SYNCORA HOLDINGS LTD.

CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2011 AND 2010

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Report of Independent Auditors

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and shareholders' deficit and of cash flows present fairly, in all material respects, the financial position of Syncora Holdings Ltd. and its subsidiaries (the "Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As described in Note 2 to the consolidated financial statements, the 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.

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May 21, 2012

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SYNCORA HOLDINGS LTD.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2011 and 2010
(U.S. dollars in thousands, except share and per share amounts)

	2011	2010
ASSETS		
Debt securities available for sale, at fair value (amortized cost: $984,304 and $696,867)	$ 1,021,524	$ 736,990
Other invested assets, at fair value	5,583	—
Cash and cash equivalents	156,607	413,292
Total cash and invested assets	1,183,714	1,150,282
Restricted cash and cash equivalents	5,518	102,219
Accrued investment income	9,898	7,102
Deferred acquisition costs, net	106,361	125,459
Prepaid reinsurance premiums	5,310	6,581
Premiums receivable	276,637	365,385
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	5,023	5,472
Salvage and subrogation recoverable	209,398	133,191
Credit default swap contracts, at fair value	401,082	302,991
Receivables on insurance cash flow certificates, net	91,950	275,851
Replacement bank warrants, at fair value (face value: $167,942 and $171,692)	100,765	94,431
Interest rate derivative instrument, at fair value	192	3,801
Other assets	17,463	25,274
Assets of consolidated variable interest entities, at fair value	450,762	745,492
Total assets	$ 2,864,073	$ 3,343,531
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Liabilities		
Unpaid losses and loss adjustment expenses	$ 1,020,032	$ 1,140,022
Unearned premium revenue	762,616	902,179
Credit default swap contracts, at fair value	1,271,546	1,466,090
Notes payable (par value: $715,801 and $679,731)	283,045	217,822
Payable for securities purchased	3,538	—
Reinsurance premiums payable	1,584	2,089
Accounts payable, accrued expenses and other liabilities	46,272	38,643
Liabilities of consolidated variable interest entities, at fair value	239,398	591,823
Total liabilities	3,628,031	4,358,668
Shareholders' deficit		
Non-controlling interest in subsidiary- Series B non-cumulative preferred shares of Syncora Guarantee Inc. ($200,000 liquidation preference)	20,000	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	2,675,166	2,675,166
Accumulated deficit	(3,780,620)	(4,024,392)
Accumulated other comprehensive income	74,903	67,496
Total Syncora Holdings Ltd. common shareholders' deficit	(1,030,551)	(1,281,730)
Total Syncora Holdings Ltd. shareholders' deficit	(783,958)	(1,035,137)
Total shareholders' deficit	(763,958)	(1,015,137)
Total liabilities and shareholders' deficit	$ 2,864,073	$ 3,343,531

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND SHAREHOLDERS' DEFICIT
YEARS ENDED DECEMBER 31, 2011 and 2010
(U.S. dollars in thousands, except share and per share amounts)

	2011	2010
Revenues		
Net premiums earned	$ 96,299	$ 104,108
Net investment income	43,063	52,512
Net realized gains on investments, net of other-than-temporary impairment losses of $(2,984) and $(2,646).	15,999	57,371
Net earnings on insurance cash flow certificates	186,528	300,188
Fee income and other	12,018	10,723
Change in fair value of credit default swap contracts:		
Realized gains (losses) and other settlements	27,572	(25,448)
Net unrealized gains (losses)	276,497	(41,228)
Net change in fair value of credit default swap contracts	304,069	(66,676)
Net change in consolidated variable interest entities	20,345	141,536
Total revenues	678,321	599,762
Expenses		
Net losses and loss adjustment expenses	279,725	126,875
Amortization of deferred acquisition costs, net	15,022	12,385
Realized loss on interest rate derivative instrument	3,610	16,349
Foreign currency exchange loss (gain)	3,800	(1,677)
Operating expenses	132,388	140,069
Total expenses	434,545	294,001
Income before income tax expense	243,776	305,761
Income tax expense	4	128
Net income	243,772	305,633
Other comprehensive income:		
Net unrealized gains on investments	7,407	12,887
Comprehensive income	251,179	318,520
Cumulative effect of change in accounting principles for consolidation of variable interest entities.	—	32,589
Change in shareholders' deficit	251,179	351,109
Total shareholders' deficit—beginning of period	(1,015,137)	(1,366,246)
Total shareholders' deficit—end of period	$ (763,958)	$ (1,015,137)
Basic and diluted income per common share:		
Net income.	$ 4.11	$ 5.15
Comprehensive income..	$ 4.23	$ 5.37
Weighted average common shares outstanding	59,336,686	59,336,686

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 and 2010
(U.S. dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Premiums collected	$ 42,550	$ 48,297
Investment income collected	42,969	53,089
Fees received on credit default swaps	32,357	40,664
Losses paid on credit default swaps	(20,922)	(66,250)
Interest collected on replacement bank warrants	8,699	13,352
Reinsurance recoveries collected on paid losses	1,308	14,830
Claims paid to policyholders	(435,841)	(1,150,574)
Operating expenses paid	(100,413)	(116,762)
Income taxes paid	(95)	(37)
Cash paid for insurance cash flow certificates	(15,013)	(152,175)
Cash received on insurance cash flow certificates	374,248	765,746
Cash paid for interest rate derivative instrument	—	(20,150)
Transfers from restricted cash	96,701	276
Other cash (disbursements) receipts	(11,676)	9,123
Investment income collected by variable interest entities	38,675	46,841
Interest and other expenses paid by variable interest entities	(29,025)	(46,137)
Net cash provided by (used in) operating activities	24,522	(559,867)
Cash flows from investing activities:		
Net proceeds from sales of debt securities	432,854	357,230
Net proceeds from maturity of debt securities	122,790	131,189
Purchases of debt securities	(894,252)	(270,701)
Proceeds from consolidated variable interest entities' assets	205,037	283,169
Net cash (used in) provided by investing activities	(133,571)	500,887
Cash flows from financing activities:		
Net paydowns of consolidated variable interest entity liabilities	(147,636)	(158,073)
Net cash used in financing activities	(147,636)	(158,073)
Decrease in cash and cash equivalents	(256,685)	(217,053)
Cash and cash equivalents—beginning of year	413,292	630,345
Cash and cash equivalents—end of year	$ 156,607	$ 413,292

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 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 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. 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

Significant Risks and Uncertainties

Given the significant risks and uncertainties discussed below and the fact that the Company has a $764.0 million shareholders' deficit and its capitalization includes debt, in the form of surplus notes, with a par value of $716 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 $13.5 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 20 for condensed financial information of Syncora Holdings.

The Company in connection with Syncora Guarantee's estimate of its reserves for unpaid losses faces a projected liquidity mismatch between expected future medium to long-term claim payments and recoveries relating to such claims, which if not mitigated 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, as discussed further below in regard to risks in estimating loss reserves, no assurance can be given that the actual severity or timing of claims payments, related recoveries, or ultimate losses will not be different than Syncora Guarantee’s estimates, and such differences could be material. The Company is actively seeking to enhance its liquidity and remediate the aforementioned liquidity mismatch. As of December 31, 2011, absent any significant future adverse developments associated with its future claim payments, recoveries, reserves for losses, or the assumptions regarding surplus notes and the availability of previously generated net operating losses (“NOLs”), the Company expects to be able to satisfy its anticipated liquidity needs over the next twelve months. However, 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 liquidity mismatch between expected future medium to long-term claim payments and recoveries of such claims.

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) the potential for future adverse loss and claims development on its insured obligations, (ii) the inability to realize recoveries on put-back notices requiring repurchases, as, when and in the amounts anticipated, (iii) the failure to receive payments on its Insurance Cash Flow Certificates, (iv) the resolution of various litigation matters 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.

