

[1] Residential mortgage-backed securities include $0.9 million related to Uninsured Cash Flow Certificates which represent both the fair value and carrying value of such securities at December 31, 2012 and reflects an other than temporary impairment charge of $2.4 million.

	December 31, 2011			
(U.S. dollars in thousands)	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Debt securities				
Mortgage-backed securities:				
RMBS [1]…	$ 227,971	$ 10,479	$ (160)	$ 238,290
CMBS…	77,868	3,235	(473)	80,630
Asset-backed securities	45,785	733	(44)	46,474
U.S. Government and government agencies	252,395	6,549	(40)	258,904
Corporate and other	340,780	15,715	(3,628)	352,867
U.S. states and political subdivisions of the states	38,559	4,770	(10)	43,319
Non-U.S. sovereign government	946	94	—	1,040
Total debt securities	$ 984,304	$ 41,575	$ (4,355)	$ 1,021,524

[1] Residential mortgage-backed securities include $2.4 million related to Uninsured Cash Flow Certificates which represent both the fair value and carrying value of such securities at December 31, 2011 and reflects an other than temporary impairment charge of $1.7 million.

The change in net unrealized gains consists of changes in the valuation and holdings of debt securities of $24.6 million and $(2.9) million for the years ended December 31, 2012 and 2011, respectively.

Proceeds from sales of debt securities, net of receivables, for the years ended December 31, 2012 and 2011 were $417.7 million and $432.9 million, respectively.

The gross realized gains and gross realized (losses) for the years ended December 31, 2012 and 2011 were $25.5 million and $(14.1) million and $19.5 million and $(3.5) million, respectively. Realized investment gains and losses on the sale of investments are determined on the basis of the specific identification method and are included in net income.

The amortized cost and fair value of bonds at December 31, 2012 and 2011 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. Mortgage-backed securities are generally more likely to be prepaid than other fixed-maturity securities. As the stated maturities of such securities may not be indicative of actual maturities, the totals for mortgage-backed securities are shown separately.

(U.S. dollars in thousands)	2012 Amortized Cost	2012 Fair Value	2011 Amortized Cost	2011 Fair Value
Due within one year	$ 108,416	$ 108,460	$ 140,896	$ 141,061
Due after one through five years	445,128	459,798	230,940	239,829
Due after five through ten years	201,238	217,086	210,153	218,776
Due after ten years	64,925	74,898	50,691	56,464
Subtotal	819,707	860,242	632,680	656,130
Mortgage- and asset-backed securities	481,224	502,555	351,624	365,394
Total	$ 1,300,931	$ 1,362,797	$ 984,304	$ 1,021,524

Net investment income is derived from the following sources:

(U.S. dollars in thousands)	2012	2011
Debt securities and cash and cash equivalents	$ 37,942	$ 43,833
Equity securities	644	333
Less: Investment expenses	(1,229)	(1,103)
Net investment income	$ 37,357	$ 43,063

The Company has a formal review process for all securities in the Company's investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;
- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- whether scheduled interest payments are past due; and
- whether the Company intends to sell the security prior to its recovery in fair value.

The Company's review process, in certain instances, also includes analyses of the ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. If the Company believes a decline in the value of a particular investment is temporary, the Company records the decline as an unrealized loss on the Company's consolidated balance sheets in "accumulated other comprehensive income" in shareholders' equity. The Company recognizes an other-than-temporary impairment loss in the consolidated statements of operations for a debt security in an unrealized loss position when either the Company has the intent to sell the debt security or it is more-likely-than not that the Company will be required to sell the debt security before its anticipated recovery.

Any credit-related impairment on debt securities the Company does not plan to sell and more-likely-than-not will not be required to sell is recognized in the consolidated statement of operations, with the non-credit-related impairment recognized in other comprehensive income. For other impaired debt securities, where the Company has the intent to sell the security or where the Company will more-likely-than not be required to sell or where the entire impairment is deemed by the Company to be credit-related, the entire impairment is recognized in the consolidated statements of operations.

The Company's assessment of a decline in value includes management's current assessment of the factors noted above. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

For the years ended December 31, 2012 and 2011, the Company recorded other than temporary impairment charges of $3.3 million and $3.0 million, respectively. The other-than-temporary impairment charges recorded by the Company during the years ended December 31, 2012 and December 31, 2011 were primarily due to the Company's conclusion, resulting from its near term anticipated cash needs, that it was more-likely-than not that the Company would be required to sell certain securities (including its Uninsured Cash Flow Certificates) before recovering their cost.

The following tables present the aggregate gross unrealized losses and fair value by investment category at December 31, 2012 and 2011, respectively:

	Less Than 12 Months					
	December 31 2012			**December 31 2011**		
U.S. Dollars in thousands	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities						
RMBS	$ 48	$ (2)	2	$ 7,859	$ (160)	9
CMBS	4,568	(257)	7	26,295	(392)	19
Asset-backed securities	3,841	(3)	18	11,324	(44)	55
US Government and government agency	26,760	(70)	10	18,003	(41)	12
Corporate and other	17,739	(100)	41	85,935	(3,627)	95
US states & political subdivisions	2,110	(4)	4	2,039	(10)	2
Total debt securities	**$ 55,066**	**$ (436)**	**82**	**$ 151,455**	**$ (4,274)**	**192**

	12 Months or More					
	December 31 2012			**December 31 2011**		
U.S. Dollars in thousands	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities						
RMBS	$ 1,165	$ (266)	7	$ 3	$ -	2
CMBS	373	(75)	2	2,855	(81)	1
Asset-backed securities	203	(1)	3	-	-	-
US Government and government agency	-	-	-	-	-	-
Corporate and other	4,154	(80)	5	-	-	-
US states & political subdivisions	-	-	-	-	-	-
Total debt securities	**$ 5,895**	**$ (422)**	**17**	**$ 2,858**	**$ (81)**	**3**

	Total					
	December 31 2012			**December 31 2011**		
U.S. Dollars in thousands	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities						
RMBS	$ 1,213	$ (268)	9	$ 7,862	$ (160)	11
CMBS	4,941	(332)	9	29,150	(473)	20
Asset-backed securities	4,044	(4)	21	11,324	(44)	55
US Government and government agency	26,760	(70)	10	18,003	(41)	12
Corporate and other	21,893	(180)	46	85,935	(3,627)	95
US states & political subdivisions	2,110	(4)	4	2,039	(10)	2
Total debt securities	**$ 60,961**	**$ (858)**	**99**	**$ 154,313**	**$ (4,355)**	**195**

Based on the Company's analysis of the unrealized losses as of December 31, 2012, the Company determined that there were no specific credit related impairment losses on investments.

Debt securities with an amortized cost and fair value of $6.3 million and $7.4 million at December 31, 2012 and $6.3 million and $7.2 million at December 31, 2011, respectively, were on deposit with various regulatory authorities as required by insurance laws.

6. Credit Default and Other Swap Contracts

Prior to suspending writing substantially all new business, 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, 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.

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 primarily include structured pools of obligations, such as collateralized loan obligations, corporate CDOs and commercial mortgage-backed securities ("CMBS") CDOs. 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 2009 MTA discussed in Note 3, the Company commuted (in whole or in part) certain of its CDS contracts representing substantially all of Syncora Guarantee's anticipated claims on CDS contracts.

Typical market CDS contracts are standardized, liquid instruments that reference tradable securities such as corporate bonds. These market standard CDS contracts also involve collateral posting, and upon a default of the referenced 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 an underlying 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: timely interest and ultimate principal; ultimate principal only at final maturity; and payments upon settlement of individual collateral losses as they occur upon erosion of subordination.

The Company's CDS contracts are generally governed by a single transaction International Swaps and Dealers Association ("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 provided for mark-to-market termination payments following the occurrence of events that are outside the Company's control, such as Syncora Guarantee being placed into receivership or rehabilitation or a regulator taking control of Syncora Guarantee or, in some instances, Syncora Guarantee's insolvency. Pursuant to the 2009 MTA, substantially all of the Company's guarantees of CDS contracts that were not commuted were novated to Syncora Capital Assurance and amended to remove any events triggering mark-to-market termination payments except for Syncora Capital Assurance failing to make payment under the applicable contract or being placed into receivership or rehabilitation or a regulator taking control of Syncora Capital Assurance. Under current market conditions, if the Company were required to pay such termination payments, it would result in a liability to the Company which would be substantially in excess of that currently recorded by the Company and its ability to pay (see Note 2). 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.

Set forth below is certain information regarding the Company's in-force CDS and other swap contracts as of December 31, 2012 and December 31, 2011, including the aggregate notional amount outstanding, the weighted average life of such contracts, and the ratings of obligations referenced in such contracts.

(U.S. dollars in millions)	2012 Syncora Guarantee	2012 Syncora Capital Assurance	2012 Consolidated	2011 Syncora Guarantee	2011 Syncora Capital Assurance	2011 Consolidated
Notional amount outstanding	$ 694	$ 18,973	$ 19,667	$ 779	$ 21,314	$ 22,093
Weighted average life (years)	5.8	10.5	10.4	5.9	10.4	10.3
Percentage of referenced assets by rating [1]						
AAA	0.0%	10.4%	10.1%	0.0%	13.8%	13.4%
At or above investment grade but below AAA	0.0%	65.2%	62.9%	0.0%	58.3%	56.1%
Below investment grade	100.0%	24.4%	27.0%	100.0%	27.9%	30.5%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

[1] Based on S&P ratings. If not rated by S&P, the Moody's rating is used. If not rated by S&P or Moody's, the Syncora internal rating is used.

The following table provides the components of the net change in fair value of credit default and other swap contracts for the years ended December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Change in fair value of credit default and other swap contracts :		
Realized gains (losses) and other settlements:		
Net CDS contract premiums received and receivable	$ 22,695	$ 44,328
Net CDS contract losses paid and payable	(1,000)	(16,756)
Total realized gains and losses and other settlements	21,695	27,572
Unrealized gains (losses):		
Change in fair value of CDS contracts	432,021	276,497
Net change in fair value of credit default and other swap contracts[1] [2]	$ 453,716	$ 304,069

[1] The change in realized/unrealized gains or (losses) relating to the CDS and other swap contracts still held was $454.7 million for the year ended December 31, 2012 and $320.8 million for the year ended December 31, 2011.

[2] Includes unrealized gains (losses) of $109.2 million and $59.6 million for interest rate swap contracts for the years ended December 31, 2012 and 2011, respectively.

7. Consolidation of VIEs

The Company has exposure to VIEs through the issuance of financial guaranty insurance contracts that typically ensure the timely payment of principal and interest to the holders of VIE. As part of the terms of its insurance contracts, at the outset of a contract, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. In addition, the Company has exposure to VIEs through the ownership of Uninsured Cash Flow Certificates (see Note 3) and other interests.

The Company is not primarily liable for the debt obligations issued by the VIEs; however, where the Company has issued an insurance contract, the Company would only be required to make payments on the debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. The Company or the Company's creditors do not have any rights with regard to the assets of the VIEs.

As of December 31, 2012, the Company's qualitative and quantitative analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, such VIEs are not consolidated in the Company’s consolidated financial statements. The Company's exposure provided through its financial guarantee insurance with respect to debt obligations issued by VIEs is included within net par outstanding in Note 11.

The table below shows the fair value of the consolidated VIE assets and liabilities in the Company's consolidated balance sheets, segregated by the types of assets held by VIEs that collateralize their respective debt obligations:

(U.S. dollars in thousands)	As of December 31, 2012 Assets	As of December 31, 2012 Liabilities	As of December 31, 2011 Assets	As of December 31, 2011 Liabilities
Power & Utilities	$ 151,331	$ 151,330	$ 135,023	$ 141,620
Subprime (1st lien)	93,276	92,328	95,149	92,527
Prime (HELOC)	21,784	700	75,715	2,375
Prime (2nd lien)	-	-	24,027	-
Alt-A (2nd lien)	13,012	953	14,285	2,694
Global Infrastructure	53,519	-	33,997	-
Alt-A (1st lien)	15,841	97	28,956	182
General Obligation	21,308	-	26,997	-
Subprime (2nd lien)	4,454	-	5,968	-
Structured Single Risk	99,387	88,078	-	-
	$ 473,912	$ 333,486	$ 440,117	$ 239,398

The following table presents the revenues and expenses of consolidated VIEs included in the Company's consolidated statements of operations for the year ended December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Interest income	$ 15,364	$ 38,468
Interest expense	(21,883)	(20,910)
Other expenses	(178)	(7,738)
Net realized and unrealized (losses) gains	(24,947)	10,525
Net change in variable interest entities	$ (31,644)	$ 20,345

Set forth below is the cumulative effect of consolidating VIEs on net income and shareholders' deficit as of December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Net premiums earned	$ (1,310)	$ (1,944)
Net investment income	(25,315)	(34,911)
Earnings on insurance cash flow certificates	(34,656)	(118,518)
Net realized losses on investments	20,444	5,653
Net losses and loss adjustment expenses	49,888	30,067
Net change in variable interest entities	(31,644)	20,345
Total effect on net income	(22,594)	(99,308)
Total effect on other comprehensive income	16,858	29,846
Total effect on comprehensive income	(5,736)	(69,462)
Total effect on shareholders' deficit- beginning of year	$ (1,762)	67,700
Total effect on shareholders' deficit- end of year	$ (7,498)	$ (1,762)

8. Financial Instruments and Fair Value Measurements and Disclosures

A significant number of the Company's financial instruments are carried at fair value with changes in fair value recognized in earnings or loss each period. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). In determining fair value, the Company uses various valuation techniques and considers the fair value hierarchy.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical instruments (Level 1) and the lowest priority to valuation techniques using unobservable inputs (Level 3). Observable inputs are inputs that market participants would use in pricing the financial instruments that are based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company's estimates of the assumptions market participants would use in pricing the financial instruments based on the best information available in the circumstances. These valuation techniques involve some level of management estimation and judgment. The degree to which management's estimation and judgment is required is generally dependent upon the market price transparency for the instruments, the availability of observable inputs, frequency of trading in the instruments and the instrument's complexity.