- Syncora Guarantee’s policyholders’ surplus at December 31, 2011 of $186.1 million exceeds the statutory minimum by $121.1 million. Future adverse loss and claims development may have a material adverse effect on Syncora Guarantee’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. There can be no assurance that, were such adverse loss and claims development to occur, Syncora Guarantee would be able to remediate any losses or restore such policyholders’ surplus in a timely manner or at all. In addition, because of Syncora Guarantee’s limited surplus and liquidity as of December 31, 2011, it is possible that, were such adverse loss and claims development to occur, Syncora Guarantee could become insolvent in the near term. Since the closing of the 2009 MTA (discussed and defined in Note 3), Syncora Guarantee has continued to experience significant adverse development on its insured obligations that has placed further demands on its near term liquidity. Due to the significant constraints on Syncora Guarantee’s liquid resources and the modest margin by which Syncora Guarantee’s policyholders’ surplus exceeds the statutory minimum, the Company cannot provide any assurance that were Syncora Guarantee 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 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, 2011, the Company’s in-force direct guaranteed principal exposure to the European Union was approximately $7.0 billion of which $618.6 million was specifically related to certain credits in higher risk countries, such as Portugal, Italy and Spain. See Note 11 for further discussion.

- 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 53% of the Company's in-force guaranteed net par outstanding exposure of $16.2 billion at December 31, 2011 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.

- Syncora Guarantee continues to be materially exposed (directly and indirectly) to risks associated with any continuing deterioration in the residential mortgage market through its guarantees of residential mortgage-backed securities ("RMBS"), as well as the spread of such deterioration to 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 Syncora Guarantee 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. Syncora Guarantee continues to have significant exposure to Jefferson County, including to event-driven risks, such as adverse outcomes or rulings in Jefferson County's Chapter 9 bankruptcy filing. (See Notes 10 and 17). Such adverse outcomes could have a material adverse effect on Syncora Guarantee's liquidity and financial position.

- The Company has significant exposure to a number of large structured single risk transactions and to public finance transactions certain of which have a material risk of adverse development, including 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.

- Any payment of principal or interest on the surplus notes issued by Syncora Guarantee or Syncora Capital Assurance (all of which are held by Syncora Guarantee) is subject to risks and uncertainties, including, without limitation, prior regulatory approval by the NYDFS and, in the case of Syncora Capital Assurance, compliance with certain contractual restrictions. Consequently, no assurance can be given as to whether or when any payment of interest or principal on these surplus notes, in whole or in part, may be made.

- The failure of Syncora Guarantee to receive all or any substantial portion of future payments from Syncora Capital Assurance would reduce its anticipated liquidity and could have a material adverse effect on Syncora Guarantee's anticipated liquidity position. Whether or not Syncora Capital Assurance makes any payments on its remaining surplus note to Syncora Guarantee, no assurance can be given as to whether or when Syncora Guarantee may make any payment on its surplus notes in whole or in part, including principal and interest payment previously scheduled for December 28, 2011 from Syncora Guarantee to its surplus note holders (see Note 9 for further discussion). A payment by Syncora Guarantee on its surplus notes would reduce its policyholders' surplus and liquidity and could have a material adverse effect on its anticipated policyholders' surplus and liquidity position.

- 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 the 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 $212.1 million at December 31, 2011, reflecting an estimate of its ultimate recovery from such repurchases. The 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 its policyholders' surplus, which may cause it not to be in compliance with its regulatory minimum policyholder surplus requirement, which may cause the NYDFS to commence regulatory action, which may include commencement of rehabilitation or liquidation proceedings. 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 policyholders' surplus. The aforementioned benefit recorded as a reduction in statutory reserves of $212.1 million compares to Syncora Guarantee's policyholders' surplus at December 31, 2011 of $186.1 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. Syncora Guarantee has not reached an agreement with any of the sponsors but intends to continue if appropriate to pursue settlement discussions aimed at maximizing Syncora Guarantee's recovery. As with any litigation, the outcome is uncertain and there can be no assurance that it will be able to resolve these claims for a greater amount or at all.

- As a result of the RMBS Fund (discussed and defined in Note 3), alternative transactions effectively replicating the RMBS Fund 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 (see Note 3). To date, all scheduled payments on the Insurance Cash Flow Certificates have been received. However, failure of the Company to receive these payments would have a material adverse effect on the Company.

- 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 residential mortgage-backed securities it insures that require the sponsors of such securities to repurchase mortgage loans that breached certain representations and warranties. 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 and may result in material changes in Syncora Guarantee's policyholders' surplus. 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).

- The Company's estimate of reserves for losses on its exposures is based on certain assumptions. Changes in these assumptions could materially adversely affect 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 immediate to medium term. The Company 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 to the Company 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 the Company), and if made, whether they would ultimately result in any losses to the Company.

- Failure to make claim payments by the Company in the future 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 or other swap contracts guaranteed by the Company on which the Company 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 the Company'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 financial and liquidity position. Prosecuting and defending these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources from other matters (see Note 17).

- 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, as well as Syncora Guarantee's ability to pay dividends on its preferred or 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.

- 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 the Company 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 precise effects of 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, 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 events is more severe than the Company currently foresees. Other events, such as interest rate changes or volatility, could also materially affect the Company or its insured obligations.

- 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 also subject the Company to additional legal liability and regulatory requirements, affect the credit performance of the securities that the insurance subsidiaries insure and otherwise affect the Company's financial condition.

- 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 2014. 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 Directive-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, 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, Syncora Guarantee'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 Syncora Guarantee'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 Syncora Guarantee's policyholders' surplus 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 previously generated NOLs could be subject to an annual limitation, 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 Syncora Holdings' 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 factors affecting Syncora Holdings Ltd. and its consolidated subsidiaries' ability to continue as a going concern are the Company's ability to maintain adequate liquidity and mitigate the risk of adverse loss and claims development on Syncora Guarantee's and, or, Syncora Capital Assurance's remaining in-force business.

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, 2011 and 2010 are prepared assuming Syncora Holdings Ltd. and its consolidated subsidiaries continue as a going concern and does not include any adjustment that might result from their inability to continue as a going concern.

Description of the Company's On-Going Strategic Plan

Management is actively seeking to (i) remediate deteriorated 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 and capital 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 may materially affect (favorably or adversely) the Company's capital structure, or 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.

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

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, 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).

During the year ended December 31, 2010, the Company purchased additional RMBS and effected an alternative transaction, as described above, with an aggregate principal exposure of approximately $413.8 million for consideration of approximately $239.3 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, 2011 and 2010:

(U.S. dollars in thousands)

	2011	2010
Receivables on Insurance Cash Flow Certificates	$ 342,846	$ 696,858
Deferred gain	(250,896)	(421,007)
Receivables on Insurance Cash Flow Certificates, net	$ 91,950	$ 275,851

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, 2011 and 2010:

(U.S. dollars in thousands)

	2011	2010
Amortization of deferred gain, net	$ 165,185	$ 272,037
Change in loss reserves, net of reimbursements	21,343	28,151
Net earnings on Insurance Cash Flow Certificates[1]	$ 186,528	$ 300,188

[1] Net earnings on insurance cash flow certificates during 2011 and 2010 include an immaterial amount of $6.3 million and $2.0 million, respectively, which was not reflected in 2010 and 2009, respectively.

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. The Company has evaluated all subsequent events through May 21, 2012, the date the financial statements were issued.

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 as discussed below. All intercompany accounts and transactions have been eliminated.

Effective January 1, 2010, the Company adopted the new consolidation accounting guidance related to VIEs, where the Company is required to perform an analysis to determine whether its variable interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both (1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and (2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. The Company is required to consolidate the VIE if it is determined to be the primary beneficiary.