In measuring the fair market values of its financial instruments, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs based on the fair value hierarchy. The hierarchy is categorized into three levels based on the reliability of inputs as follows:

Level 1—Unadjusted quoted prices for identical instruments in active markets. The Company generally defines an active market as a market in which trading occurs at significant volumes. Active markets generally are more liquid and have a lower bid-ask spread than an inactive market.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.

Level 3—Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation techniques applied to the Company's assets and liabilities measured at fair value follows:

Valuation Techniques — Credit Default Swap Contracts

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 (vi) the market perception of the Company’s ability to meet its obligations under its CDS contracts which is factored into the Company’s fair value estimates as discussed below.

The fair value of the Company’s in-force portfolio of CDS contracts represents the net present value of the difference between the remaining uncollected 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.

Key variables used in the Company’s valuation of substantially all of its CDS contracts include the balance of unpaid notional, expected remaining 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 Non-Performance Risk (as defined and described below) of its subsidiaries with in-force CDS contract exposure, 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, CDX (which index is comprised of investment grade corporate credits), or CMBX (which is comprised of commercial mortgage-backed securities). 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 proxy index (the “premium percentage”) that management believes is consistent with (i) historical

premium pricing for high credit spread transactions and (ii) levels attainable in the market just prior to the collapse of the market for CDS from financial guarantors. This data indicates that this premium percentage decreases as a function of increasing underlying credit spreads. A component of this relationship is the lack of liquidity reflected in the credit spread (the liquidity premium) that has historically flowed directly to the CDS counterparty as the funding institution and to cover the funders' additional funding costs and risks. Using the historical data available, a regression analysis was completed to determine the approximate rate of change of the premium percentage as underlying credit spreads move up and down. The resulting relationship from these analyses were applied to the current credit spread levels of the underlying reference securities, or their proxy index, to generate the expected current premium for each outstanding CDS.

In addition to that discussed above, the fair value of the Company's CDS contracts reflects the risk that Syncora Guarantee or Syncora Capital Assurance, as applicable, will not be able to honor their obligations under their CDS contracts, or its Non-Performance Risk. Generally, the Company would measure Non-Performance Risk as implied by the market price of buying credit protection on Syncora Guarantee or Syncora Capital Assurance, as applicable. Since Syncora Guarantee and Syncora Capital Assurance do not have an observable market credit spread, Syncora Guarantee and Syncora Capital Assurance estimate their Non-Performance Risk based on market observable credit spreads of comparable financial guarantee insurance companies.

Such Non-Performance Risk was reflected in the fair value of the companies' CDS contracts by incorporating the estimated spreads at which the CDS contracts would trade on the companies, as discussed above, into the discount rate used. The companies estimated a discount rate for each CDS contract based on the swap rate and the companies' estimated credit spread for the duration that is the closest to the remaining weighted average life of the obligation referenced in the CDS contract.

Since the estimate of fair value of the Company's CDS contracts reflects significant unobservable inputs, the Company's CDS contracts are categorized in Level 3 of the fair value hierarchy.

Valuation Techniques — Interest Rate Swap Guarantees

The Company's interest rate swap exposure consists primarily of financial guarantees that cover one party's payment obligations to another party under an interest rate swap contract. These interest rate swap guarantees are considered derivative financial instruments and are recorded at fair value. The fair value of these interest rate swap guarantees is included in the caption "credit default and other swap contracts, at fair value" on the consolidated balance sheets.

The Company's interest rate swap guarantees cannot be legally traded and do not have observable market prices. The Company determines fair value based on valuation techniques involving management's judgment using internal valuation models. The estimated fair value of the interest rate swap guarantees are primarily based upon unobservable inputs, including estimated default probabilities of the obligor, contractual terms, estimated recovery rates and the application of credit value adjustments for the Company's own non-performance risk.

Since the estimate of fair value of the Company's interest rate swap guarantees reflects significant unobservable inputs, the Company's interest rate swap contracts are categorized in Level 3 of the fair value hierarchy.

Valuation Techniques — VIE Assets and Liabilities

The consolidated VIE assets and liabilities consist primarily of RMBS and other debt instruments. The fair value of the Company's consolidated VIE assets and liabilities is determined based on quoted market prices, if available. When observable quoted market prices are not available, fair value is determined based on internal discounted cash flow valuation models. The inputs to the valuation models primarily include estimated prepayment rates, market values of the underlying collateral, estimated default rates, market yields, credit spread indices, discount rates, estimated recovery rates, and for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing timely principal and interest for the VIE assets insured by the Company and the application of credit value adjustments for the Company's own non-performance credit risk. Since the majority of the significant inputs are unobservable, which reflect the Company's estimates of market assumptions, the fair value measurements of the consolidated VIE assets and liabilities are categorized as Level 3 in the fair value hierarchy.

Valuation Techniques — Debt Securities Available for Sale

U.S. Government and government agencies

U.S. Treasury securities are valued using unadjusted quoted market prices. Accordingly, U.S. Treasury securities are generally categorized in Level 1 of the fair value hierarchy. U.S. government agency securities are generally valued using quoted

market prices and obtained from an independent third-party investment service provider. U.S. government agency securities are generally categorized in Level 2 of the fair value hierarchy.

Mortgage and asset-backed securities

Mortgage and asset-backed securities are generally valued based on quoted prices or spread data, which are obtained from an independent third-party investment service provider. Mortgage and asset-backed securities are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, the Company will determine fair value using its own internal model estimates. In such cases, mortgage and asset-backed securities are categorized in Level 3 of the fair value hierarchy.

Corporate

The fair value of corporate bonds is determined using recently executed transactions or market price quotations obtained from an independent third-party investment service provider. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy.

U.S. State and political subdivisions

The fair value of state and municipal securities is determined using recently executed transactions or market price quotations obtained from an independent third-party service provider. These bonds are generally categorized in Level 2 of the fair value hierarchy.

Non-U.S. sovereign government

Foreign sovereign government obligations are valued using quoted prices in active markets and obtained from an independent third-party service provider. These bonds are generally categorized in Level 2 of the fair value hierarchy.

Valuation Techniques — Cash and Cash Equivalents

The carrying amounts of these items approximate fair value due to the short-term maturity of these instruments. Cash and cash equivalents include deposits in banks, money market accounts and money market funds, which fair value of these instruments is based upon quoted market prices. The Company does not adjust the quoted market price for such instruments. Cash and cash equivalents are categorized in Level 1 of the fair value hierarchy.

Valuation Techniques — Other Invested Assets

Other invested assets primarily include direct investments in equity securities and exchange-traded direct equity investments. Equity securities and exchange-traded equity securities are generally valued based on quoted prices. Such investments are categorized in Level 1 of the fair value hierarchy. Investment in a certain fund that is not actively traded but inputs that are observable in the market or can be derived principally from observable market data is categorized in Level 2 of the fair value hierarchy.

Valuation Techniques — Replacement Bank Warrants

The fair value of the Company's replacement bank warrants is based upon an unadjusted market price obtained from an independent pricing service. Replacement bank warrants are categorized in Level 3 of the fair value hierarchy.

Valuation Techniques — Interest Rate Derivative Instrument

The fair value of the Company's interest rate swap contract is based upon observable market data including contractual terms, market prices and interest rates and is obtained from the counterparty. The interest rate derivative instrument is categorized in Level 2 of the fair value hierarchy.

Fair Value Hierarchy Tables

The following fair value hierarchy table presents information about the company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2012:

(U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets / Liabilities at Fair Value
ASSETS				
Debt securities available for sale:				
Mortgage and asset-backed securities				
RMBS	$ -	$ 263,036	$ 896	$ 263,932
CMBS	-	118,669	-	118,669
Asset-backed securities	-	119,954	-	119,954
U.S. Government and government agencies	195,653	125,699	-	321,352
Corporate and other	5,579	476,477	4,277	486,333
U.S. states and political subdivisions	-	52,456	-	52,456
Non-U.S. sovereign government	-	101	-	101
Total debt securities available for sale	201,232	1,156,392	5,173	1,362,797
Other invested assets	8,395	1,878	-	10,273
Cash and cash equivalents	115,418	-	-	115,418
Restricted cash and cash equivalents	709	-	-	709
Credit default and other swap contracts	-	-	212,116	212,116
Replacement bank warrants	-	-	138,132	138,132
Assets of consolidated variable interest entities	-	-	473,912	473,912
Total assets	$ 325,754	$ 1,158,270	$ 829,333	$ 2,313,357
LIABILITIES				
Credit default and other swap contracts	$ -	$ -	$ 590,382	$ 590,382
Liabilities of consolidated variable interest entities	-	-	333,486	333,486
Total liabilities	$ -	$ -	$ 923,868	$ 923,868

The following fair value hierarchy table presents information about the company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2011:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Assets / Liabilities at Fair Value
ASSETS				
Debt securities available for sale:				
Mortgage and asset-backed securities				
RMBS	$ -	$ 235,893	$ 2,397	$ 238,290
CMBS	-	80,630	-	80,630
Asset-backed securities	-	46,474	-	46,474
U.S. Government and government agencies	182,973	75,931	-	258,904
Corporate and other	5,966	346,901	-	352,867
U.S. states and political subdivisions	-	43,319	-	43,319
Non-U.S. sovereign government	-	1,040	-	1,040
Total debt securities available for sale	188,939	830,188	2,397	1,021,524
Other invested assets	3,591	1,992	-	5,583
Cash and cash equivalents	156,607	-	-	156,607
Restricted cash and cash equivalents	5,518	-	-	5,518
Credit and other default swap contracts	-	-	401,082	401,082
Replacement bank warrants	-	-	100,765	100,765
Interest rate derivative instrument	-	192	-	192
Assets of consolidated variable interest entities	-	-	440,117	440,117
Total assets	$ 354,655	$ 832,372	$ 944,361	$ 2,131,388
LIABILITIES				
Credit default and other swap contracts	$ -	$ -	$ 1,271,546	$ 1,271,546
Liabilities of consolidated variable interest entities	-	-	239,398	239,398
Total liabilities	$ -	$ -	$ 1,510,944	$ 1,510,944

Level 3 Assets and Liabilities Reconciliation Tables

Level 3 Assets

The following table provides a reconciliation for the Company's assets measured at fair value on a recurring basis using unobservable inputs (Level 3) for the years ended December 31, 2012 and 2011:

	2012				
(U.S. dollars in thousands)	Mortgage and Asset-Backed Securities	Corporate and Other	Credit Default and Other Swap Contracts	Replacement Bank Warrants	Assets of Consolidated Variable Interest Entities
LEVEL 3 ASSETS					
Balance, beginning of period	$ 2,397	$ -	$ 401,082	$ 100,765	$ 440,117
Deconsolidation of VIEs	39,003	-	-	-	-
Realized gains (losses)	14,707	-	-	-	-
Unrealized gains (losses) included in earnings	-	-	(188,966)	-	33,795
Unrealized gains (losses) included in OCI	(437)	-	-	37,367	-
Purchases	3,229	4,277	-	-	-
Issuances	-	-	-	-	-
Settlements	-	-	-	-	-
Sales	(58,003)	-	-	-	-
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-
Balance, end of period	$ 896	$ 4,277	$ 212,116	$ 138,132	$ 473,912

	2011			
(U.S. dollars in thousands)	Mortgage and Asset-Backed Securities	Credit Default and Other Swap Contracts	Replacement Bank Warrants	Assets of Consolidated Variable Interest Entities
LEVEL 3 ASSETS				
Balance, beginning of period	$ 4,836	$ 302,991	$ 94,431	$ 745,492
Deconsolidation of VIEs	-	-	-	-
Realized gains (losses)	(1,562)	(1,162)	-	-
Unrealized gains (losses) included in earnings	-	99,253	-	(305,375)
Unrealized gains (losses) included in OCI	(1,608)	-	6,334	-
Purchases	3,481	-	-	-
Issuances	-	-	-	-
Settlements	-	-	-	-
Sales	(2,750)	-	-	-
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	-	-	-	-
Balance, end of period	$ 2,397	$ 401,082	$ 100,765	$ 440,117

Level 3 Liabilities

The following table provides a reconciliation for the Company's liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) for the years ended December 31, 2012 and 2011:

	2012		2011	
(U.S. dollars in thousands)	**Credit Default and Other Swap Contracts**	**Liabilities of Consolidated Variable Interest Entities**	**Credit Default and Other Swap Contracts**	**Liabilities of Consolidated Variable Interest Entities**
LEVEL 3 LIABILITIES				
Balance, beginning of period	$ 1,271,546	$ 239,398	$ 1,466,090	$ 591,823
Realized gains (losses)	(21,695)	-	(28,734)	-
Unrealized gains (losses) included in earnings	(659,469)	94,088	(165,810)	(352,425)
Purchases	-	-	-	-
Issuances	-	-	-	-
Settlements	-	-	-	-
Sales	-	-	-	-
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	-	-	-	-
Balance, end of period	$ 590,382	$ 333,486	$ 1,271,546	$ 239,398

The following table provides quantitative information regarding the significant unobservable inputs used to measure the fair value of the Company's Level 3 assets and liabilities on a recurring basis as of December 31, 2012:

(U.S. dollars in thousands)

Level 3 Assets / Liabilities		Fair Value as of December 31, 2012	Valuation Techniques	Significant Unobservable Inputs	Range of Inputs
Assets					
Mortgage and asset-backed securities	$	896	Discounted cash flows	Constant prepayment rate	0% - 11.3%
				Constant default rate	6% - 18%
				Loss severity	74%
				Yield	8%
Corporate and other		4,277	Discounted cash flows	Yield	11.75% - 12%
Credit default and other swap contracts		212,116	Discounted cash flows	Loss severity	20% - 77%
				Default rate	0.30% - 100%
				Market premiums	0 bps - 55.9 bps
				Weighted average life	0.5 yrs - 34 yrs
				Non-performance risk	6% - 26%
Assets of consolidated VIEs		473,912	Discounted cash flows	Constant prepayment rate	3% - 23%
				Constant default rate	6% - 90%
				Loss severity	74% - 100%
				Yield	4.5% - 8%
				Non-performance risk	6% - 26%
Liabilities					
Credit default and other swap contracts	$	590,382	Discounted cash flows	Loss severity	10% - 77%
				Default rate	0.22% - 100%
				Market premiums	11.4 bps - 295 bps
				Weighted average life	0.25 yrs - 42 yrs
				Non-performance risk	6% - 26%
Liabilities of consolidated VIEs		333,486	Discounted cash flows	Constant prepayment rate	0% - 10%
				Constant default rate	15.5% - 90%
				Loss severity	90% - 100%
				Yield	5% - 15%
				Non-performance risk	6% - 26%

The significant unobservable inputs used in the fair value measurement of the Company's credit default and other swap contracts and assets and liabilities of consolidated VIEs are shown in the table above. Significant changes in any of those inputs in isolation can result in a materially lower or higher fair value measurement.

Non-Performance Risk

The Company considers the effect of nonperformance risk in determining the fair value of its liabilities and the consolidated VIE liabilities. The fair value of the Company's CDS reflects the risk that Syncora Guarantee or Syncora Capital Assurance, as applicable, will not be able to honor their obligations under their CDS contracts, or its Non-Performance Risk. Since neither the Company, Syncora Guarantee or Syncora Capital Assurance have an observable market credit spread, the Company, Syncora Guarantee and Syncora Capital Assurance each measure their Non-Performance Risk based on market observable credit spreads of comparable financial guarantee insurance companies.

The fair value of the Company's consolidated VIE liabilities reflects the Non-Performance Risk that the Company will not be able to honor VIE obligations where VIE liabilities exceed the value of the related pledged assets.

Set forth below is information regarding the Company's in-force CDS and other swap contracts as of December 31, 2012 and December 31, 2011, including the fair value of such contracts, the Non-Performance Risk discount on such contracts which is embedded in the credit default and other swap contracts liability on the accompanying consolidated balance sheets:

(U.S. dollars in millions)	2012 Syncora Guarantee	2012 Syncora Capital Assurance	2012 Consolidated	2011 Syncora Guarantee	2011 Syncora Capital Assurance	2011 Consolidated
Fair value of credit default and other swap contracts, before giving effect to Non-Performance Risk	$ 400.2	$ 978.8	$ 1,379.0	$ 687.7	$ 1,393.5	$ 2,081.2
Less: Non-Performance Risk	184.7	603.9	788.6	85.7	724.0	809.7
Fair value of credit default and other swap contracts, after giving effect to Non-Performance Risk	$ 215.5	$ 374.9	$ 590.4	$ 602.0	$ 669.5	$ 1,271.5

Set forth below is certain information regarding the Company's VIE liabilities as of December 31, 2012 and 2011, including the fair value, the Non-Performance Risk discount on such liabilities which is embedded in the VIE liability on the accompanying balance sheet:

(U.S. dollars in thousands)	December 31, 2012	December 31, 2011
Fair value of VIE liabilities, before giving effect to Non-Performance Risk	$ 336,146	$ 245,253
Less: Non-Performance Risk	2,660	5,855
Fair value of VIE liabilities, after giving effect to Non-Performance Risk	$ 333,486	$ 239,398

Financial Instruments Not Carried at Fair Value

At December 31, 2012 and 2011, the carrying value of the Company's notes was $292.4 million and $283.0 million, respectively. The fair value of the Company's notes, are difficult and complex to value as such notes are not listed on any exchange or publicly traded in any market. The interest rate on these notes is 5.0% and 6.0% for each series with the first maturity date on such notes scheduled for December 2011 and in June 2024. In connection with the Countrywide settlement, the Company valued notes with an original par value of $40.2 million at an estimated fair value of $10.4 million based on a discounted cash flow model and available information at the time of transaction. See Note 9 below for further discussion.

Fair Value Option

Effective January 1, 2010, upon consolidation of the VIEs, the Company elected fair value option treatment under the accounting guidance to measure the VIE assets and VIE liabilities as the amortized cost transition method was not practical.

9. Notes Payable

As part of the consideration paid in connection with the effective defeasance, or in-substance commutation, of certain of the Company's guarantees of CDS contracts pursuant to the 2009 MTA discussed in Note 3, Syncora Guarantee issued the notes described in the table below to the counterparties of such CDS contracts. In accordance with GAAP, the Company recorded the notes at their estimated fair value of $141.0 million at the date of their issuance and accretes the discount from the face amount of the notes over the term of the notes on a level basis using the interest method. Such accretion is recorded as interest expense which is reflected in other "Operating expenses" in the accompanying consolidated statements of operations.

Scheduled repayment of the Company's short-term notes on December 28, 2011 was subject to conditions that were not met and consequently principal and interest payments were not approved by the NYDFS as described in footnote (a) below. Further, in November 2012, the Company again sought approval for payment on its short-term notes, and on November 8, 2012 the NYDFS did not approve such payment. Although the terms of the short-term notes do not require the Company to seek NYDFS approval for such payments according to any schedule, the Company intends to seek approval thereof on an annual basis. There can be no assurance as to when or whether the conditions to payment of the Company's short-term notes, including NYDFS approval thereof, will be satisfied.

The table below sets forth certain information regarding the aforementioned notes.

Date Issued	Interest Rate	Date of Maturity	Par Value (Face Amount of Notes)	Estimated Fair Value At Issuance	Total Interest Expense Year Ended December 31, 2012	Total Interest Expense Year Ended December 31, 2011	Carrying Value At December 31, 2012	Carrying Value At December 31, 2011	Estimated Yield to Maturity
7/15/2009	5.00% **(a)**	12/28/2011	$ 144,197,488	$ 91,155,000	$ 8,118,767	$ 41,082,965	$ 144,197,488	$ 165,414,677	31.88%
7/15/2009	6.00% **(b)**	6/27/2024	558,355,894	49,875,000	36,737,115	28,438,044	148,203,517	117,630,253	31.88%
			$ 702,553,382	$ 141,030,000	$ 44,855,882	$ 69,521,009	$ 292,401,005	$ 283,044,930	

(a) Interest was payable semi-annually, on June 27th and December 28th of each year (commencing December 28, 2009). Such interest was payable in cash or in-kind at the election of the Company through June 27, 2011. Interest subsequent to June 27, 2011 was required to be paid in cash, subject to the prior approval of the NYDFS. As described below, absent the satisfaction of the conditions to payment, including the approval of the NYDFS, the Company is not entitled to make payments on its notes. Failure to make any payment on such notes as a result of the failure of any such condition would not constitute a default thereunder. Principal and interest scheduled to be paid on December 28, 2012 and 2011 was not approved by the NYDFS. Accordingly, the interest not approved for payment by the NYDFS on December 28, 2012 and 2011 was not capitalized on the outstanding principal balance reflected above, but accrues interest at the existing rate. The outstanding principal balance of the notes as of June 27, 2011 also will separately accrue interest at such rate.

(b) Interest is payable semi-annually on June 27th and December 28th of each year commencing December 28, 2009. Such interest is payable in cash or in-kind at the election of the Company through June 27, 2013; thereafter, interest must be paid in cash through the maturity of the notes. Commencing on December 28, 2018, principal amortizes in twelve equal installments payable semi-annually on June 27th and December 28th through the maturity of the notes.

Each payment of interest on (other than that paid-in-kind) or principal of the notes is subject to restrictions under the terms of the notes themselves and the NYIL, including that such payments may only be made with the prior approval of the NYDFS and to the extent the Company has sufficient free and divisible surplus to make such payment. Absent the satisfaction of these conditions, the Company is not entitled to make any payments on its notes.

Each of the notes noted in the table above ranks *pari passu*. In the event the Company is subject to liquidation or other such proceeding, policyholder claims would be afforded greater priority than that of noteholders, and the noteholders' claims would be afforded greater priority than claims of the Company's stockholders.

10. Liabilities for Unpaid Losses and Loss Adjustment Expenses

The Company's reserve for unpaid losses and loss adjustment expenses as of December 31, 2012 and 2011 consists of case basis reserves established in accordance with GAAP. Such case basis reserves represent the probability weighted average of the Company's estimates of the present value, discounted at the risk free rate of interest, of expected losses on insured debt obligations that have defaulted or are expected to default. As of December 31, 2012, the range of risk free rates used to discount the Company's liability for losses and loss adjustment expenses was 0.0% to 2.8%. Activity in the Company's liability for unpaid losses and loss adjustment expenses for the years ended December 31, 2012 and 2011 are summarized as follows:

(US dollars in thousands)	**2012**	**2011**
Gross unpaid losses and loss adjustment expenses at beginning of year	$ 1,020,032	$ 1,140,022
Salvage and subrogation recoverable	(209,398)	(133,191)
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	(5,023)	(5,472)
Net unpaid losses and loss adjustment expenses at beginning of year	805,611	1,001,359
Increase in net losses and loss adjustment expenses incurred in respect of losses occurring in:		
Current year	61,508	39,176
Prior years	230,666	240,549
Current year effect for consolidation of VIEs	8,984	15,232
Net losses and loss adjustment expenses paid	(17,665)	(490,705)
Net unpaid losses and loss adjustment expenses at end of period	1,089,104	805,611
Salvage and subrogation recoverable	139,226	209,398
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	3,715	5,023
Gross unpaid losses and loss adjustment expenses at end of period	$ 1,232,045	$ 1,020,032

Case Basis Reserves for Losses and Loss Adjustment Expenses

A discussion of certain case basis reserves established by the Company as of December 31, 2012 and December 31, 2011 is set forth below.

Reserves for unpaid losses and loss adjustment expenses on the Company's guarantees of obligations supported by HELOC, CES, and Alt-A mortgage loan collateral, after giving effect to reinsurance, were $1,007.8 million and $825.0 million as of December 31, 2012 and 2011, respectively ($1,007.9 million and $825.1 million, respectively, before giving effect to reinsurance). Salvage and subrogation recoverable as of December 31, 2012 includes an immaterial amount of $29.0 million not reflected in 2011. The change in reserves from December 31, 2011 to December 31, 2012 is primarily attributable to adverse loss development of $237.0 million.

The aforementioned reserves as of December 31, 2012 and 2011 represent the Company's probability weighted average estimate of the: (i) the net present value of claims to be paid subsequent to the balance sheet date, less (ii) the net present value of recoveries subsequent to the balance sheet date, and (iii) any unearned premium revenue relating to such guarantees at the balance sheet date. The Company's probability weighted average estimate of losses on the aforementioned guarantees is based on assumptions and estimates extending over many years into the future. Such assumptions and 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 probability weighted average 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 generally 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. The losses for the second lien transactions (HELOCs and CESs) are estimated based on a model using a constant default rate curve. At both December 31, 2012 and December 31, 2011, the Company had assumed that the majority of the peak defaults occurred in mid-2009 and would continue until mid-2010. The Company extended the assumed ramp down of such defaults to steady state from nine months at December 31, 2009 to a default rate, which generally remained fixed for a range of six to twelve months followed by a ramp down over a range of eighteen to thirty-six months at December 31, 2012. Most of the transactions are currently in their modeled ramp down periods. Net losses will be greater if the time it takes the mortgage performance to stabilize is longer than currently anticipated or if the ramp down period is extended beyond the Company's current assumption.

After the ramp down, the Company assumes a steady state constant default rate well above historical norms. The constant default rate 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 constant default rate could be longer than modeled. If the current constant default rate were extended one quarter longer than projected, it would result in an increase in expected paid loss of approximately $3.8 million. If the current constant default rate were extended one year longer than projected, it would result in an increase in expected paid loss of approximately $12.2 million.

The Company's default assumptions for the first lien transactions at December 31, 2012 were based on current delinquent loans and analysis of historical defaults for loans with similar characteristics. A loss severity was applied to the first lien defaults ranging from 54% to 85% based upon actual loss severity observances and collateral characteristics to determine the expected loss on the collateral in those transactions.

The Company has exercised rights available to it in connection with its insurance of certain RMBS to require the sponsors of such securities to repurchase mortgage loans backing such securities that breached certain representations and warranties. While the sponsors have disputed, and may in the future dispute, their obligations to repurchase 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 the Company expects to incur through its insurance of the aforementioned securities. As of December 31, 2012, the amount of mortgage loans that the Company is seeking sponsors to repurchase aggregated approximately $0.8 billion; the sponsor of a substantial majority of such mortgage loans is GreenPoint Mortgage Funding, Inc. ("GreenPoint"). As of December 31, 2011, the amount of mortgage loans that the Company was seeking sponsors to repurchase aggregated approximately $1.6 billion; the sponsors of a substantial majority of such

mortgage loans were Countrywide Home Loans, Inc. and affiliated entities ("Countrywide"), GreenPoint, and EMC Mortgage Corporation ("EMC"). No assurance can be given that the Company will be successful in enforcing its rights to require sponsors to repurchase the mortgages discussed above. If the Company were successful in enforcing these rights, its ability to realize a financial benefit from the repurchase by sponsors of the aforementioned mortgages is limited to the losses incurred by the Company through its insurance of the RMBS backed by such mortgages and by the financial ability of the sponsors to honor their obligations. As of December 31, 2012 and 2011, the Company estimated that it would realize a net benefit from such recoveries aggregating $144.9 million and $586.3 million, respectively. This benefit is recorded in the Company's consolidated financial statements through a reduction in reserves for losses that it would otherwise have had to carry. The Company's estimate considers a variety of factors including its historical rate of success at requiring sponsors to repurchase mortgages, uncertainties associated with a favorable resolution to its disputes with the sponsors, as well as the aforementioned limits regarding the financial benefit it may realize from such repurchases. The actual salvage recovery may vary materially (favorably or unfavorably) from the Company's estimates.

The Company insured payment of scheduled debt service in aggregate of approximately $1.1 billion principal value of sewer revenue warrants issued by Jefferson County in 2002 and 2003 and, in addition, has provided a surety bond policy (with a notional exposure of $137.5 million at December 31, 2012) in connection therewith. On April 12, 2010, the Company commuted approximately $507 million of its principal exposure to such warrants. This commuted exposure was held by certain banking institutions that acquired the warrants pursuant to a liquidity facility they provided in connection with the issuance by Jefferson County of the sewer revenue warrants. There was no effect on the Company's financial position or results of operations from the commutation as a result of reserves previously established by the Company. However, pursuant to the agreement, the Company was required to make, and did make, cash payments to the aforementioned banking institutions aggregating $105.0 million, of which $75.0 million was paid during 2010 and the remaining $30.0 million of Replacement Bank Warrants (as defined below) was paid on February 1, 2012. There are no further payments required under the agreement.