Upon adoption of this accounting change as of January 1, 2010, the guidance required that the adoption be recognized as a cumulative effect adjustment to retained earnings. The cumulative transition adjustment represents the recognized changes in assets and liabilities resulting from the adoption, including the effect of the fair value option election for the financial assets and liabilities, offset in part by the elimination of intercompany balances with the consolidated VIEs. The effect of the adoption on the Company's consolidated assets and liabilities was an increase of $649.3 million and $616.7 million, respectively, as of January 1, 2010 and the cumulative effect thereof on the Company's accumulated deficit at such date was $32.6 million. Refer to Note 7 for disclosures regarding VIEs consolidated as of December 31, 2011 and 2010, as well as revenues and expenses of VIEs, which were consolidated by the Company during the years ended December 31, 2011 and 2010 and, accordingly, reflected in the accompanying consolidated statements of operations.

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

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

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 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, 2011 was 1.4%. 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 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.

Earnings Per Share

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, 2011 and 2010, respectively.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Improving Disclosures about Fair Value Measurements: In January 2010, the Financial Accounting Standards Board ("FASB") issued accounting guidance to require additional disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. The standard also clarified existing disclosures about the level of disaggregation, valuation techniques and inputs to fair value measurements. The Company adopted this standard as of the first quarter of 2010 except for the requirement to provide the Level 3 activity of purchases, sales issuances and settlements on a gross basis, which the Company adopted in the first quarter of 2011. As this standard only affects 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 Pronouncements Pending Adoption

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 new guidance is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the guidance on January 1, 2012 on a prospective basis. As the Company is not expected to write any new insurance policies, the Company believes that the adoption of this standard will 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 new guidance is effective for the Company beginning January 1, 2012. The amendment also requires reclassification adjustments for items that are reclassified from other comprehensive income to net income to be presented in the statements where the components of net income and the components of other comprehensive income are presented. However, in December 2011, the FASB temporarily deferred the effective date of this additional requirement. 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.

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, 2011 and 2010 are as follows:

	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	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.

	December 31, 2010			
(U.S. dollars in thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities				
Mortgage-backed securities:				
RMBS [1]	$ 225,227	$ 8,698	$ (2,311)	$ 231,614
CMBS	41,055	3,719	(114)	44,660
Asset-backed securities	8,348	264	—	8,612
U.S. Government and government agencies	157,815	8,732	—	166,547
Corporate	259,193	21,636	(849)	279,980
U.S. states and political subdivisions of the states	744	48	—	792
Non-U.S. sovereign government	4,485	300	—	4,785
Total debt securities	$ 696,867	$ 43,397	$ (3,274)	$ 736,990

[1] Residential mortgage-backed securities include $4.8 million related to Uninsured Cash Flow Certificates which represent both the fair value and carrying value of such securities at December 31, 2010 and reflects an other than temporary impairment charge of $2.0 million.

The change in net unrealized gains consists of changes in the valuation and holdings of debt securities of $(2.9) million and $(15.3) million for the years ended December 31, 2011 and 2010, respectively.

Proceeds from sales of debt securities, net of receivables, for the years ended December 31, 2011 and 2010 were $432.9 million and $357.2 million, respectively.

The gross realized gains and gross realized (losses) for the years ended December 31, 2011 and 2010 were $19.5 million and $(3.5) million and $65.2 million and $(7.8) million, respectively.

The amortized cost and fair value of bonds at December 31, 2011 and 2010 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.

	2011		2010	
(U.S. dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$ 140,896	$ 141,061	$ 120,464	$ 121,117
Due after one through five years	230,940	239,829	153,626	165,520
Due after five through ten years	210,153	218,776	136,324	152,065
Due after ten years	50,691	56,464	11,823	13,402
Subtotal	632,680	656,130	422,237	452,104
Mortgage- and asset-backed securities	351,624	365,394	274,630	284,886
Total	$ 984,304	$ 1,021,524	$ 696,867	$ 736,990

Net investment income is derived from the following sources:

(U.S. dollars in thousands)	2011	2010
Debt securities and cash and cash equivalents	$ 43,833	$ 53,337
Equity securities	333	—
Less: Investment expenses	(1,103)	(825)
Net investment income	$ 43,063	$ 52,512

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, 2011 and 2010, the Company recorded other than temporary impairment charges of $3.0 million and $2.6 million, respectively. The other-than-temporary impairment charges recorded by the Company during the years ended December 31, 2011 and December 31, 2010 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, 2011 and 2010, respectively:

(U.S. dollars in thousands)	Less than 12 Months					
	December 31, 2011			December 31, 2010		
	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities:						
RMBS	$ 7,859	$ (160)	9	$ 138,151	$ (2,311)	34
CMBS	26,295	(392)	19	4,844	(114)	1
Asset-backed securities	11,324	(44)	55	-	-	-
US Government and government agency	18,003	(41)	12	-	-	-
Corporate	85,935	(3,627)	95	67,594	(849)	15
US states & political subdivisions	2,039	(10)	2	-	-	-
Total debt securities	**$ 151,455**	**$ (4,274)**	**192**	**$ 210,589**	**$ (3,274)**	**50**

	12 Months or More					
	December 31, 2011			December 31, 2010		
	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities:						
RMBS	$ 3	$ -	2	$ -	$ -	-
CMBS	2,855	(81)	1	-	-	-
Asset-backed securities	-	-	-	-	-	-
US Government and government agency	-	-	-	-	-	-
Corporate	-	-	-	-	-	-
US states & political subdivisions	-	-	-	-	-	-
Total debt securities	**$ 2,858**	**$ (81)**	**3**	**$ -**	**$ -**	**-**

	Total					
	December 31, 2011			December 31, 2010		
	Fair Value	Unrealized Loss	Number of Securities	Fair Value	Unrealized Loss	Number of Securities
Mortgage-backed securities:						
RMBS	$ 7,862	$ (160)	11	$ 138,151	$ (2,311)	34
CMBS	29,150	(473)	20	4,844	(114)	1
Asset-backed securities	11,324	(44)	55	-	-	-
US Government and government agency	18,003	(41)	12	-	-	-
Corporate	85,935	(3,627)	95	67,594	(849)	15
US states & political subdivisions	2,039	(10)	2	-	-	-
Total debt securities	**$ 154,313**	**$ (4,355)**	**195**	**$ 210,589**	**$ (3,274)**	**50**

Based on the Company's analysis of the unrealized losses as of December 31, 2011, 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 $7.2 million at December 31, 2011 and $6.3 million and $6.8 million at December 31, 2010, respectively, were on deposit with various regulatory authorities as required by insurance laws.

6. Credit Default 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, CDO squareds 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 contracts as of December 31, 2011 and December 31, 2010, 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)	2011 Syncora Guarantee	2011 Syncora Capital Assurance	2011 Consolidated	2010 Syncora Guarantee	2010 Syncora Capital Assurance	2010 Consolidated
Notional amount outstanding	$ 779	$ 21,314	$ 22,093	$ 864	$ 36,426	$ 37,290
Weighted average life (years)	5.9	10.4	10.3	4.4	8.6	8.6
Percentage of referenced assets by rating [1]						
AAA	0.0%	13.8%	13.4%	0.0%	18.9%	18.4%
At or above investment grade but below AAA	0.0%	58.3%	56.1%	0.0%	59.6%	58.2%
Below investment grade	100.0%	27.9%	30.5%	100.0%	21.5%	23.4%
	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 swap contracts for the years ended December 31, 2011 and 2010:

(U.S. dollars in thousands)	2011	2010
Change in fair value of credit default swap contracts :		
Realized gains (losses) and other settlements:		
Net CDS contract premiums received and receivable	$ 44,328	$ 36,635
Net CDS contract losses paid and payable	(16,756)	(62,083)
Total realized gains and losses and other settlements	27,572	(25,448)
Unrealized gains (losses):		
Change in fair value of CDS contracts	276,497	(41,228) [1]
Net change in fair value of credit default swap contracts[2]	$ 304,069	$ (66,676)

[1] The change in fair value of CDS contracts during 2010 includes $9.7 million of CDS liabilities that were not fair valued as of December 31, 2009.

[2] Change in realized/unrealized gains or losses relating to the CDS contracts still held was $(232.2) million for the year ended December 31, 2011 and $77.9 million for the year ended December 31, 2010.

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.

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, 2011 Assets	As of December 31, 2011 Liabilities	As of December 31, 2010 Assets	As of December 31, 2010 Liabilities
Cashflow CDO	$ -	$ -	$ 355,214	$ 355,214
Power & Utilities	135,023	141,620	107,631	114,632
Subprime (1st lien)	95,149	92,527	115,276	115,276
Prime (HELOC)	75,715	2,375	87,625	2,798
Prime (2nd lien)	24,027	-	49,211	3,787
Alt-A (2nd lien)	14,285	2,694	-	-
Global Infrastructure	33,997	-	-	-
Alt-A (1st lien)	28,956	182	30,535	116
General Obligation	26,997	-	-	-
Subprime (2nd lien)	5,968	-	-	-
Other	10,645	-	-	-
	$ 450,762	$ 239,398	$ 745,492	$ 591,823

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, 2011 and 2010.

(U.S. dollars in thousands)	2011	2010
Interest income	$ 38,468	$ 46,635
Interest expense	(20,910)	(33,668)
Other expenses	(7,738)	(12,164)
Net realized and unrealized gains (losses)	10,525	140,733
Net change in variable interest entities	$ 20,345	$ 141,536

Set forth below is the cumulative effect of consolidating VIEs on net income and shareholders' deficit as of December 31, 2011 and 2010.

(U.S. dollars in thousands)	2011	2010
Net premiums earned	$ (1,944)	$ (2,055)
Net investment income	(34,911)	(13,119)
Earnings on insurance cash flow certificates	(118,518)	(64,242)
Net realized losses on investments	5,653	252
Net losses and loss adjustment expenses	30,067	2,583
Net change in variable interest entities	20,345	141,536
Total effect on net income	(99,308)	64,955
Total effect on other comprehensive income (loss)	29,846	(29,844)
Total effect on comprehensive income	(69,462)	35,111
Cumulative transition adjustment	-	32,589
Total effect on shareholders' deficit- beginning of year	67,700	-
Total effect on shareholders' deficit- end of year	$ (1,762)	$ 67,700

Non-Consolidated VIEs

As of December 31, 2011, 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.

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 a comparable financial guarantee insurance company.

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 the significance of unobservable inputs, the Company's CDS 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 represent 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 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, 2011:

(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	$ -	$ 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	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 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	-	-	450,762	450,762
Total assets	$ 354,655	$ 832,372	$ 955,006	$ 2,142,033
LIABILITIES				
Credit default 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

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, 2010:

(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	$ -	$ 226,778	$ 4,836	$ 231,614
CMBS	-	44,660	-	44,660
Asset-backed securities	-	8,612	-	8,612
U.S. Government and government agencies	151,258	15,289	-	166,547
Corporate	10	279,970	-	279,980
U.S. states and political subdivisions	-	792	-	792
Non-U.S. sovereign government	-	4,785	-	4,785
Total debt securities available for sale	151,268	580,886	4,836	736,990
Cash and cash equivalents	413,292	-	-	413,292
Restricted cash and cash equivalents	102,219	-	-	102,219
Credit default swap contracts	-	-	302,991	302,991
Replacement bank warrants	-	-	94,431	94,431
Interest rate derivative instrument	-	3,801	-	3,801
Assets of consolidated variable interest entities	-	-	745,492	745,492
Total assets	$ 666,779	$ 584,687	$ 1,147,750	$ 2,399,216
LIABILITIES				
Credit default swap contracts	$ -	$ -	$ 1,466,090	$ 1,466,090
Liabilities of consolidated variable interest entities	-	-	591,823	591,823
Total liabilities	$ -	$ -	$ 2,057,913	$ 2,057,913

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, 2011 and 2010:

	2011				2010			
(U.S. dollars in thousands)	Mortgage and Asset-Backed Securities	Credit Default Swap Contracts	Replacement Bank Warrants	Assets of Consolidated Variable Interest Entities	Mortgage and Asset-Backed Securities	Credit Default 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	$ 54,848	$ 81,590	$ 66,309	$ -
Adoption of Consolidation of VIEs	-	-	-	-	-	-	-	794,286
Realized gains (losses)	(1,562)	(1,162)	-	-	27,375	(292)	-	-
Unrealized gains (losses) included in earnings	-	99,253	-	(294,730)	-	221,693	28,122	(48,794)
Unrealized gains (losses) included in OCI	(1,608)	-	6,334	-	2,045	-	-	-
Purchases	3,481	-	-	-	30,167	-	-	-
Issuances	-	-	-	-	-	-	-	-
Settlements	-	-	-	-	-	-	-	-
Sales	(2,750)	-	-	-	(109,599)	-	-	-
Transfers into Level 3	-	-	-	-	-	-	-	-
Transfers out of Level 3	-	-	-	-	-	-	-	-
Balance, end of period	$ 2,397	$ 401,082	$ 100,765	$ 450,762	$ 4,836	$ 302,991	$ 94,431	$ 745,492

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, 2011 and 2010:

(U.S. dollars in thousands)	2011 Credit Default Swap Contracts	2011 Liabilities of Consolidated Variable Interest Entities	2010 Credit Default Swap Contracts	2010 Liabilities of Consolidated Variable Interest Entities
LEVEL 3 LIABILITIES				
Balance, beginning of period	$ 1,466,090	$ 591,823	$ 1,206,100	$ -
Adoption of Consolidation of VIEs	-	-	-	697,217
Realized gains (losses)	(28,734)	-	25,156	-
Unrealized gains (losses) included in earnings	(165,810)	(352,425)	234,834	(105,394)
Purchases	-	-	-	-
Issuances	-	-	-	-
Settlements	-	-	-	-
Sales	-	-	-	-
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	-	-	-	-
Balance, end of period	$ 1,271,546	$ 239,398	$ 1,466,090	$ 591,823

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 Syncora Guarantee or Syncora Capital Assurance have an observable market credit spread, Syncora Guarantee and Syncora Capital Assurance each measure their Non-Performance Risk based on market observable credit spreads of a comparable financial guarantee insurance company.

The fair value of the Company’s consolidated VIE liabilities reflects the risk that the Company will not be able to honor VIE obligations where VIE liabilities exceed the value of the related pledged assets (“Non-Performance Risk”). Generally, the Company would measure Non-Performance Risk as implied by the market price of buying credit protection on the Company. However, since the Company does not have an observable market credit spread, the Company measured its Non-Performance Risk based on market observable credit spreads of a comparable financial guarantee insurance company.

Set forth below is information regarding the Company’s in-force CDS contracts as of December 31, 2011 and December 31, 2010, including the fair value of such contracts, the Non-Performance Risk discount on such contracts which is embedded in the net credit default swap contracts liability on the accompanying consolidated balance sheets.

(U.S. dollars in millions)	2011 Syncora Guarantee	2011 Syncora Capital Assurance	2011 Consolidated	2010 Syncora Guarantee	2010 Syncora Capital Assurance	2010 Consolidated
Fair value of CDS contracts, before giving effect to Non-Performance Risk	$ 229.8	$ 1,392.2	$ 1,622.0	$ 136.9	$ 1,664.6	$ 1,801.5
Less:						
Non-Performance Risk	27.1	724.4	751.5	33.6	604.8	638.4
Fair value of CDS contracts, after giving effect to Non-Performance Risk	$ 202.7	$ 667.8	$ 870.5	$ 103.3	$ 1,059.8	$ 1,163.1

Set forth below is certain information regarding the Company's VIE liabilities as of December 31, 2011 and 2010, including the fair value, the Non-Performance Risk discount on such liabilities which is embedded in the net VIE liability on the accompanying balance sheet.