As of December 31, 2012, the remaining outstanding principal amount of the warrants and related surety bond policy, after the aforementioned commutation, and the Company's exposure thereto, before giving effect to reinsurance and the Company's reserves for losses thereon discussed below, was $562.0 million (after giving effect to reinsurance and the Company reserves for losses thereon, the Company's exposure was $416.8 million). Such obligations are secured by a pledge of the net revenues of Jefferson County's sewer system. However, Jefferson County's sewer system is experiencing severe financial difficulties and on November 9, 2011, Jefferson County filed for bankruptcy protection under Chapter 9 of the United States Bankruptcy Code.

During the years ended December 31, 2012 and 2011, the Company recorded a (benefit) provision for losses and loss adjustment expenses, after giving effect to reinsurance, of $(8.2) million and $37.9 million, respectively, on its guarantees of the sewer revenue warrants and the surety bond policy. The reserve on the Company's remaining exposure to the sewer revenue warrants and the surety bond policy was based on the Company's probability- weighted estimate of: (i) the net present value of claims previously paid and to be paid subsequent to the balance sheet date, less (ii) the net present value of recoveries subsequent to the balance sheet date, and (iii) any unearned premium revenue relating to such guarantees.

As of December 31, 2012 and 2011, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on the Jefferson County warrants and the surety bond policy was $135.8 million and $149.8 million ($139.6 million and $154.7 million before giving effect to reinsurance), respectively. The change in reserves from December 31, 2011 to December 31, 2012 is primarily due to positive loss development on the Company's remaining exposure to the warrants.

In satisfaction of claims paid by the Company through April 26, 2009 (the date the Company originally ceased making claims payments pursuant to an order of the NYDFS) on its guarantees of the warrants, the Company has received $184.2 million face value of sewer revenue warrants (known as "Replacement Bank Warrants"), of which approximately $21.8 million face value inures to the benefit or detriment of certain of the Company's reinsurers. As a result of the commutation agreements with insurers, the Company derecognized $16.9 million of warrants from its assets in 2011.

The Company continues to monitor its remaining exposure to Jefferson County's sewer revenue warrants and, as new information becomes available, it may be required to adjust its provision for loss reserves thereon in the future.

As of December 31, 2012 and 2011, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on other public finance transactions was $62.5 million and $6.1 million ($62.5 million and $6.1 million before giving effect to reinsurance), respectively.

As of December 31, 2012 and 2011, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on structured single risk transactions was $14.0 million and $24.5 million ($14.0 million and $24.5 million before giving effect to reinsurance), respectively.

As of December 31, 2012 and 2011, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on its guarantees of CDOs was $8.0 million and $9.6 million ($8.0 million and $9.6 million before giving effect to reinsurance), 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 could be incurred by the company with respect to such credits.

The Company's surveillance department focuses its review on monitoring lower rated bond sectors and potentially troubled sectors, which have included certain subsectors within the ABS, CDO, Public Finance and Structured Single Risk portfolios. For the ABS and CDO portfolios, it tracks performance monthly to determine whether or not covenants have 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 or take other remedial action. 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 audit 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. For the Public Finance portfolio, Surveillance uses a Frequency of Review Schedule to prioritize reviews to ensure lower rated and larger exposure credits are being looked at more frequently. In addition, Surveillance uses screening tools to review the entire Public Finance portfolio based upon news feeds, trade data, material event notices and other third party information. For the Structured Single Risk portfolio, Surveillance will retain technical consultants as needed to track construction and operational risk and reviews this portfolio based upon reports it receives on a monthly, quarterly or annual basis.

The Company estimates claims based on its surveillance department's best estimate of net cash outflows under a contract, on a present value basis. 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 cases, 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. Credits that are not closely monitored credits are considered to be fundamentally sound, normal risk.

The following table sets forth certain information in regard to the Company's closely monitored credits as of December 31, 2012. The number of policies, remaining weighted-average contract period, and insured contractual payments outstanding in the table below excludes exposures that were effectively defeased or, in-substance, commuted through the acquisition of Insurance Cash Flow Certificates and related alternative structures.

(U.S. dollars in millions)	Special Monitoring List	Yellow Flag List	Red Flag List	Loss List	Total
Number of policies	115	27	17	37	196
Remaining weighted-average contract period (in years)	13.9	12.6	8.8	13.6	11.9
Insured contractual payments outstanding:					
Principal	$ 1,344	1,347	2,212	1,749	6,652
Interest	911	764	711	1,265	3,651
Total	$ 2,255	2,111	2,923	3,014	10,303
Gross loss and LAE liability	$ 3	46	77	2,318	2,444
Less:					
Gross potential recoveries	—	1	—	1,443	1,444
Unearned premium reserve [(1)]	1	1	13	62	77
Discount, net	—	—	3	(312)	(309)
Loss and LAE liabilities reported in the balance sheet	$ 2	44	61	1,125	1,232

(1) The claim liability is determined on a contract by contract basis. As such, instances may arise where the unearned premium revenue on a contract may exceed the present value of the expected net cash outflows. The unearned premium in the table above represents the aggregate of unearned premium revenue on each contract but not in excess of the associated present value of the expected net cash outflows on such contract.

11. Exposures Under Guarantees

While the Company establishes reserves for losses and loss adjustment expenses on obligations it has guaranteed or reinsured (see Note 4), the risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed. Set forth below are tables which reflect certain information regarding the Company's in-force principal and interest exposure at December 31, 2012. References in the tables below to "Gross" mean that the amounts are before the effect of ceded reinsurance and references to "Net" mean that the amounts are after the effect of ceded reinsurance.

The following table sets forth the Company's in-force guaranteed principal and interest exposure by bond sector as of December 31, 2012:

Bond Exposure
(U.S. dollars in millions)

	GPO[1]	GIO[1]	Total	NPO[1]	NIO[1]	Total
Public Finance						
General Obligation	$ 13,485	$ 5,004	$ 18,489	$ 13,485	$ 5,004	$ 18,489
Special Revenue	9,559	8,355	17,914	9,412	8,168	17,580
Utility	5,454	3,128	8,582	5,447	3,128	8,575
Non Ad Valorem	4,106	1,982	6,088	4,106	1,982	6,088
Appropriation	2,014	1,005	3,019	2,014	1,005	3,019
Total Public Finance	$ 34,618	$ 19,474	$ 54,092	$ 34,464	$ 19,287	$ 53,751
Asset-Backed Securities						
RMBS	$ 1,556	$ 336	$ 1,892	$ 1,546	$ 334	$ 1,880
Commercial ABS	673	52	725	673	52	725
Total Asset-Backed Securities	$ 2,229	$ 388	$ 2,617	$ 2,219	$ 386	$ 2,605
Collateralized Debt Obligations						
Cashflow CDO	$ 6,216	$ 536	$ 6,752	$ 6,216	$ 536	$ 6,752
Synthetic CDO	5,361	-	5,361	5,361	-	5,361
Market Value CDO	568	30	598	568	30	598
Total Collateralized Debt Obligations	$ 12,145	$ 566	$ 12,711	$ 12,145	$ 566	$ 12,711
Structured Single Risk						
Power & Utilities	$ 8,607	$ 8,185	$ 16,792	$ 8,607	$ 8,185	$ 16,792
Global Infrastructure	8,227	5,090	13,317	8,171	5,048	13,219
Specialized Risk	1,251	310	1,561	1,251	310	1,561
Total Structured Single Risk	$ 18,085	$ 13,585	$ 31,670	$ 18,029	$ 13,543	$ 31,572
Total Outstanding	$ 67,077	$ 34,013	$101,090	$ 66,857	$ 33,782	$100,639

[1] GPO, GIO, NPO and NIO represent Gross Principal Outstanding, Gross Interest Outstanding, Net Principal Outstanding and Net Interest Outstanding, respectively.

The following table sets forth the number of years to maturity of the Company's in-force guaranteed principal and interest exposure at December 31, 2012:

Years to Maturity - Debt Service Amortization
(U.S. dollars in millions)

	Scheduled Net Debt Service	NPIO[1]
2012 Q4	$ -	$ 100,639
2013 Q1	1,534	99,105
2013 Q2	2,173	96,932
2013 Q3	1,273	95,659
2013 Q4	2,040	93,619
Total 2013	$ 7,020	
2014	$ 7,728	$ 85,891
2015	5,667	80,224
2016	6,249	73,975
2017	4,951	69,024
Total 2014-2017	$ 24,595	
2018-2022	$ 17,995	$ 51,029
2023-2027	15,491	35,538
2028-2032	10,986	24,552
2033 and thereafter	24,552	-
Total 2018-thereafter	$ 69,024	
Total	$ 100,639	

[1] NPIO represents Net Principal and Interest Outstanding.

The following table sets forth the Company's in-force guaranteed principal exposure by geographic concentration at December 31, 2012:

Geographic Distribution - Par Exposure
(U.S. dollars in millions)

	GPO	NPO	% NPO
United States			
California	$ 6,825	$ 6,778	10.1 %
New York	3,519	3,519	5.3
Illinois	2,864	2,864	4.3
Texas	2,097	2,097	3.1
Alabama	2,090	2,082	3.1
Florida	1,836	1,736	2.6
Pennsylvania	1,418	1,418	2.1
New Jersey	1,263	1,263	1.9
Colorado	1,062	1,062	1.6
Georgia	953	953	1.4
Michigan	898	898	1.3
Massachusetts	841	841	1.3
Puerto Rico	829	829	1.2
Washington	780	780	1.2
Tennessee	733	733	1.1
Ohio	677	677	1.0
Virginia	669	669	1.0
Other[1]	8,348	8,348	12.5
Non-PF Multi[2][3]	11,889	11,880	17.8
Total United States	$ 49,591	$ 49,427	73.9 %
International			
United Kingdom	$ 9,320	$ 9,264	13.9 %
Australia	2,172	2,172	3.2
Ireland	1,095	1,095	1.6
Chile	873	873	1.3
France	772	772	1.2
New Zealand	713	713	1.1
Other[1]	2,235	2,235	3.3
Non-PF Multi[2][4]	306	306	0.5
Total International	$ 17,486	$ 17,430	26.1 %
Total Par Outstanding	$ 67,077	$ 66,857	100.0 %

[1] Single state/country with NPO < 1% of the total exposure plus any multi-state/country Public Finance exposures.
[2] Non-Public Finance deals with underlying securities in multiple states/countries.
[3] Consists of $9,662 million in CDO, $2,019 million in ABS and $200 million in SSR net par.
[4] Consists of $266 million in CDO and $40 million in SSR net par.

Exposure to Residential Mortgage Market

The Company is exposed to residential mortgages directly, through its insurance guarantees of RMBS.

As of December 31, 2012, the Company's total net direct exposure to RMBS aggregated approximately $1.5 billion (the amount excludes exposure related to guarantees which were effectively defeased or, in-substance, commuted pursuant to Insurance Cash Flow Certificates – see Note 3), representing approximately 2.3% of its total in-force guaranteed net principal outstanding at such date. The RMBS exposure consisted of various collateral types as set forth in the table below. The tables below also set forth the Company's internal ratings, as well as the ratings of certain rating agencies, of the insured transactions at December 31, 2012 (excluding exposure related to guarantees which were effectively defeased or, in-substance, commuted pursuant to Insurance Cash Flow Certificates as discussed above).

Exposure to RMBS

The following table presents the net principal outstanding for the Company's insured RMBS portfolio by type of collateral as of December 31, 2012:

RMBS Exposure
(U.S. dollars in millions)

	NPO	% NPO
Prime (1st lien)	$ 43	2.8 %
Prime (2nd lien)	47	3.0
Prime (HELOC)	252	16.3
Alt-A (1st lien)	738	47.8
Alt-A (2nd lien)	15	1.0
Subprime (1st lien)	336	21.8
Subprime (2nd lien)	69	4.4
Subprime (1st lien) - International	46	2.9
Total RMBS Outstanding	$ 1,546	100.0 %

[1] Collateral type is defined as follows: Prime (1st lien) mortgage loans are secured by first liens on one-to-four family residential properties. The underwriting standards used to underwrite prime mortgage loans are the standards applied to the most creditworthy borrowers and are generally acceptable to Fannie Mae and Freddie Mac. Prime (2nd lien) mortgage loans are secured by 2nd liens on one-to-four family residential properties. The underwriting standards used to underwrite prime mortgage loans are the standards applied to the most creditworthy borrowers and are generally acceptable to Fannie Mae and Freddie Mac. This category also includes Alt-A (2nd lien) loans. HELOC is an adjustable rate line of credit secured by a second lien on residential properties. An Alt-A loan means a mortgage loan secured by first liens on residential properties, which is ineligible for purchase by Fannie Mae or Freddie Mac. Subprime (1st lien) mortgage loans are secured by first liens on residential properties to non-prime borrowers. The underwriting standards used to underwrite subprime mortgage loans are less stringent than the standards applied to the most creditworthy borrowers and less stringent than the standards generally acceptable to Fannie Mae and Freddie Mac with regard to the borrower's credit standing and repayment ability. Subprime (2nd lien) mortgage loans are secured by second liens on residential properties to non-prime borrowers. See Subprime (1st lien) for a description of the underwriting standards. Subprime (1st lien) – International mortgage loans are secured by first liens on residential properties to non-prime borrowers located outside the United States.

The following table presents the net principal outstanding and net reserves for unpaid losses for the Company's insured RMBS portfolio by year of origination (year the guarantee was underwritten and issued) as of December 31, 2012. Net principal outstanding in the table below excludes principal effectively defeased or, in-substance, commuted by the Company in connection with its acquisition of Insurance Cash Flow Certificates, whereas net reserves for unpaid losses in the table below are reported on the same basis as reflected in the Company's balance sheet (not adjusted to reflect reserves effectively defeased or, in-substance, commuted pursuant to the Company's acquisition of Insurance Cash Flow Certificates).

RMBS Exposure
(U.S. dollars in millions)

	2004	2005	2006	2007	Total
Prime/Alt-A	$ 177	$ 69	$ 134	$ 715	$ 1,095
Subprime	64 [1]	107	-	280	451
Total RMBS Outstanding	$ 241	$ 176	$ 134	$ 995	$ 1,546

[1] Includes $0.1 million relating to business underwritten and issued in 1999.

(U.S. dollars in millions)					
Net case reserves for unpaid losses	$ 63	$ 217	$ 459	$ 219	$ 958

The following tables show the Company's current internal and rating agency ratings on all of the Company's direct RMBS exposure by deal, grouped by collateral type. The Company's internal ratings are based on its internal credit assessment of each transaction taking into account the overall credit strengths and weaknesses, transaction structure and the trends in the asset sector. The Company bases its analysis on information received from the trustees or from the issuer, as well as on-site visits to issuers, servicers, collateral managers and project sites. Modeling results are also considered. The Company also takes into consideration the rating agencies' rationale for their ratings; however, variations may exist between the Company's ratings and the ratings of the rating

agencies. Rating agencies' may change their ratings on obligations on a frequent basis and in some cases ratings issued by ratings agencies may be withdrawn by such ratings agencies. Accordingly, the following tables may not reflect the ratings agencies most current published ratings.

RMBS Ratings
(U.S. dollars in millions)

	Vintage	Internal Rating	S&P Rating(1)	Moody's Rating(1)	NPO
Prime (1st lien)					
1. ……	2004	bbb	NR	B1	$ 24
2. ……	2004	aa	AAA	NR	14
3. ……	2004	aa	AA+	Ba1	5
Total					$ 43
Prime (2nd lien)					
1. ……	2006	d	D	C	$ 47
Total					$ 47
Prime (HELOC)					
1. ……	2004	d	B-	Ca	$ 81
2. ……	2004	d	BB+	Ca	53
3. ……	2005	d	D	Ca	23
4. ……	2006	d	D	C	53
5. ……	2006	d	D	Ca	29
6. ……	2006	d	NR	C	5
7. ……	2006	d	CC	Ca	-
8. ……	2007	d	D	Ca	8
Total					$ 252
Alt-A (1st lien)					
1. ……	2005	c	AA+	Caa3	$ 33
2. ……	2005	d	CC	Caa2	13
3. ……	2006	d	CC	C	-
4. ……	2006	d	D	C	-
5. ……	2007	bbb-	CCC	Caa3	299
6. ……	2007	b-	NR	Caa3	255
7. ……	2007	c	CCC	Caa3	138
8. ……	2007	d	D	C	-
Total					$ 738
Alt-A (2nd lien)					
1. ……	2007	d	CC	Ca	$ 15
2. ……	2007	d	D	B1	-
Total					$ 15

	Vintage	Internal Rating	S&P Rating(1)	Moody's Rating(1)	NPO
Subprime (1st lien)					
1.	1999	b	D	Caa1	$ -
2.	2004	a-	AAA	A1	36
3.	2004	b-	AA-	B2	21
4.	2004	aa	AAA	Aa2	7
5.	2005	c	CCC	-	93
6.	2005	bbb-	AA+	A2	12
7.	2005	bbb-	BBB+	Baa3	2
8.	2007	c	CCC	C	165
Total					$ 336
Subprime (2nd lien)					
1.	2007	b	CCC	Caa3	$ 47
2.	2007	c	CC	C	16
3.	2007	c	B	Ca	6
Total					$ 69
Subprime (1st lien) - International					
1.	2007	bbb	BBB	Baa2	$ 46
Total					$ 46
Total RMBS Outstanding					$ 1,546

Exposure to CDOs

The following table presents the net notional exposure of the Company's guaranteed CDOs by type[1] of referenced asset as of December 31, 2012. A CDO is a security that is collateralized by, or synthetically references, a pool of debt obligations such as corporate loans, bonds and ABS:

CDO Exposure
(U.S. dollars in millions)

	NPO	% NPO	# of Credits
Cash flow CDO			
US CLO	$ 3,470	28.70 %	18
Euro CLO	2,483	20.40	10
TRUPS CDO	234	1.90	5
High Yield Bond CBO	13	0.10	1
Multi-Sector CDO	10	0.10	2
ABS CDO	5	0.00	1
Investment Grade Bond CBO	1	0.00	1
Total Cash flow CDO	$ 6,216	51.20 %	38
Synthetic CDO			
Corporate Synthetic CDO	$ 3,500	28.80 %	11
CMBS CDO	1,861	15.30	3
Total Synthetic CDO	$ 5,361	44.10 %	14
Market Value CDO			
US CLO	$ 568	4.70 %	1
Total Market Value CDO	$ 568	4.70 %	1
Total Collateralized Debt Obligations Outstanding	$ 12,145	100.00 %	53

[1] Asset type is defined as follows. A Cash flow CDO is a securitized bond that is collateralized by a pool of debt obligations such as corporate loans, bonds and ABS. A US CLO is a CDO with underlying collateral primarily consisting of senior secured bank loans made to corporate entities domiciled in the United States and rated below investment grade at inception (i.e., rated below "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch). A Euro CLO is a CDO with underlying collateral primarily consisting of senior secured bank loans made to corporate entities domiciled in Europe and generally rated below investment grade at inception (i.e., rated below "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch). An Emerging Markets CDO is a CDO with underlying collateral primarily consisting of sovereign debt securities from emerging markets issuers and/or corporate bonds issued by companies domiciled in emerging markets jurisdictions. A Trups CDO is a CDO with underlying collateral primarily consisting of trust preferred securities issued by bank holding companies. A High Yield Bond CBO is a CDO with underlying collateral primarily consisting of unsecured bonds issued by corporate entities rated below investment grade at inception (i.e., rated below "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch). A Multi-Sector CDO is a CDO with underlying collateral primarily consisting of ABS securities (including less than 50% RMBS bonds). An ABS CDO is a CDO with underlying collateral primarily consisting of RMBS bonds (greater than 50%) and other ABS securities. An Investment Grade Bond CBO is a CDO with underlying collateral primarily consisting of senior unsecured bonds issued by corporate entities rated investment grade at inception (i.e., rated at least "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch or higher).

A Synthetic CDO is a CDO that synthetically references a portfolio of debt obligations through the use of credit default swaps. A Corporate Synthetic CDO is a CDO that references a pool primarily consisting of senior unsecured corporate credits rated investment grade at inception (i.e., rated at least "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch or higher). A CMBS CDO is a CDO that synthetically references a portfolio of Commercial Mortgage Backed Securities. A CDO Squared is a CDO that synthetically references a portfolio of securities issued by other CDOs.

A Market Value CDO is a CDO that is collateralized by a pool of debt obligations such as corporate loans, bonds and ABS. Unlike Cash flow CDOs, a Market Value CDO measures ongoing transaction performance based on the market value of the collateral rather than par value.

The following table presents the net notional exposure of the Company's guaranteed CDOs by rating as of December 31, 2012:

CDO Ratings[1]
(U.S. dollars in millions)

	NPO	% NPO
AAA	$ 2,728	22.5 %
AA	6,726	55.4
A	568	4.7
BBB	1,024	8.4
Below investment grade	1,099	9.0
Total Collateralized Debt Obligations Outstanding	$ 12,145	100.0 %

[1] Based on S&P rating as reflected in Syncora's records, if available, and internal Syncora rating if no S&P rating is available.

12. Insurance Premiums

As of December 31, 2012, the Company reported a premium receivable of $227.5 million primarily related to installment policies for which premiums will be collected over the term of the contracts. Premiums are discounted at a risk-free rate that considers the expected maturity of each contract. The weighted average risk-free rate used to discount future installment premiums was 2.4% and the weighted average collection term of the premium receivable was 11.8 years. For the year ended December 31, 2012, the accretion of the premium receivable was $6.3 million and is reported in "Premiums earned" on the accompanying consolidated statement of operations. As of December 31, 2012, the Company reported a reinsurance premium payable of $1.6 million, which represents the portion of the Company's premium receivable that is due to reinsurers. The reinsurance premium payable will be accreted and paid, as premiums due to the Company are accreted and collected. The following table presents a roll forward of the Company's premium receivable for the year ended December 31, 2012:

(U.S. dollars in thousands)

			Adjustments			
Premium Receivable as of December 31, 2011	**Premium Payments Received**	**Premiums from New Business Written**	**Changes in Expected Term of Policies**	**Accretion of Premium Receivable Discount**	**Other**	**Premium Receivable as of December 31, 2012**
$ 276,637	$ (36,185)	$ -	$ (19,303)	$ 6,344	$ -	$ 227,493

The following table presents, as of December 31, 2012, the Company's installment premiums on direct business expected to be collected in the future and the periods in which such collections are expected to occur. In addition to that presented in the table below, the Company had installment premiums receivable of $37.8 million (on a present value basis) relating to assumed reinsurance business at December 31, 2012:

(U.S. dollars in thousands)	**Expected Collection of Premiums**
Three months ended:	
March 31, 2013	$ 4,774
June 30, 2013	5,537
September 30, 2013	4,946
December 31, 2013	3,124
Twelve months ended:	
December 31, 2013	18,381
December 31, 2014	16,331
December 31, 2015	15,119
December 31, 2016	13,342
December 31, 2017	11,989
Five years ended:	
December 31, 2017	75,162
December 31, 2022	44,978
December 31, 2027	31,052
December 31, 2032	20,710
December 31, 2037	12,996
December 31, 2042	1,801
December 31, 2047	318
December 31, 2052	58
Total	$ 187,075

The following table presents the expected unearned premium revenue balance and the expected future premium earnings of the Company's direct in-force business as of and for the periods presented. In addition to that presented in the table below, the Company had unearned premium revenue of $91.3 million relating to assumed reinsurance business at December 31, 2012.

(U.S. dollars in thousands)	Unearned Premium Revenue	Expected Premium Earnings			
		Upfront	Installments	Accretion	Total
Three months ended:					
March 31, 2013	$ 559,747	$ 7,855	$ 5,066	$ 1,418	$ 14,339
June 30, 2013	547,432	7,432	4,883	1,392	13,707
September 30, 2013	535,577	7,118	4,737	1,358	13,213
December 31, 2013	523,996	7,032	4,549	1,325	12,906
Twelve months ended:					
December 31, 2013	523,996	29,437	19,235	5,493	54,165
December 31, 2014	479,627	27,392	16,977	4,994	49,363
December 31, 2015	437,930	26,233	15,464	4,553	46,250
December 31, 2016	398,963	25,059	13,908	4,119	43,086
December 31, 2017	362,607	23,869	12,488	3,729	40,086
Five years ended:					
December 31, 2017	362,607	131,990	78,072	22,888	232,950
December 31, 2022	219,754	99,922	42,930	13,898	156,750
December 31, 2027	124,280	68,100	27,375	7,841	103,316
December 31, 2032	65,147	42,509	16,624	3,960	63,093
December 31, 2037	34,180	21,652	9,314	1,243	32,209
December 31, 2042	22,320	10,370	1,490	114	11,974
December 31, 2047	14,668	7,419	233	26	7,678
December 31, 2052	6,849	7,777	42	2	7,821
December 31, 2057	463	6,386	-	-	6,386
December 31, 2062	-	463	-	-	463
Total		$ 396,588	$ 176,080	$ 49,972	$ 622,640

The following sets forth the components of premiums earned for the years ended December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Gross premiums written	$ (11,064)	$ (38,414)
Reinsurance premiums assumed	1,216	(4,924)
Total premiums written	(9,848)	(43,338)
Change in direct unearned premium revenue	91,593	124,380
Change in assumed unearned premium revenue	9,008	15,969
Gross premiums earned	90,753	97,011
Reinsurance premiums ceded	(73)	558
Change in prepaid reinsurance premiums	(437)	(1,270)
Ceded premiums earned	(510)	(712)
Net premiums earned	$ 90,243	$ 96,299

For the years ended December 31, 2012 and 2011, net premiums earned include $22.0 million and $10.0 million, respectively, of earned premium relating to Refundings.

13. 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, 2012 and 2011 are as follows:

(U.S. dollars in thousands)	2012	2011
Deferred acquisition costs, net—beginning of year	$ 106,361	$ 125,459
Acquisition costs and ceding commission revenue amortized:		
Acquisition costs amortized	(11,142)	(15,072)
Ceding commission revenue amortized	51	50
Amortization of deferred acquisition costs	(11,091)	(15,022)
Commutations	—	(4,076)
Deferred acquisition costs, net—end of year	$ 95,270	$ 106,361

Accelerated amortization of deferred acquisition costs due to Refundings was $3.1 million and $1.3 million for the years ended December 31, 2012 and 2011, respectively.

14. Reinsurance

The Company enters into ceded reinsurance arrangements principally to manage its risk guidelines and to reduce the risk of loss on business written or assumed. 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, 2012 and 2011 there were no amounts provided by the Company for uncollectible reinsurance recoverable. The following table sets forth certain amounts ceded to reinsurers as of and for the years ended December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Year Ended December 31		
Ceded premiums written	$ 73	$ (558)
Ceded premiums earned	510	712
Ceding commission revenue	51	50
Ceded losses and loss adjustment expenses	(1,244)	991
As of December 31		
Par exposure ceded	$ 220,824	$ 274,656
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	3,715	5,023

The following table sets forth reinsurance balances recoverable on unpaid losses and loss adjustment expenses by reinsurer as of December 31, 2012 and 2011:

(U.S. dollars in thousands)	2012	2011
Radian Asset Assurance Inc.	$ 2,153	$ 2,649
CIFG Assurance North America Inc.	—	117
American Overseas Reinsurance Co. Ltd	260	376
Assured Guaranty Corp	1,302	1,881
Total	$ 3,715	$ 5,023

15. Income Taxes

Syncora Holdings is not subject to any taxes in Bermuda on either income or capital gains under current Bermuda law. In the event that there is a change such that these taxes are imposed, Syncora Holdings would be exempted from any such tax until March 2016 pursuant to Bermuda law.

Syncora Guarantee has subsidiary and branch operations in certain international jurisdictions that are subject to relevant taxes in those jurisdictions. Syncora Guarantee and Syncora Capital Assurance file a consolidated U.S. federal tax return with Syncora Holdings U.S. Inc. (the U.S. common parent of the Syncora Holdings' group) and its subsidiaries (which consists of Syncora Guarantee, Syncora Capital Assurance and Syncora Holdings U.S. Inc.'s other U.S. based subsidiaries). Syncora Holdings U.S. Inc. maintains a tax sharing agreement with its subsidiaries, whereby each subsidiary determines its payment due to/from Syncora Holdings U.S., Inc. on a separate company return basis. Further, if the subsidiary's separate return computation results in a taxable

loss for the period, Syncora Holdings U.S., Inc. will reimburse the subsidiary to the extent that such loss reduces the Company's consolidated income tax liability.