(U.S. dollars in thousands)	December 31, 2011	December 31, 2010
Fair value of VIE liabilities, before giving effect to Non-Performance Risk	$ 245,253	$ 593,792
Less:		
Non-Performance Risk	5,855	1,969
Fair value of VIE liabilities, after giving effect to Non-Performance Risk	$ 239,398	$ 591,823

Financial Instruments Not Carried at Fair Value

At December 31, 2011 and 2010, the carrying value of the Company's notes was $283.0 million and $217.8 million, respectively. It is not practicable to estimate the fair value of the Company's notes, 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. 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. 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, 2011	Total Interest Expense Year Ended December 31, 2010	Carrying Value At December 31, 2011	Carrying Value At December 31, 2010
7/15/2009	5.00% **(a)**	12/28/2011	$ 165,414,677	$ 91,155,000	$ 41,082,965	$ 31,242,497	$ 165,414,677	$ 128,629,660
7/15/2009	6.00% **(b)**	6/27/2024	550,386,478	49,875,000	28,438,044	22,374,126	117,630,253	89,192,209
			$ 715,801,155	$ 141,030,000	$ 69,521,009	$ 53,616,623	$ 283,044,930	$ 217,821,869

(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, 2011 was not approved by the NYDFS. Accordingly, the interest not approved for payment by the NYDFS on December 28, 2011 will not be capitalized on the outstanding principal balance reflected above, but will accrue 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, 2011 and 2010 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, 2011, the range of risk free rates used to discount the Company's liability for losses and loss adjustment expenses was 0.01% to 2.93%. Activity in the Company's liability for unpaid losses and loss adjustment expenses for the years ended December 31, 2011 and 2010 are summarized as follows:

(US dollars in thousands)	**2011**	**2010**
Gross unpaid losses and loss adjustment expenses at beginning of year	$ 1,140,022	$ 2,146,210
Salvage and subrogation recoverable	(133,191)	(27,822)
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	(5,472)	(17,972)
Consolidation of VIEs transition adjustment, net	—	(70,581)
Net unpaid losses and loss adjustment expenses at beginning of year	1,001,359	2,029,835
Increase in net losses and loss adjustment expenses incurred in respect of losses occurring in:		
Current year	39,176	3,258
Prior years	240,549	123,617
Current year effect for consolidation of VIEs	15,232	53,862
Less net losses and loss adjustment expenses paid	490,705	1,209,213
Net unpaid losses and loss adjustment expenses at end of period	805,611	1,001,359
Salvage and subrogation recoverable	209,398	133,191
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	5,023	5,472
Gross unpaid losses and loss adjustment expenses at end of period	$ 1,020,032	$ 1,140,022

Case Basis Reserves for Losses and Loss Adjustment Expenses

A discussion of certain case basis reserves established by the Company as of December 31, 2011 and December 31, 2010 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 $825.0 million and $1,002.8 million as of December 31, 2011 and 2010, respectively ($825.1 million and $1,005.2 million, respectively, before giving effect to reinsurance). The change in reserves from December 31, 2010 to December 31, 2011 is primarily attributable to claims paid partially offset by adverse loss development of $208.1 million.

The aforementioned reserves as of December 31, 2011 and 2010 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, 2011 and December 31, 2010, 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, 2011. 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 until approximately year seven of the deal. By year seven of the deal, for most transactions, the Company assumed another step down to a constant default rate to reflect lower default rates due to seasoning offset by recoveries on previously charged-off loans, based on shape of the constant default rate curve for a similar product. 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.

The Company's default assumptions for the first lien transactions at December 31, 2011 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 56% to 83% 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, 2011 and 2010, the amount of mortgage loans that the Company is seeking sponsors to repurchase aggregated approximately $1.6 billion and $1.3 billion, respectively; the sponsors of a substantial majority of such mortgage loans are Countrywide Home Loans, Inc. and affiliated entities ("Countrywide"), GreenPoint Mortgage Funding, Inc. ("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, 2011 and 2010, the Company estimated that it would realize a net benefit from such recoveries aggregating $586.3 million and $491.7 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.

Included in the Company's provision for losses and loss adjustment expenses for the years ended December 31, 2011 and 2010, is a net benefit of $94.6 million and $333.4 million, respectively, relating to changes in the Company's estimate of the benefit it expects to realize from the exercise of its rights to require sponsors to repurchase mortgages backing securities it has insured (see also Note 17).

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, 2011) 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, 2011, 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 $592.0 million (after giving effect to reinsurance and the Company reserves for losses thereon, the Company's exposure was $436.0 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, 2011 and 2010, the Company recorded a provision for losses and loss adjustment expenses, after giving effect to reinsurance, of $37.9 million and $64.8 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, 2011 and 2010, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on the warrants and the surety bond policy was $149.8 million and $115.5 million ($154.7 million and $118.5 million before giving effect to reinsurance), respectively. The change in reserves from December 31, 2010 to December 31, 2011 is primarily due to adverse 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 $18.7 million face value inures to the benefit or detriment of certain of the Company's reinsurers. During 2010, the Company commuted $12.5 million of the aforementioned reinsurance, transferred the reinsurers' share of the Replacement Bank Warrants to a trust for their benefit, and de-recognized such warrants on its balance sheet.

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 increase its provision for loss reserves thereon in the future.

As of December 31, 2011 and 2010, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on other public finance transactions was $6.1 million and $3.1 million ($6.1 million and $3.1 million before giving effect to reinsurance), respectively.

As of December 31, 2011 and 2010, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on structured single risk transactions was $24.5 million and $3.9 million ($24.5 million and $3.9 million before giving effect to reinsurance), respectively.

As of December 31, 2011 and 2010, the Company's reserves for losses and loss adjustment expenses, after giving effect to reinsurance, on its guarantees of CDOs was $9.6 million and $9.3 million ($9.6 million and $9.3 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 mortgages and CDOs. It tracks performance monthly to try to ensure that covenants have not been breached. If a covenant is breached, the Company may have the right to put the transaction into rapid amortization so that all cash flow generated from that transaction is used to pay down principal and stay current with interest 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.

The Company's surveillance department estimates claims based on the probability weighted average of net cash outflows 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. 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, 2011. 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	29	35	5	36	105
Remaining weighted-average contract period (in years)	14.7	12.7	7.6	14.0	12.7
Insured contractual payments outstanding:					
Principal	$ 1,937	$ 1,471	$ 1,193	$ 1,896	$ 6,497
Interest	1,219	920	311	1,305	3,755
Total	$ 3,156	$ 2,391	$ 1,504	$ 3,201	$ 10,252
Gross loss and LAE liability	$ 20	$ 15	$ 12	$ 1,972	$ 2,019
Less:					
Gross potential recoveries	3	3	—	482	488
Unearned premium reserve [1]	11	6	—	40	57
Discount, net	2	2	—	450	454
Loss and LAE liabilities reported in the balance sheet	$ 4	$ 4	$ 12	$ 1,000	$ 1,020

[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, 2011. 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, 2011:

Bond Exposure
(U.S. dollars in millions)

	GPO[(1)]	GIO[(1)]	Total	NPO[(1)]	NIO[(1)]	Total
Public Finance						
General Obligation	$ 15,582	$ 6,199	$ 21,781	$ 15,582	$ 6,199	$ 21,781
Special Revenue	10,463	9,163	19,626	10,315	8,969	19,284
Utility	5,937	3,504	9,441	5,875	3,475	9,350
Non Ad Valorem	4,242	2,201	6,443	4,242	2,201	6,443
Appropriation	2,371	1,218	3,589	2,371	1,218	3,589
Total Public Finance	$ 38,595	$ 22,285	$ 60,880	$ 38,385	$ 22,062	$ 60,447
Asset-Backed Securities						
RMBS	$ 1,778	$ 439	$ 2,217	$ 1,767	$ 436	$ 2,203
Commercial ABS	842	79	921	842	79	921
Consumer ABS - Auto	107	2	109	107	2	109
Total Asset-Backed Securities	$ 2,727	$ 520	$ 3,247	$ 2,716	$ 517	$ 3,233
Collateralized Debt Obligations						
Cashflow CDO	$ 7,336	$ 1,152	$ 8,488	$ 7,336	$ 1,152	$ 8,488
Synthetic CDO	6,418	-	6,418	6,418	-	6,418
Market Value CDO	568	62	630	568	62	630
Total Collateralized Debt Obligations	$ 14,322	$ 1,214	$ 15,536	$ 14,322	$ 1,214	$ 15,536
Structured Single Risk						
Power & Utilities	$ 9,298	$ 9,862	$ 19,160	$ 9,298	$ 9,862	$ 19,160
Global Infrastructure	8,265	5,534	13,799	8,211	5,489	13,700
Specialized Risk	1,791	578	2,369	1,791	578	2,369
Total Structured Single Risk	$ 19,354	$ 15,974	$ 35,328	$ 19,300	$ 15,929	$ 35,229
Total Outstanding	$ 74,998	$ 39,993	$114,991	$ 74,723	$ 39,722	$114,445