Management has concluded that results from operations forecasted to be generated in the future are more likely than not insufficient to permit realization of the deferred tax assets, thus a valuation allowance has been established against the entire deferred tax assets of the Company at December 31, 2012 and December 31, 2011. The valuation allowance was calculated in accordance with the provisions of the accounting pronouncements for income taxes, which place primary importance on operating results in recent periods when assessing the need for a valuation allowance. 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.

At December 31, 2012, the Company's cumulative NOLs, which may be carried forward to offset future taxable income, are $3.1 billion. The Company's ability to utilize its NOLs at December 31, 2012 expires from 2027 through 2032. Approximately $161.3 million of the Company's NOLs as of December 31, 2012 are subject to limitation under Section 382 of the Internal Revenue Code as a result of an ownership change, as defined under that code section that occurred on August 5, 2008. An ownership change, as defined under the aforementioned code section, will occur if shareholders owning (or deemed under the aforementioned code section to own) 5% or more of Syncora Holdings' common shares increase their collective ownership of the aggregate amount of outstanding shares of Syncora Holdings by more than 50% over a defined period of time. To avoid an ownership change in the future and further limitation on the use of the Company's NOLs, on October 21, 2008, Syncora Holdings' Board of Directors approved changes to Syncora Holdings' By-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 such bye-laws.

The Company's significant NOLs are expected to reduce future tax liability that otherwise would be payable by the Company. The ability to utilize these NOLs would be limited in certain events, including if an "ownership change" under Section 382 of the Internal Revenue Code ("Section 382") were to occur. Section 382 limits the ability of a corporation that experiences an ownership change to utilize its NOLs and certain built-in losses after 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 rolling 3-year period. These rules generally operate by focusing on ownership changes among shareholders 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. Generally under Section 382, in the event of an ownership change, the amount of taxable income that a corporation can offset by its "pre-change losses" (which include its NOLs) is restricted to an annual amount equal to the equity value of the corporation immediately prior to the ownership change multiplied by the long-term tax-exempt rate.

As of December 31, 2012 and 2011, respectively, the Company had no unrecognized tax benefit and no adjustments to liabilities or operations were required.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense, which were zero for the years ended 2012 and 2011. Tax years 2009 through 2012 are subject to examination by federal authorities. There are currently no federal, state or local tax audits underway for the Company as of December 31, 2012.

The Company is a Bermuda corporation and, except for gross basis withholding taxes on U.S. source investment income, neither it nor its non-U.S. subsidiaries have paid U.S. Federal corporate income taxes, on the basis that they are not engaged in a trade or business or otherwise subject to taxation in the United States. However, because definitive identification of activities which constitute being engaged in a trade or business in the United States is not provided by the Internal Revenue Code of 1986, as amended, regulations or court decisions, there can be no assurance that the Internal Revenue Service would not contend that the Company or its non-U.S. subsidiaries are engaged in a trade or business or otherwise subject to taxation in the United States.

In addition to the foregoing, there is a risk that the Internal Revenue Service could disagree with a number of tax positions taken by the Company with respect to certain transactions, including but not limited to, certain transactions undertaken in connection with the 2009 MTA. If any of the positions taken by the Company were successfully challenged by the Internal Revenue Service, there could be a material adverse effect on the amount of NOLs available to the Company to offset taxable income.

The Company's income tax provision for the years ended December 31, 2012 and 2011 was $2,612,937 and $4,000, respectively. The increase of $2.6 million is primarily due to a $2.3 million current foreign income tax provision for Syncora Guarantee-UK.

The difference between the expected and actual tax benefit or expense for each of the years ending December 31, 2012 and 2011 is primarily attributable to the full valuation allowance recorded by the Company in such years, as discussed above.

The Company's net deferred tax assets as of December 31, 2012 and 2011 consist of the following:

(U.S. dollars in thousands)	2012	2011
Gross deferred tax assets	$ 2,282,257	$ 2,047,578
Valuation allowance	(2,061,590)	(1,814,576)
Deferred tax assets, net	220,667	233,002
Deferred tax liability	220,667	233,002
Net deferred tax assets	$ —	$ —

The gross deferred tax assets are due principally to the Company's NOLs, the mark-to-market on CDS contracts, loss and loss adjustment reserves and capital loss carry forwards. Gross deferred tax liabilities are due principally to the Company's mark-to-market on CDS contracts, Insurance Cash Flow Certificates and deferred acquisition costs. As of December 31, 2012 and 2011 the Company recorded a full valuation allowance against its gross deferred tax assets.

16. Preferred Shares

Non-Controlling Interest in Subsidiary – Series B Perpetual Non-Cumulative Preferred Shares of Syncora Guarantee

On February 11, 2008, Syncora Guarantee Re Ltd., a former affiliate of Syncora Guarantee issued 2,000 shares of non-cumulative perpetual Series B preferred shares (the "Series B Preferred Shares") for consideration aggregating $200 million pursuant to the exercise of a put option under its capital facility. After the merger of Syncora Guarantee Re with and into Syncora Guarantee, the Series B Preferred Shares became preferred shares of Syncora Guarantee. 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 Syncora Guarantee's common shares non-cumulative cash dividends at a percentage rate per Series B Preferred Share 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 for any subsequent dividend period, one-month LIBOR plus 2.00% per annum, calculated on an actual/360 day basis. Accordingly, the carrying value of the Series B Preferred Shares of $20.0 million represents the net proceeds received upon the issuance less the reversal of the fair value of the put option on the date of exercise.

The holders of the Series B Preferred Shares are not entitled to any voting rights as shareholders of Syncora Guarantee 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 Syncora Guarantee 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. Syncora Guarantee has not declared or paid dividends on the Series B Preferred Shares during the years ended December 31, 2012 and 2011. In connection with the Countrywide settlement discussed above, Syncora Guarantee holds 655 shares of its non-cumulative perpetual Series B preferred shares, which were transferred by BAC.

Series A Perpetual Non-Cumulative Preferred Shares

On April 5, 2007, Syncora Holdings consummated a private placement sale of $250.0 million of its Series A Preferred Shares. Net proceeds from the offering were $246.6 million after offering costs of $3.4 million. The Series A Preferred Shares are perpetual securities with no fixed maturity date and, if declared by the Board of Syncora Holdings, pay a fixed dividend, on a semi-annual basis during the first and third quarters of each fiscal year, at the annualized rate of 6.88% until September 30, 2017. After such date, the Series A Preferred Shares, if declared by the Board of Syncora Holdings, will pay dividends, on a quarterly basis, at a floating rate based on three-month LIBOR plus 2.715%. Dividends on the Syncora Holdings Series A Preferred Shares are non-cumulative. See Note 18. The Syncora Holdings Series A Preferred Shares have a liquidation preference of $1,000 per preferred share. There are 250,000 Syncora Holdings Series A preferred shares outstanding.

17. Commitments and Contingencies

a. Legal Matters

In the ordinary course of business, Syncora Guarantee is subject to litigation or other legal proceedings. Syncora Guarantee intends to vigorously defend against all actions in which it is a defendant and against other potential actions, and Syncora Guarantee does not expect the outcome of these matters to have a material adverse effect on Syncora Guarantee's financial position, results of operations or liquidity. Syncora Guarantee can provide no assurance that the ultimate outcome of these actions will not cause a loss nor have a material adverse effect on Syncora Guarantee's financial position, results of operations or liquidity.

As of March 31, 2013, 26 states or jurisdictions have suspended the Company's license to conduct insurance business in such states or jurisdictions, revoked, placed an order of impairment against it, or the Company voluntarily surrendered its license, agreed to cease writing business in such states or jurisdictions, its license expired or the Company opted not to renew its license. Management anticipates that Syncora Guarantee will be able to continue to collect premiums on existing business in such states or jurisdictions. Additional states or jurisdictions may suspend Syncora Guarantee's license, place an order of impairment against it or, in lieu of a suspension or order, Syncora Guarantee may voluntarily agree to cease writing business and let such licenses expire or opt not to renew its licenses in additional states or jurisdictions.

Set forth below is a description of certain legal proceedings to which Syncora Guarantee is a party.

Bond Insurers Conspiracy Litigation

From July 2008 to July 2010, lawsuits were filed by a number of California municipal entities in California state court against several bond insurers, including Syncora Guarantee, the three major credit rating agencies, and two individual defendants. The complaints include allegations that the bond insurer 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. On October 20, 2011, defendants' motion to dismiss the complaints for failure to allege a claim was denied. Defendants filed a motion to strike the pleadings under a California statute, which was denied with respect to certain of the claims on May 1, 2012, granted as to certain of the claims on March 21, 2013, and remains pending as to other claims.

Jefferson County Litigation

On November 9, 2011, Jefferson County (the "County") filed for protection under Chapter 9 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Alabama (the "Bankruptcy Court"). Accordingly, all proceedings against the County are subject to the automatic stay. The proceedings in the Jefferson County bankruptcy are not summarized herein, however, as described in Note 2, the Company may be materially and adversely affected by adverse outcomes or rulings in this bankruptcy proceeding. Syncora Guarantee entered into a Plan Support Agreement ("PSA"), dated as of June 6, 2013, with the County and other bond insurers that insure County obligations, pursuant to which certain County related litigation has been stayed.

On June 17, 2008, Charles Wilson, on behalf of himself and a class consisting of every Jefferson County taxpayer and sewer ratepayer since January 1, 1993, filed suit against Syncora Guarantee and numerous other defendants. The suit alleged that through the wrongful conduct of the members of the Jefferson County Commission, most notably Larry Langford, the county incurred a bonded indebtedness of $3.2 billion relating to improvements to its sewer system. The complaint alleged 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 alleged, 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 Syncora Guarantee, the complaint alleged 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 alleged damages on the ground that their sewer rates are much higher than they otherwise would have been without the wrongdoing of all parties.

The Sixth Amended Complaint, filed April 15, 2010, dropped all claims for damages against Syncora Guarantee. The only claims currently asserted by plaintiffs are for equitable relief. Plaintiffs seek to have the bonds declared invalid and all monies returned to the County. Plaintiffs also seek payment under the contracts of the bond insurers, requesting that the bond insurers pay all amounts due on the policies for the use and benefit of the ratepayers . The court conducted a hearing on the motions to dismiss on November 22, 2010 and denied the motions. Syncora Guarantee and all other defendants have filed a petition for writ of mandamus with the Alabama Supreme Court seeking reversal of the trial court's decision. The appeal was stayed in light of Jefferson County's bankruptcy filing. Shortly after the bankruptcy filing, some of the defendants removed the case to federal district court on the basis of bankruptcy jurisdiction. The case is currently before the bankruptcy judge presiding over the County's bankruptcy proceeding. Plaintiffs have not moved for a remand to state court, and no other material activity has occurred since removal to federal court.

On April 15, 2009, Syncora Guarantee and Financial Guaranty Insurance Company submitted a Notice of Claim with the County asserting damages resulting from fraud by the County in connection with the issuance of insurance policies in respect of the sewer warrants. On April 28, 2010, Syncora Guarantee submitted an Amended and Supplemented Notice of Claim to Jefferson County, Alabama. On September 10, 2010, Syncora Guarantee submitted a Notice of Claim with the County asserting damages resulting from the County's failure to comply with its payment obligations to Syncora Guarantee pursuant to a certain debt service reserve insurance policy and accompanying Financial Guaranty Agreement.

On April 29, 2010, Syncora Guarantee filed a complaint against the County, JPMorgan Chase Bank N.A. and JPMorgan Securities, Inc. (together, "JPMorgan") in the Supreme Court of the State of New York, County of New York. The complaint includes claims that the County and JPMorgan fraudulently induced Syncora Guarantee to provide bond insurance policies between 2002 and 2004 covering debt issued by the County. On July 8, 2010, JPMorgan filed a motion to dismiss Syncora Guarantee's complaint against it; the issues presented in JPMorgan's motion to dismiss were fully briefed on September 9, 2010 and argued to the court on October 18, 2010. On July 8, 2010, the County filed an answer to Syncora Guarantee's complaint as it respects the County and filed counterclaims alleging that Syncora Guarantee injured the County by failing to maintain its credit rating and seeking $100 million in damages on the basis of contract, negligence and fraud claims. On August 23, 2010, Syncora Guarantee filed a motion to dismiss the County's counterclaims. On October 29, 2010, Syncora Guarantee's motion to dismiss the County's counterclaims was fully briefed. On December 21, 2010, JPMorgan's motion to dismiss Syncora Guarantee's complaint was denied, and Syncora Guarantee's motion to dismiss the County's counterclaim was granted. On January 24, 2011, JPMorgan filed an answer to the complaint. As a result of the County's Chapter 9 filing, the action is stayed as against the County and *de facto* stayed against JPMorgan. Syncora Guarantee intends to continue, at an appropriate time, to pursue its claims against JPMorgan, including seeking to modify any stay of the action, if applicable, or taking other appropriate action to continue to litigate its claims.

Prior to the County's chapter 9 filing, as a result of the County's persistent management and operational failures respecting its sewer system (the "System"), The Bank of New York Mellon, as Indenture Trustee, (the "Trustee") sought—and obtained—a receiver (the "Receiver") for the System. The Receiver operated and controlled every aspect of the System until January 2012 when the Bankruptcy Court determined that the County's chapter 9 filing terminated the Receiver's control over the System. At the same time the Bankruptcy Court restored the County's control and administration of the System, it ruled that the County must, pursuant to 11 U.S.C. § 922(d), continue to pay monthly revenues, net of Operating Expenses (as defined in that certain Trust Indenture dated February 1, 1997 (the "Indenture")), to the Trustee. Beginning in late January 2012, the Trustee, Syncora Guarantee, and other creditors filed notices of appeal of the Bankruptcy Court's decision with respect to restoring the County's control and operation of the System; around the same time, the County filed a notice of appeal concerning the Bankruptcy Court's section 922(d) ruling. The appeal and cross-appeal were certified for direct review by the United States Circuit Court for the Eleventh Circuit (the "Eleventh Circuit"); the Eleventh Circuit granted the parties' respective petitions for appeal in July 2012 and scheduled briefing. All briefing has since been completed and oral argument has been set for the week of July 22, 2013.