[(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 exposure at December 31, 2011:

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

	Scheduled Net Debt Service	NPIO[1]
2011 Q4	$ -	$ 114,445
2012 Q1	1,579	112,866
2012 Q2	1,224	111,642
2012 Q3	1,489	110,153
2012 Q4	2,576	107,577
Total 2012	$ 6,868	
2013	$ 7,062	$ 100,515
2014	8,942	91,573
2015	6,245	85,328
2016	5,877	79,451
Total 2013-2016	$ 28,126	
2017-2021	$ 21,500	$ 57,951
2022-2026	16,967	40,984
2027-2031	12,098	28,886
2032 and thereafter	28,886	-
Total 2017-thereafter	$ 79,451	
Total	$ 114,445	

[1] NPIO represents Net Principal and Interest Outstanding.

The following table sets forth the Company's in-force guaranteed principal and interest exposure by geographic concentration at December 31, 2011:

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

	GPO	NPO	% NPO
United States			
California	$ 7,294	$ 7,246	9.7%
New York	3,831	3,831	5.1%
Illinois	3,020	3,020	4.0%
Alabama	2,486	2,475	3.3%
Texas	2,278	2,278	3.0%
Florida	2,147	1,997	2.7%
Pennsylvania	1,739	1,739	2.3%
New Jersey	1,453	1,453	1.9%
Colorado	1,359	1,359	1.8%
Michigan	1,089	1,089	1.5%
Georgia	997	997	1.3%
Puerto Rico	970	970	1.3%
Massachusetts	953	953	1.3%
Washington	852	852	1.1%
Tennessee	799	799	1.1%
Minnesota	778	778	1.0%
Other[1]	10,259	10,259	13.7%
Non-PF Multi[2][3]	14,396	14,384	19.5%
Total United States	$ 56,700	$ 56,479	75.6%
International			
United Kingdom	$ 9,399	$ 9,345	12.5%
Australia	2,244	2,244	3.0%
Ireland	1,059	1,059	1.4%
France	825	825	1.1%
Chile	814	814	1.1%
New Zealand	769	769	1.0%
Other[1]	2,435	2,435	3.3%
Non-PF Multi[2][4]	753	753	1.0%
Total International	$ 18,298	$ 18,244	24.4%
Total Par Outstanding	$ 74,998	$ 74,723	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 $11,331 million in CDO, $2,483 million in ABS and $570 million in SSR net par.
[4] Consists of $487 million in CDO and $266 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, 2011, the Company's total net direct exposure to RMBS aggregated approximately $1.8 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 2.4% 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, 2011 (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, 2011:

RMBS Exposure
(U.S. dollars in millions)

	NPO	% NPO
Prime (1st lien)	$ 44	2.5%
Prime (2nd lien)	57	3.2%
Prime (HELOC)	305	17.3%
Alt-A (1st lien)	840	47.5%
Alt-A (2nd lien)	19	1.1%
Subprime (1st lien)	361	20.4%
Subprime (2nd lien)	90	5.1%
Subprime (1st lien) - International	51	2.9%
Total RMBS Outstanding	$ 1,767	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, 2011. 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).

(U.S. dollars in millions)	2004	2005	2006	2007	Total
Subprime	$ 73 [1]	$ 113	$ -	$ 316	$ 502
Prime/Alt A	193	80	179	813	1,265
	$ 266	$ 193	$ 179	$ 1,129	$ 1,767
Net case reserves for unpaid losses	$ 22	$ 128	$ 339	$ 143	$ 632

(1) Includes $0.2 million relating to business underwritten and issued in 1999.

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	Moody's Rating	NPO
Prime (1st lien)					
1.	2004	bbb	NR	B1	$ 24
2.	2004	aaa	AAA	NR	14
3.	2004	aaa	AAA	A3	6
Total					$ 44
Prime (2nd lien)					
1.	2006	d	D	Ca	$ 57
Total					$ 57
Prime (HELOC)					
1.	2004	d	CCC	Ca	$ 89
2.	2004	d	BBB	Ca	60
3.	2005	d	D	Ca	28
4.	2006	d	D	Ca	66
5.	2006	d	D	Ca	41
6.	2006	d	D	Ca	7
7.	2006	d	CC	Ca	-
8.	2007	d	D	Ca	14
Total					$ 305
Alt-A (1st lien)					
1.	2005	c	AAA	Caa3	$ 38
2.	2005	c	CC	Caa2	14
3.	2005	c	CC	Ca	-
4.	2006	d	D	Ca	5
5.	2006	d	D	Ca	3
6.	2006	d	CC	Ca	-
7.	2006	d	D	Ca	-
8.	2007	bbb-	CCC	Caa3	329
9.	2007	c	CCC	Caa3	296
10.	2007	c	CCC	Caa3	155
11.	2007	d	D	C	-
Total					$ 840
Alt-A (2nd lien)					
1.	2007	d	CC	Ca	$ 19
2.	2007	d	D	B1	-
Total					$ 19

	Vintage	Internal Rating	S&P Rating	Moody's Rating	NPO
Subprime (1st lien)					
1.	1999	b	D	Caa1	$ -
2.	2004	a-	AAA	A1	42
3.	2004	c	AA-	B2	24
4.	2004	aaa	AAA	Aa1	7
5.	2005	d	CCC	-	93
6.	2005	bbb-	BBB	A2	17
7.	2005	bbb-	AA	Baa3	3
8.	2007	c	CCC	Ca	175
Total					$ 361
Subprime (2nd lien)					
1.	2007	bbb-	CCC	Caa3	$ 52
2.	2007	c	CC	Ca	31
3.	2007	c	B	Ca	7
Total					$ 90
Subprime (1st lien) - International					
1.	2007	bbb	BBB	Baa2	$ 51
Total					$ 51
Total RMBS Outstanding					$ 1,767

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, 2011. 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
Cashflow CDO			
US CLO	$ 3,981	27.9%	22
Euro CLO	2,622	18.3%	10
Emerging Markets CDO	368	2.6%	1
TRUPS CDO	292	2.0%	5
High Yield Bond CBO	48	0.3%	2
Multi-Sector CDO	17	0.1%	3
ABS CDO	5	0.0%	1
Investment Grade Bond CBO	3	0.0%	1
Total Cashflow CDO	$ 7,336	51.2%	45
Synthetic CDO			
Corporate Synthetic CDO	$ 4,551	31.8%	15
CMBS CDO	1,861	13.0%	3
CDO Squared	6	0.0%	1
Total Synthetic CDO	$ 6,418	44.8%	19
Market Value CDO			
US CLO	$ 568	4.0%	1
Total Market Value CDO	$ 568	4.0%	1
Total Collateralized Debt Obligations Outstanding	$ 14,322	100.0%	65

(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, 2011:

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

	NPO	% NPO
AAA	$ 4,215	29.4%
AA	8,007	56.0%
A	844	5.9%
BBB	563	3.9%
Below investment grade	693	4.8%
Total Collateralized Debt Obligations Outstanding	$ 14,322	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, 2011, the Company reported a premium receivable of $276.6 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 12.6 years. For the year ended December 31, 2011, the accretion of the premium receivable was $9.0 million and is reported in "Premiums earned" on the accompanying consolidated statement of operations. As of December 31, 2011, 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, 2011:

(U.S. dollars in thousands)

			Adjustments			
Premium Receivable as of December 31, 2010	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, 2011
$ 365,385	$ (46,081)	$ -	$ (51,635)	$ 8,968	$ -	$ 276,637

The following table presents, as of December 31, 2011, 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 $40.3 million (on a present value basis) relating to assumed reinsurance business at December 31, 2011:

(U.S. dollars in thousands)		**Expected Collection of Premiums**
Three months ended:		
March 31, 2012	$	5,861
June 30, 2012		7,033
September 30, 2012		5,655
December 31, 2012		4,125
Twelve months ended:		
December 31, 2012		22,674
December 31, 2013		20,344
December 31, 2014		18,363
December 31, 2015		17,307
December 31, 2016		15,248
Five years ended:		
December 31, 2016		93,936
December 31, 2021		54,059
December 31, 2026		37,220
December 31, 2031		24,303
December 31, 2036		16,704
December 31, 2041		4,584
December 31, 2046		1,436
December 31, 2051		101
Total	$	232,343

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 $99.0 million relating to assumed reinsurance business at December 31, 2011.

(U.S. dollars in thousands)	Unearned Premium Revenue	Expected Premium Earnings			
		Upfront	Installments	Accretion	Total
Three months ended:					
March 31, 2012	$ 651,637	$ 8,721	$ 6,316	$ 1,808	$ 16,845
June 30, 2012	637,714	7,876	6,047	1,771	15,694
September 30, 2012	623,972	7,894	5,849	1,727	15,470
December 31, 2012	610,471	7,790	5,711	1,682	15,183
Twelve months ended:					
December 31, 2012	610,471	32,281	23,923	6,988	63,192
December 31, 2013	559,170	30,040	21,261	6,354	57,655
December 31, 2014	511,638	28,602	18,930	5,764	53,296
December 31, 2015	466,729	27,418	17,490	5,232	50,140
December 31, 2016	424,801	26,222	15,706	4,708	46,636
Five years ended:					
December 31, 2016	424,801	144,563	97,310	29,046	270,919
December 31, 2021	262,146	109,395	53,261	17,515	180,171
December 31, 2026	153,313	75,137	33,695	10,204	119,036
December 31, 2031	84,501	48,714	20,098	5,465	74,277
December 31, 2036	44,229	28,130	12,142	2,140	42,412
December 31, 2041	26,824	13,962	3,443	413	17,818
December 31, 2046	17,612	8,232	981	104	9,317
December 31, 2051	9,305	8,188	118	4	8,310
December 31, 2056	1,142	8,163	-	-	8,163
December 31, 2061	-	1,142	-	-	1,142
Total		$ 445,626	$ 221,048	$ 64,891	$ 731,565

The following sets forth the components of premiums earned for the years ended December 31, 2011 and 2010:

(U.S. dollars in thousands)	2011	2010
Gross premiums written	$ (38,414)	$ (25,522)
Reinsurance premiums assumed	(4,924)	(9,359)
Total premiums written	(43,338)	(34,881)
Change in direct unearned premium revenue	124,380	119,663
Change in assumed unearned premium revenue	15,969	21,114
Gross premiums earned	97,011	105,896
Reinsurance premiums ceded	558	2,296
Change in prepaid reinsurance premiums	(1,270)	(4,084)
Ceded premiums earned	(712)	(1,788)
Net premiums earned	$ 96,299	$ 104,108

For the years ended December 31, 2011 and 2010, net premiums earned include $10.0 million and $11.8 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, 2011 and 2010 are as follows:

(U.S. dollars in thousands)	2011	2010
Deferred acquisition costs, net—beginning of year	$ 125,459	$ 137,844
Acquisition costs and ceding commission revenue amortized:		
Acquisition costs amortized	(15,072)	(12,729)
Ceding commission revenue amortized	50	344
Amortization of deferred acquisition costs	(15,022)	(12,385)
Commutations	(4,076)	—
Deferred acquisition costs, net—end of year	$ 106,361	$ 125,459

Accelerated amortization of deferred acquisition costs due to Refundings was $1.3 million and $1.5 million for the years ended December 31, 2011 and 2010, 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, 2011 and 2010 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, 2011 and 2010.

(U.S. dollars in thousands)	2011	2010
Year Ended December 31		
Ceded premiums written	$ (558)	$ (2,296)
Ceded premiums earned	712	1,788
Ceding commission revenue	50	344
Ceded losses and loss adjustment expenses	991	2,658
As of December 31		
Par exposure ceded	$ 274,656	$ 967,271
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses	5,023	5,472

The following table sets forth reinsurance balances recoverable on unpaid losses and loss adjustment expenses by reinsurer as of December 31, 2011 and 2010:

(U.S. dollars in thousands)	2011	2010
Radian Asset Assurance Inc.	$ 2,649	$ 1,690
CIFG Assurance North America Inc.	117	1,560
American Overseas Reinsurance Co. Ltd	376	1,134
Assured Guaranty Corp	1,881	1,088
Total	$ 5,023	$ 5,472

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, 2011 and December 31, 2010. 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's cumulative loss in recent periods represents negative evidence sufficient to require a full valuation allowance under the provisions of this standard. 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, 2011, 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, 2011 expires from 2027 through 2032. Approximately $161.0 million of the Company's NOLs as of December 31, 2011 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. Reference should be made to the Company's website at www.syncora.com for more information regarding such limits. Information found on the Company's website does not constitute part of these financial statements and is not incorporated by reference herein.

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, 2011 and 2010, respectively, the Company had no material unrecognized tax benefit and no adjustments to liabilities or operations were required.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense, which were zero for the years ended 2011 and 2010. Tax years 2009 through 2011 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, 2011.

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. 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, 2011 and 2010 was $4,000 and $128,000, respectively.

The difference between the expected and actual tax benefit or expense for each of the years ending December 31, 2011 and 2010 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, 2011 and 2010 consist of the following:

(U.S. dollars in thousands)	2011	2010
Gross deferred tax assets	$ 2,047,578	$ 2,197,538
Valuation allowance	(1,814,576)	(1,925,183)
Deferred tax assets, net	233,002	272,355
Deferred tax liability	233,002	272,355
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, 2011 and 2010 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, 2011 and 2010.

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

As of May 21, 2012, 26 states have suspended the Company's license to conduct insurance business in such states or jurisdiction, revoked, placed an order of impairment against it, or the Company voluntarily surrendered its license, agreed to cease writing business in such 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 jurisdictions. Additional 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 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. On December 2, 2011, defendants filed a motion to strike the pleadings under a California statute.

Jefferson County Litigation

On November 9, 2011, Jefferson County filed for protection under Chapter 9 of the Bankruptcy Code. Accordingly, all proceedings against the County are subject to the automatic stay. The proceedings in Jefferson County bankruptcy are not summarized herein, however, as described in Note 3, the Company may be materially and adversely affected by adverse outcomes or rulings in this bankruptcy proceeding.

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 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 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 which was 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 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 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 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 the 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. Discovery in the action is ongoing.

As a result of the County's Chapter 9 filing, the action is stayed as against the County. Syncora Guarantee intends to continue 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.

Claims Suspension Litigation

Countrywide Home Loans, Inc. and affiliated entities filed a Summons with Notice in the Supreme Court for the State of New York, dated June 2, 2009, initiating an action against Syncora Guarantee for breach of contract and breach of the duty of good faith and fair dealing in connection with Syncora Guarantee's suspension of payments of claims under certain insurance policies. The Summons with Notice seeks unspecified damages in excess of $100 million. As discussed below under Other Litigation, on August 5, 2011, Syncora Guarantee and Countrywide Home Loans, Inc. and affiliates jointly agreed to dismiss this claim without prejudice.