In February 2012, the Trustee filed a declaratory judgment complaint against the County in connection with the County's unilateral decision to modify the meaning of "Operating Expenses" (as defined in the Indenture) to include, among other things, reserves for amortization and depreciation, capital expenditures, and reserves for professional expenses. Since this modification could significantly reduce the amount of net revenues paid to the Trustee on a monthly basis, the Trustee sought a declaration from the Bankruptcy Court that the Indenture's definition of "Operating Expenses" controlled and that, to the extent that 11 U.S.C. § 928(b) applied, the term "necessary operating expenses," as used in that section, did not include the expenditures and reserves proposed by the County. On June 29, 2012, the Bankruptcy Court ruled in favor of the Trustee, holding that the Indenture's definition of "Operating Expenses" determined the amount of funds that the County could deduct prior to payment of debt service. The County filed a notice of appeal on November 21, 2012; the appeal was certified for direct appeal to the Eleventh Circuit. The Eleventh Circuit granted the petition for direct appeal in January 2013. The County filed its opening brief on April 5, 2013; The creditors, including Syncora Guarantee, filed their brief in opposition to the County's brief on June 4, 2013. The County will have until June 25, 2013 to reply to the creditors' opposition brief. Thereafter, the parties will await the scheduling of oral argument.

Certain of the counts of the Trustee's declaratory judgment complaint, as amended (to add Syncora Guarantee and certain others as plaintiffs), regarding, among other things, the nature and amount of expenditures the County could deduct from System revenues under either the Indenture or section 928(b) of the Bankruptcy Code were severed into a separate adversary proceeding.

Though the severed counts were mooted after the Bankruptcy Court's ruling on June 29, 2012, as discussed above, the County also filed counterclaims against the Trustee in which the County asserted that the Trustee's lien under the Indenture did not extend to certain escrowed funds. The parties have fully briefed cross-motions for summary judgment and now await the Bankruptcy Court's ruling.

On September 6, 2012, Roderick Royal and Andrew Bennett, et al. filed a complaint in the Bankruptcy Court on behalf of a putative class of approximately 127,000 residential and 13,000 industrial, similarly situated property owners, ratepayers and taxpayers against Jefferson County, as "nominal" defendant, and several other defendants, including Syncora Guarantee. The plaintiffs filed an amended complaint on September 29, 2012. In addition to certain breach of contract and aiding and abetting conversion claims against certain defendants, the initial and first amended complaint sought to invalidate the issuance of the County's 2002 and 2003 warrants and the pledge of net revenues securing the 2002 and 2003 warrants by obtaining a declaration from the district court (it has asked the Bankruptcy Court only to enter proposed findings of facts and conclusions of law) (1) that the 2002 and 2003 warrants violate Section 10.2 of the Indenture, (2) that the 2002 and 2003 warrants violate the Alabama constitutional debt requirements, (3) that the payment of the 2002 and 2003 warrants is not secured by a statutory lien and trust under the Alabama Code and Alabama Constitution.

Although the initial and first amended complaint made specific allegations against certain defendants, primarily, JPMorgan, neither complaint made specific allegations against Syncora Guarantee. The claims asserted in the initial, first amended, and second amended Royal complaints overlap significantly with the Wilson litigation, discussed above. On November 19, 2012, Syncora Guarantee, along with the Trustee and certain other named defendants, filed a motion to dismiss the amended complaint. Thereafter, on December 6, 2012, on oral motion of the plaintiffs, the Bankruptcy Court entered an order dismissing counts 4-9 with prejudice. The only claims that remained pending following this order were those that seek to invalidate the 2002 and 2003 Warrants. On January 19, 2013, the plaintiffs filed an objection to the defendants' motion to dismiss. The defendants filed their reply to the plaintiffs' opposition on February 13, 2013. The Bankruptcy Court held a hearing on February 20, 2013. At the hearing, the Bankruptcy Court ordered the plaintiffs to further amend their complaint; as a result, the motion to dismiss was moot. On April 4, 2013, the plaintiffs filed their second amended complaint. The second amended complaint, which asserts claims against only the Trustee and the County, again seeks to have the 2002 and 2003 warrants invalidated on the various grounds previously described as well as on grounds that the issuance of the 2002 and 2003 warrants was procured as a result of criminal conduct, constitutes a violation of certain sections of the Alabama Constitution (these new sections are additive of the sections previously pled), and amounts to a taking in violation of the Fifth Amendment to the United States Constitution. The second amended complaint, like the previous versions and similar to the Wilson litigation, seeks to invalidate the warrants' issuance, seeks an injunction both limiting sewer rate increases and barring future increases in sewer rates, seeks a declaration that the County (and the Receiver) are not permitted to increase rates without the approval of a majority of County taxpayers, and seeks to recover funds from the amount of net revenues recovered as a result of the invalidation of the 2002 and 2003 warrants. The Trustee and the County each filed a motion to dismiss the plaintiffs' second amended complaint on April 18, 2013.

On February 6, 2013, the Trustee filed a motion to lift the automatic stay to permit it to accelerate the balance of the warrants issued by Jefferson County (the "Motion"). In the Motion, the Trustee stated that it seeks to accelerate the balance of the warrants because it has insufficient funds to pay the (1) approximately $792.3 million in principal already due and owing with respect to certain bank warrants previously called for redemption and (2) the principal payments of approximately $18.2 million that came due on February 1. A preliminary hearing on the Motion was initially set for March 7, 2013, but by agreement of the parties, was adjourned to April 11, 2013. Pursuant to the parties' subsequent agreement, the preliminary hearing on the Motion has been carried until the earlier of the entry of an order deciding each count in the Complaint (as defined below) or the scheduling by the Bankruptcy Court of a preliminary hearing in response to a motion filed by a party.

Simultaneously with filing the Motion, the Trustee filed a complaint for declaratory judgment (the "Complaint") against Jefferson County, Syncora Guarantee, and Assured Guaranty Municipal Corp. ("Assured"). In its Complaint, the Trustee has asked the Bankruptcy Court to determine a number of issues with respect to the warrants and the priority of reimbursement of surety draws including (1) whether the Trustee has the authority to accelerate any of the warrants without Assured's consent; (2) the method for allocating surety draws to warrantholders following an acceleration, and (3) whether reimbursement of the draws under the surety policies is subordinate to, or *pari passu* with, the payment of the warrants. On March 22, 2013, the Trustee voluntarily dismissed the count of the Complaint that sought to determine whether reimbursement of surety draws was *pari passu* or subordinated. On the same day, Syncora Guarantee filed a motion to dismiss the complaint (as did Assured). The Trustee has until May 17, 2013 to file its opposition to the motions to dismiss filed by Syncora Guarantee and Assured; Assured and Syncora Guarantee will have until May 29, 2013 to reply to the Trustee's opposition. The Bankruptcy Court has set a hearing on the motions to dismiss for June 5, 2013. Syncora Guarantee may be materially and adversely affected by unfavorable outcomes or rulings in the Bankruptcy Court's adjudication of the Motion and Complaint or otherwise in connection with the bankruptcy.

RMBS Litigation

On January 29, 2009, Syncora Guarantee filed suit in the Supreme Court of the State of New York, New York County, against Countrywide, alleging that Countrywide made misrepresentations in connection with several securitizations of home equity mortgage loans originated and serviced by Countrywide, and for which Syncora Guarantee acted as credit enhancer, and seeking damages and other relief under various legal theories. On May 6, 2010, Syncora Guarantee filed an amended complaint which BAC as an additional defendant as the successor to Countrywide. On July 17, 2012, Syncora Guarantee settled all claims with Countrywide, BAC and affiliates thereof. See caption above "a. Countrywide Settlement" for further discussion.

On February 5, 2009, Syncora Guarantee, together with co-plaintiffs U.S. Bank National Association ("US Bank") and CIFG Assurance North America, Inc. ("CIFG"), filed suit in the Supreme Court of the State of New York, New York County, against GreenPoint, alleging that GreenPoint breached representations and warranties in connection with a securitization of primarily home-equity mortgage loans originated by GreenPoint, and for which Syncora Guarantee acted as credit enhancer, and seeking damages and other relief for breach of contract. GreenPoint moved to dismiss all of the claims against it. In response, Syncora Guarantee argued it is a third-party beneficiary of the underlying sale agreements between GreenPoint and the purchaser of the loans originated by GreenPoint, and CIFG made the same argument. On March 3, 2010, the court denied GreenPoint's motion with regard to the claims of US Bank and granted the motion with regard to Syncora Guarantee and CIFG's arguments that they are third-party beneficiaries of the

underlying sale agreements. On April 14, 2010, all plaintiffs filed their First Amended Complaint. Syncora Guarantee now alleges claims against GreenPoint under the Indemnification Agreement among Syncora Guarantee, GreenPoint and another person. Syncora Guarantee's claims relate to GreenPoint's breaches of representations and warranties in the Indemnification Agreement and breaches of GreenPoint's promises to indemnify Syncora Guarantee. Following oral argument on January 6, 2011 regarding GreenPoint's motion to dismiss Syncora Guarantee's claims (and CIFG's claims) in the First Amended Complaint and the plaintiffs' cross-motion for permission to serve a Second Amended Complaint, the court granted GreenPoint's motion without prejudice and denied the plaintiffs' cross-motion without prejudice, but permitted the plaintiffs to make a motion for leave to file a Third Amended Complaint. The plaintiffs' motion for leave to file a Third Amended Complaint was filed on June 10, 2011. By Decision and Order dated February 24, 2012, and entered by the court on February 28, 2012, the court denied the motion for leave to file a Third Amended Complaint on grounds of res judicata. On March 26, 2012, Syncora Guarantee and CIFG filed a Notice of Appeal appealing that decision to the Supreme Court of the State of New York, Appellate Division, First Department. On May 4, 2012, Syncora Guarantee and CIFG filed a second Notice of Appeal raising additional issues. On July 20, 2012, GreenPoint moved to dismiss the second Notice of Appeal, and the plaintiffs filed their opposition on August 27, 2012. By Order dated October 4, 2012, the court denied GreenPoint's motion to dismiss the second appeal. The plaintiffs perfected their appeal on December 3, 2012; GreenPoint's opposition was filed on February 5, 2013, and plaintiffs' reply brief was filed on March 8, 2013. Oral argument on the appeal was heard on April 3, 2013. On April 25, 2013, First Department affirmed the trial court's dismissal of Syncora Guarantee and CIFG. On May 28, 2013, Syncora Guarantee and CIFG filed motions for reconsideration and leave to appeal.

Meanwhile, US Bank's prosecution of its claims as Indenture Trustee on behalf of Syncora Guarantee and CIFG has continued and Syncora Guarantee is actively involved in discovery.

On March 31, 2009, Syncora Guarantee filed suit against 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 Syncora Guarantee acted as credit enhancer, and seeking damages and other relief for breach of contract. On February 1, 2010, Syncora Guarantee filed suit against EMC in the United States District Court of the Southern District of New York in connection with another securitization seeking to specifically enforce the terms of a certain insurance and indemnification agreement to which they are parties. On April 26, 2010, a Protective Order and Confidentiality Stipulation were signed into order that requires EMC to produce requested documents by June 1, 2010, and the matter was closed subject to EMC's compliance with the order. On June 25, 2010, Syncora Guarantee moved for partial summary judgment for a ruling that Syncora Guarantee has multiple legal remedies against EMC and is not limited to a contractual remedy that involves submitting loans to EMC for EMC's review and possible repurchase. The motion was fully briefed on August 6, 2010, oral argument was held on March 15, 2011, and on March 25, 2011 the Court granted the motion. On November 22, 2010, the Company filed a motion to amend its complaint to add fraudulent inducement and securities fraud claims against EMC and JP Morgan Securities, LLC. (formerly known as Bear, Stearns & Co.), and a tortious-interference-with-contract claim against JP Morgan Securities, LLC. The final brief on the Company's motion to amend was submitted to the Court on January 12, 2011. On March 25, 2011, the Company's motion to add these claims (and an additional party) was denied. On October 26, 2011, Syncora Guarantee filed a partial summary judgment motion concerning its burden for establishing EMC's liability for its material breach and repurchase claims and the availability of equitable relief for its material breach claim. The motion was fully briefed on December 12, 2011 and oral argument was held on June 13, 2012. On June 19, 2012, the Court granted summary judgment for the Company regarding its burden for establishing EMC's liability on its repurchase and material breach claims, and denied as premature the Company's motion with respect to the availability of equitable relief for its material breach claim. On July 3, 2012, EMC filed a motion with the Court to reconsider its ruling with respect to the Company's repurchase claims. The motion was fully briefed on August 1, 2012, and on September 7, the court denied EMC's motion. Fact discovery is currently scheduled to end in May 2013.

On June 6, 2011, Syncora Guarantee filed suit against J.P. Morgan Securities LLC (formerly known as Bear, Stearns & Co.) in the Commercial Division of the Supreme Court of the State of New York, New York County, asserting claims of fraudulent inducement and tortious interference in connection with the securitization that is the subject of the Company's litigation with EMC described immediately above. On June 24, 2011, the Company filed an amended complaint adding allegations pertaining to facts learned during the course of discovery in the EMC litigation. J.P. Morgan Securities filed its answer to the complaint on August 30, 2011. On November 4, 2011, the Company filed a motion for a protective order regarding JP Morgan's discovery demands pertaining to other RMBS transactions. On June 4, 2012, the court ordered Syncora Guarantee to produce credit committee memoranda for certain other RMBS transactions, and Syncora Guarantee has subsequently complied with that order. Also on November 4, 2011, JP Morgan filed a joint motion to dismiss/motion for summary judgment seeking a ruling that the Company's claims were barred by claim preclusion. On May 2, 2012, JP Morgan's motion was denied. On June 19, 2012, JP Morgan filed a Notice to Appeal the Court's denial of its motion, and briefing on its appeal was completed on October 12, 2012. Oral argument on JP Morgan's appeal was held on February 15, 2013. A decision is pending.