Other Litigation

On January 29, 2009, Syncora Guarantee filed suit in the Supreme Court of the State of New York, New York County, against Countrywide Home Loans, Inc., Countrywide Securities Corp., and Countrywide Financial Corp. (collectively referred to as "Countrywide"), alleging that Countrywide made misrepresentations in connection with several securitizations of home equity mortgage loans originated and serviced by Countrywide, and for which Syncora Guarantee acted as credit enhancer, and seeking damages and other relief for fraud and breach of contract. On March 31, 2010, Countrywide's motion to dismiss was denied in part and granted in part. Countrywide's appeal of the denial of its motion was withdrawn on October 6, 2011. On May 6, 2010, Syncora Guarantee filed an amended complaint. Syncora Guarantee's amended complaint names Bank of America Corp. ("BAC") as an additional defendant as the successor to and vicariously for Countrywide. Countrywide filed a counterclaim against Syncora Guarantee which the parties jointly stipulated to dismiss without prejudice on August 5, 2011. The parties concluded fact discovery on June 3, 2011. The parties filed initial expert reports on December 20, 2011. Expert discovery and depositions are ongoing. On June 6, 2011, BAC moved to sever the claims (which had previously been stayed) against it and to consolidate those claims with claims brought against it by three other monolines (Ambac Assurance Corporation, Financial Guaranty Insurance Company, and MBIA Insurance Corporation) and on October 31, 2011 (with respect to Syncora Guarantee), this motion was denied, and on January 3, 2012, BAC perfected an appeal of the decision that Syncora will oppose. Oral argument was held on October 5, 2011 regarding a motion submitted by Syncora Guarantee for summary judgment on certain causation issues. On January 3, 2012, Syncora's motion for summary judgment was granted in part and denied it in part. Syncora Guarantee and Countrywide have each appealed.

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 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 is scheduled to be held on June 13, 2012. Fact discovery is currently scheduled to end on May 25, 2012.

On June 6, 2011, Syncora Guarantee filed suit against JP Morgan Securities LLC 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. JP 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. 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 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, which materially increased Syncora Guarantee's risk. JP 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.

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 August 18, 2011, Reliance Rail Pty Limited, as trustee for the Reliance Rail trust pertaining to the Waratah train project in Australia, filed a summons in the Supreme Court of New South Wales against Syncora Guarantee, co-financial guarantor FGIC UK Limited and Permanent Custodians Limited as intercreditor agent seeking declarations that an event of default notice delivered by the financial guarantors is invalid and that no events of default subsist and seeking to prevent the financial guarantors from taking any enforcement action. Syncora Guarantee and FGIC UK Limited filed a cross-summons seeking opposing declarations. The parties have since reached an understanding on the subject matter at issue, and filed Notices of Discontinuance with the court on February 20, 2012.

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 regarding the quality of certain toll road assets that back certain of Syncora Guarantee’s insured securities.

Securities Litigation

In December 2007 and January 2008, three lawsuits were commenced in the United States District Court for the Southern District of New York. On April 24, 2008, an order was entered consolidating these actions under the caption In re Security Capital Assurance Ltd. Securities Litigation. On August 6, 2008, the plaintiffs filed a consolidated amended complaint. The complaint named Syncora Holdings, XL Capital Ltd, XL Insurance Ltd, the principal underwriters for the secondary offering, the financial advisors for the preferred share offering, Paul S. Giordano, David P. Shea, Edward B. Hubbard, and Richard P. Heberton as defendants. The complaint included claims that defendants' public statements, including the registration statement and prospectus related to the secondary offering, contained false and misleading statements and omitted to disclose material facts necessary to make the statements contained therein not misleading, in violation of the Securities Act of 1933, as amended and the Exchange Act. The complaint sought unspecified damages and other relief. The Company filed a motion to dismiss on behalf of itself and the individual defendants. On March 31, 2010, the Company's motion was granted in full. On June 29, 2010 the remaining plaintiff filed an amended complaint. On September 10, 2010, the Company filed a motion to dismiss. On September 23, 2011, the Company's motion to dismiss was granted in its entirety. Accordingly, this matter is concluded.

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 $4.2 million in 2011, and then are expected to be approximately $2.5 million in each of 2012 and 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
2012	$ 2,016	$ 931	$ 1,085
2013	1,989	854	1,135
2014	1,616	493	1,123
2015	1,079	—	1,079
2016	899	—	899
Total	$ 7,599	$ 2,278	$ 5,321

Net rent expense was $1.5 million and $2.6 million for the years ended December 31, 2011 and 2010, 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, 2011 or 2010 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, 2011 and 2010, Syncora Guarantee and Syncora Capital Assurance reported policyholders surplus of $186.1 million and $132.6 million, respectively, and $132.7 million and $129.6 million, respectively. For the years ended December 31, 2011 and 2010, Syncora Guarantee reported net (loss) income of $(30.4) million and $15.4 million, respectively. For the years ended December 31, 2011 and 2010, Syncora Capital Assurance reported net income of $60.4 million and $53.1 million, respectively. See also Note 2.

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

As of December 31, 2011 and 2010, the Company had, in the aggregate, approximately $139.7 million and $120.9 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including reinsurance, lease, and letter of credit agreements. Of such deposits, $5.5 million and $102.2 million, $13.1 million and $15.2 million and $121.1 million and $3.5 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. 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, 2011 and 2010 and for the years then ended are set forth below (see Note 2 for discussion of risks and uncertainties):

(U.S. dollars in thousands)	2011	2010
Assets		
Debt securities available for sale, at fair value (amortized cost: $12,087 and $171)	$ 12,172	$ 264
Cash and cash equivalents	1,386	20,856
Accrued investment income	46	4
Investment in subsidiaries on an equity basis:		
Syncora Guarantee	(820,186)	(1,074,486)
Other subsidiaries	18,036	17,674
Assets of consolidated variable interest entity, at fair value	4,145	—
Other assets	443	551
Total assets	$ (783,958)	$ (1,035,137)
Liabilities and Shareholders' Deficit		
Liabilities— accounts payable, accrued expenses, and other liabilities	$ —	$ —
Shareholders' equity		
Series A perpetual non-cumulative preferred shares and additional paid-in capital	246,593	246,593
Common shares and additional paid-in capital	2,675,166	2,675,166
Accumulated deficit	(3,780,620)	(4,024,392)
Accumulated other comprehensive income	74,903	67,496
Total common shareholders' deficit	(1,030,551)	(1,281,730)
Total shareholders' deficit	(783,958)	(1,035,137)
Total liabilities and shareholders' deficit	$ (783,958)	$ (1,035,137)

	2011	2010
Revenues		
Net investment income	$ 155	$ 16
Net realized loss on investments	(59)	—
Total revenues	96	16
Operating expenses	3,570	5,105
Loss before equity in net income of subsidiaries	(3,474)	(5,089)
Equity in net income of Syncora Guarantee	246,881	311,016
Equity in net income (losses) of other subsidiaries	365	(294)
Equity in net income of subsidiaries	247,246	310,722
Net income	243,772	305,633
Other comprehensive income:		
Net unrealized (losses) gains on investments	(12)	10
Equity in other comprehensive income of Syncora Guarantee	7,419	12,877
Total other comprehensive income	7,407	12,887
Total comprehensive income	251,179	318,520
Cumulative effect of change in accounting principles for consolidated variable interest entities	—	32,589
Change in shareholders' deficit	251,179	351,109
Total shareholders' deficit- beginning of period	(1,035,137)	(1,386,246)
Total shareholders' deficit- end of period	$ (783,958)	$ (1,035,137)

	2011	2010
Cash flows from operating activities:		
Operating expenses paid	$ (3,490)	$ (2,349)
Investment income collected	213	15
Other cash disbursements to consolidated variable interest entity	(4,145)	—
Net cash used in operating activities	(7,422)	(2,334)
Cash flows from investing activities:		
Proceeds from sale of debt securities	1,528	—
Proceeds from maturity of debt securities	800	—
Purchases of debt securities	(14,376)	—
Net cash used in operating activities	(12,048)	—
Decrease in cash and cash equivalents	(19,470)	(2,334)
Cash and cash equivalents—beginning of year	20,856	23,190
Cash and cash equivalents—end of year	$ 1,386	$ 20,856