On February 14, 2012, Syncora Guarantee filed suit in the Supreme Court of the State of New York, New York County, against EMC Mortgage LLC, Bear, Stearns & Co., and Bear Stearns Asset Backed Securities I, LLC for breach of contract and fraud

stemming from EMC's and Bear Stearns' fraudulent actions in inducing Syncora Guarantee to enter into an insurance and indemnity agreement and issue its financial guaranty insurance policy, and for EMC's and Bear Stearns' subsequent and wholesale breaches of that agreement. J.P. Morgan Securities LLC and JPMorgan Chase Bank, were also named as defendants in the action as successors in interest to Bear, Stearns & Co. and EMC. The defendants filed a motion to dismiss on May 25, 2012. Syncora Guarantee responded on August 10, 2012. Oral argument was heard on December 6, 2012. On April 15, 2013, the court denied the motion to dismiss, with the exception of the indemnification claim. The court reserved its decision on Syncora Guarantee's fraud claim. The defendants have until May 7, 2013 to answer the complaint. Discovery is moving forward.

On October 5, 2012, Syncora Guarantee filed suit in the Supreme Court of the State of New York, New York County, against EMC Mortgage LLC, Bear, Stearns & Co. Inc., CMO Holdings III Ltd., J.P. Morgan Securities LLC, individually and as successor in interest to Bear Stearns, and JPMorgan Chase Bank, N.A., as successor in interest to EMC, relating to the BSSP 2007-R5 transaction. The complaint alleges fraud and breach of contract stemming from EMC's and Bear Stearns' fraudulent actions in inducing Syncora Guarantee to enter into an insurance and indemnity agreement and issue its financial guaranty insurance policy, and for EMC's and Bear Stearns' subsequent and wholesale breaches of that agreement. The complaint also alleges that J.P. Morgan Securities LLC tortuously interfered with EMC's and Bear Stearns' contractual obligations to Syncora Guarantee. The defendants, with the exception of CMO Holdings III Ltd., filed a motion to dismiss all claims except the breach of contract claims on December 7, 2012. Syncora Guarantee filed its response on February 15, 2013. Defendants' response was filed on March 15, 2013. Oral argument was held on April 25, 2013. A decision is pending. Discovery is moving forward.

Other Litigation

On or around July 8, 2011, Syncora Guarantee filed a request for arbitration against Desarrolladora de Concesiones Omega, S.A. de C.V. ("Omega"), a toll road concessionaire, with the International Chamber of Commerce for breaches of contract pertaining to the Matehuala toll road transaction in Mexico ("Matehuala"). On August 18, 2011, Omega answered and filed counterclaims against Syncora Guarantee alleging fraud and breaches of contract and implied covenant of good faith and fair dealing. On or around August 1, 2011, Syncora Guarantee filed suit against HSBC Mexico, S.A., Institucion de Banca Multiple, Grupo Financiero HSBC, Division Fiduciaria ("HSBC Mexico"), the trustee in the Matehuala transaction, in the United States District Court for the Southern District of New York for breaches of contract, duty of good faith and fiduciary duty for failing to pay Syncora Guarantee premiums as required by the Matehuala insurance agreements. On August 29, 2011, HSBC Mexico answered and filed counterclaims against Syncora Guarantee alleging fraud and breaches of contract and implied covenant of good faith and fair dealing. On March 22, 2012, the parties to the Matehuala transaction executed an agreement settling the dispute.

On April 18, 2012, Syncora Guarantee filed a summons with notice in the Supreme Court of the State of New York, initiating an action against Alinda Capital Partners LLC, American Roads LLC, Macquarie Securities (USA) Inc. and John S. Laxmi alleging the defendants made misrepresentations and omissions in obtaining insurance from Syncora Guarantee on bonds issued by American Roads LLC. Syncora Guarantee filed and served the complaint on September 24, 2012. In lieu of an answer, the defendants filed motion to dismiss the complaint on November 13, 2012. Syncora Guarantee responded on December 21, 2012. The motions were fully briefed and submitted to the court. Under and subject to the terms of a Pre-Negotiated Agreement (executed April 26, 2013) claims against Alinda Capital Partners LLC, American Roads LLC and John S. Laxmi were dismissed without prejudice. Oral argument on the motions was held on May 6, 2013.

On August 1, 2012, Syncora Guarantee, along with Syncora Capital Assurance filed Constitutional claims against the State of California alleging impairment of contract (alleging that certain provisions of Assembly Bill 26 ("AB26") constitute a material impairment of contract between California Redevelopment Agencies ("RDAs"); their bondholders, and Syncora Guarantee) and a taking of Syncora Guarantee's property interest in those contracts for which Syncora Guarantee is entitled to just compensation. Syncora Guarantee has approximately $1.6 billion of exposure to bonds issued by various RDAs under financial guarantees and debt service reserve surety policies. RDA bonds are secured by tax increment funding, which is derived from the increase in assessed value of property within the RDAs redevelopment area after the effective date of a redevelopment plan. In June 2011, the California State Legislature passed AB26 in response to the Governor of California's declaration of state of fiscal emergency. AB26 was designed to alleviate state funding concerns by diverting significant funds from the RDAs to other purposes. AB26 provided for the orderly dissolution of the RDAs and the transfer of their outstanding obligations to successor agencies. Although Syncora Guarantee has not established loss reserves for its exposure to the RDAs, Syncora Guarantee believes that AB26 increases the potential that it will have to pay claims and suffer losses under its financial guaranty policies or debt service reserve policies. A hearing on Syncora Guarantee's Petition for Writ of Mandamus is scheduled for May 3, 2013 in the Superior Court of the State of California for the County of Sacramento.

b. Lease and Other Commitments

The Company's lease commitments consist of its office premises leases at 135 West 50th Street, New York, New York and at Merritt 7 Corporate Park, Norwalk, Connecticut. In addition, the Company leases space at 595 Market Street, San Francisco, California and 250 Park Avenue, New York, New York, both of which have been sublet by the Company.

In addition, in December 2010, the Company entered into an amended three year agreement with International Business Machines Corporation for its information technology outsourcing services, effective January 1, 2011. Fees associated with the new agreement were $2.4 million in 2012, and then are expected to be approximately $2.5 million in 2013.

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.

(U.S. dollars in thousands) Years Ending December 31,	Minimum Lease Payments	Sub-lease Income	Net Minimum Aggregate Lease Commitments
2013	$ 2,012	854	1,158
2014	1,640	493	1,147
2015	1,079	—	1,079
2016	899	—	899
2017	—	—	—
Total	$ 5,630	$ 1,347	$ 4,283

Net rent expense was $1.2 million and $1.5 million for the years ended December 31, 2012 and 2011, respectively.

c. Other

See also Note 2 for a description of continuing risks and uncertainties affecting the Company and other information.

18. Dividend Restrictions

Syncora Holdings

Syncora Holdings' Board of Directors did not declare a quarterly dividend with respect to its common shares or a semi-annual dividend with respect to the Syncora Holdings Series A Preferred Shares during the years ended December 31, 2012 or 2011 or at any time thereafter through to the issuance date of these financial statements. Any future dividends will be subject to the discretion and approval of the Syncora Holdings' Board of Directors, applicable law, regulatory, and contractual requirements. As dividends on the Syncora Holdings Series A Preferred Shares have not been paid in an aggregate amount equivalent to dividends for at least six full quarterly periods, holders of Syncora Holdings' Series A Preferred Shares have the right to nominate two persons who, if elected, will then be appointed as additional directors to the Board of Directors of Syncora Holdings.

Syncora Guarantee and Syncora Capital Assurance

The ability of Syncora Guarantee and Syncora Capital Assurance to declare and pay a dividend is governed by applicable New York law, including the NYIL. Under the NYIL, the companies are permitted to pay dividends each calendar year, without the prior approval of the NYDFS in an amount equal to the lesser of ten percent of their policyholders' surplus as of the end of the preceding calendar year or their net investment income for the preceding calendar year, as determined in accordance with Statutory Accounting Practices prescribed or permitted by the NYDFS. The NYIL also provides that the companies may distribute dividends to their shareholders in excess of the aforementioned amount only upon giving notice of their intention to declare such dividend, and the amount thereof, to the NYDFS. Moreover, a New York-domiciled insurer may not declare or distribute any dividends except out of earned surplus. The NYDFS may disapprove such distribution if it finds that the financial condition of the companies does not warrant such distribution.

Pursuant to the terms of the 2009 MTA, Syncora Guarantee is not permitted to pay dividends or repurchase, redeem, exchange or convert any equity securities until such time as all notes issued by Syncora Guarantee (see Note 9) are paid in full and the Back-Up Guarantees (see Note 2) no longer exist.

Pursuant to the terms of the 2009 MTA, Syncora Capital Assurance is not permitted to pay any dividend or make any distribution to Syncora Guarantee of any other affiliate unless Syncora Capital Assurance's remaining note has been paid in full and

provided that, after giving effect to any such dividend or distribution Syncora Capital Assurance would have sufficient capital as calculated pursuant to the 2009 MTA.

Among other requirements, Article 69 of the NYIL provides that financial guarantee insurance companies maintain minimum policyholders' surplus of $65 million. In accordance with accounting practices prescribed or permitted by the NYDFS, as of December 31, 2012 and 2011, Syncora Guarantee and Syncora Capital Assurance reported policyholders' surplus of $510.7 million and $186.1 million, respectively, and $172.6 million and $132.7 million, respectively. For the years ended December 31, 2012 and 2011, Syncora Guarantee reported net income (loss) of $307.8 million and $(30.4) million, respectively. For the years ended December 31, 2012 and 2011, Syncora Capital Assurance reported net income of $42.0 million and $60.4 million, respectively. See also Note 2.

19. Assets on Deposit to Collateralize Certain of the Company's Contractual Obligations

As of December 31, 2012 and 2011, the Company had, in the aggregate, approximately $155.8 million and $139.7 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including reinsurance, lease, and letter of credit agreements. Of such deposits, $0.7 million and $5.5 million, $25.2 million and $13.1 million and $129.9 million and $121.1 million are recorded on the accompanying consolidated balance sheet in "Restricted cash and cash equivalents", "Other assets" and "Debt securities available for sale, at fair value", respectively.

20. Subsequent Events

On January 11, 2013, the Company settled its disputes with a counterparty and affiliates thereof in relation to one insured second lien RMBS transaction. The settlement resolves all disputes between the Company and counterparty with respect to such transaction. Accordingly, the Company released the counterparty from all of the Company's claims and will no longer pursue such demands.

Upon execution of the settlement, the Company obtained additional information on estimated amounts recoverable from its RMBS-related claims from the counterparty and affiliates thereof. This information is considered a Type I - Subsequent Event and was recognized in the Company's ultimate reserve estimates for unpaid losses at December 31, 2012. Accordingly, the December 31, 2012 reserves for unpaid losses recorded in the financial statements reflect the updated assumptions and estimates derived from the terms of the settlement.

During April 2013, the Company completed certain remediation transactions, which the Company utilized $94.1 million of cash and expects a reduction of approximately $1.4 billion in its insured exposure portfolio during the second quarter of 2013.

The Company entered into a plan support agreement ("PSA"), dated as of June 6, 2013, with Jefferson County and other bond insurers that insure Jefferson County sewer obligations. See Notes 2 and 17 for further discussion.

The Company has evaluated all subsequent events through June 11, 2013, the date the financial statements were issued.

21. Condensed Financial Information of Syncora Holdings (Parent Company Only)

The condensed balance sheets, statements of operations and shareholders' deficit, and statements of cash flows (on an unconsolidated basis) of Syncora Holdings as of December 31, 2012 and 2011 and for the years then ended are set forth below (see Note 2 for discussion of risks and uncertainties):

(U.S. dollars in thousands)	2012	2011
Assets		
Debt securities available for sale, at fair value (amortized cost: $9,065 and $12,087)	$ 9,248	$ 12,172
Cash and cash equivalents	1,483	1,386
Accrued investment income	22	46
Investment in subsidiaries on an equity basis:		
Syncora Guarantee	(122,786)	(820,186)
Other subsidiaries	21,024	18,036
Other assets	14,186	4,588
Total assets	$ (76,823)	$ (783,958)
Liabilities and Shareholders' Deficit		
Liabilities— accounts payable, accrued expenses, and other liabilities	$ —	$ —
Shareholders' deficit		
Series A perpetual non-cumulative preferred shares and additional paid-in capital	246,593	246,593
Common shares and additional paid-in capital	2,681,713	2,675,166
Accumulated deficit	(3,122,287)	(3,780,620)
Accumulated other comprehensive income	117,158	74,903
Total common shareholders' deficit	(323,416)	(1,030,551)
Total shareholders' deficit	(76,823)	(783,958)
Total liabilities and shareholders' deficit	$ (76,823)	$ (783,958)

	2012	2011
Revenues		
Net investment income	$ 51	$ 155
Net realized loss on investments	—	(59)
Total revenues	51	96
Operating expenses	(6,768)	3,570
Income (Loss) before equity in net income of subsidiaries	6,819	(3,474)
Equity in net income of Syncora Guarantee	648,757	246,881
Equity in net income of other subsidiaries	2,757	365
Equity in net income of subsidiaries	651,514	247,246
Net income	658,333	243,772
Other comprehensive income:		
Net unrealized gains (losses) on investments	159	(12)
Equity in other comprehensive income of Syncora Guarantee	42,096	7,419
Total other comprehensive income	42,255	7,407
Total comprehensive income	700,588	251,179
Acquisition of non-controlling interest	6,547	—
Change in shareholders' deficit	707,135	251,179
Total shareholders' deficit- beginning of period	(783,958)	(1,035,137)
Total shareholders' deficit- end of period	$ (76,823)	$ (783,958)

	2012	2011
Cash flows from operating activities:		
Operating expenses paid	$ (2,874)	$ (3,490)
Investment income collected	220	213
Other cash disbursements	—	(4,145)
Net cash used in operating activities	(2,654)	(7,422)
Cash flows from investing activities:		
Proceeds from sale of debt securities	1,884	1,528
Proceeds from maturity of debt securities	5,947	800
Purchases of debt securities	(4,908)	(14,376)
Net cash provided by (used in) operating activities	2,923	(12,048)
Cash flows from financing activities:		
Capital contribution to subsidiary	(172)	—
Net cash used in financing activities	(172)	
Increase (decrease) in cash and cash equivalents	97	(19,470)
Cash and cash equivalents—beginning of period	1,386	20,856
Cash and cash equivalents—end of period	$ 1,483	$ 1,386