

REPORT ON EXAMINATION

OF THE

ASSURED GUARANTY MUNICIPAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2011

DATE OF REPORT

MAY 28, 2013

EXAMINER

IAN MARTIN

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

May 28, 2013

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30850 dated May 8, 2011 attached hereto, I have made an examination into the condition and affairs of Assured Guaranty Municipal Insurance Company as of December 31, 2011, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Assured Guaranty Municipal Insurance Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s home office located at 31 West 52nd Street, New York, New York 10019.

1. SCOPE OF EXAMINATION

The Department has performed a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2006 by the Oklahoma Insurance Department. This examination covered the five year period from January 1, 2007 through December 31, 2011. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted in conjunction with the state of Maryland, which was the coordinating state of the Assured Guaranty Group. The examination was performed concurrently with the examinations of the following insurers: Assured Guaranty Corp. (“AGC”), Assured Guaranty Mortgage Insurance Company (“AG Mortgage”), Assured Guaranty Municipal Corp. (“AGM”) and Municipal and Infrastructure Assurance Corporation (now known as Municipal Assurance Corp. (“MAC”)).

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment and an evaluation based upon the Company’s Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

Significant subsequent events
Company history

Corporate records
Management and control
Fidelity bonds and other insurance
Pensions, stock ownership and insurance plans
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Assured Guaranty Municipal Insurance Company was originally incorporated under the laws of the State of Oklahoma on July 11, 1997 as FSA Insurance Company and a member of Dexia S.A., a limited liability corporation organized under the laws of the Kingdom of Belgium.

On July 1, 2009, Assured Guaranty Group's ultimate parent, Assured Guaranty Ltd. ("AGL"), through a wholly owned subsidiary acquired from Dexia S.A.'s subsidiary, Dexia Holdings Inc., Financial Security Assurance Holdings Ltd., currently known as Assured Guaranty Municipal Holdings Inc. ("AGMH"), and its subsidiaries. AGMH owns 100% of Financial Security Assurance Inc., currently known as AGM, the direct parent of the Company.

The Company redomesticated from Oklahoma to New York effective November 10, 2010 and was renamed as Assured Guaranty Municipal Insurance Company. As part of the redomestication, the Company's par value of common stock was increased from \$1 to \$5 per share and an additional 500,000 shares were issued to AGM. The redomestication and change in capital were non-objected by the Department.

Through 2011, the Company has acted solely as a reinsurer of financial guaranty insurance products written by AGM and the Company's subsidiary, Assured Guaranty (Bermuda) Ltd. ("AG Bermuda"), as per an intercompany quota share reinsurance pooling agreement. As of December 31, 2011, the Company owned 100% of FSA Mexico Holding, Inc. and approximately 82% of AG Bermuda with AGM owning the remaining 18%. The Company also owns 100% of Assured Guaranty (Europe) Ltd. ("AG Europe").

As of December 31, 2011, the Company's capital was \$15,000,000 consisting of 3,000,000 shares of \$5.00 par value per share common stock. Gross paid in and contributed surplus was \$826,673,420. Gross paid in and contributed surplus increased by \$237,500,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
December 31, 2006	Beginning gross paid in and contributed surplus	\$589,173,420
2008	Contribution	250,000,000
2010	Distribution due to change in capital	(12,500,000)
	Total Surplus Contributions	\$237,500,000
December 31, 2011	Ending gross paid in and contributed surplus	\$826,673,420

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than seven nor more than thirteen members. The board met four times or more during each calendar year. At December 31, 2011, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Howard Wayne Albert Short Hills, NJ	Chief Risk Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
Robert Adam Bailenson Cold Spring Harbor, NY	Chief Financial Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Russell Brown Brewer II Darien, CT	Chief Surveillance Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
Dominic John Frederico Palm Beach Gardens, FL	Chairman, President and Chief Executive Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
James Michael Michener Smith's, Bermuda, FL-05	General Counsel and Secretary, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
Robert Bruce Mills New Hope, PA	Chief Operating Officer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company
Donald Hal Paston Livingston, NJ	Treasurer, Assured Guaranty Mortgage Insurance Company Assured Guaranty Corp. Assured Guaranty Municipal Corp. Assured Guaranty Municipal Insurance Company

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance. The Company's By-laws require that the Company holds an annual meeting of its shareholders to elect directors and transact any business within its powers on the second Tuesday in the month of April. However, the Company was unable to provide shareholders minutes to verify that it held its Annual shareholders' meetings for the years 2010 and 2011. The Company has taken the position that such minutes do not appear to have been prepared.

It is recommended that the Company holds its annual shareholders' meetings in accordance with the schedule stipulated in its By-laws and maintains minutes for the meetings.

As of December 31, 2011, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Dominic John Frederico	Chairman, President and Chief Executive Officer
James Michael Michener	Secretary and General Counsel
Donald Hal Paston	Treasurer
Howard Wayne Albert	Chief Risk Officer
Robert Adam Bailenson	Chief Financial Officer
Laura Ann Bieling	Controller
Russell Brown Brewer II	Chief Surveillance Officer
Stephen Donnarumma	Chief Credit Officer
Robert Bruce Mills	Chief Operating Officer
John Mahlon Ringler	Assistant Vice President, Regulatory Reporting
Benjamin Gad Rosenblum	Chief Actuary

B. Territory and Plan of Operation

As of December 31, 2011, the Company was licensed to write business in Arizona, Colorado, Kentucky, Louisiana, Michigan, Missouri, New York, North Carolina, Oklahoma, Pennsylvania, South Carolina, South Dakota, and the District of Columbia.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
17	Credit
25	Financial guaranty

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41, and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$65,500,000.

C. Reinsurance

Assumed reinsurance accounted for 100% of the Company's gross premium written at December 31, 2011. During the period covered by this examination, the Company's assumed reinsurance business has decreased since the last examination.

The Company's assumed business derives solely from the Amended and Restated Quota Share Pooling Agreement ("Pooling Agreement") with its parent, AGM and its subsidiary, AG Bermuda. The Pooling Agreement was effective July 1, 1986 and amended and restated as of October 1, 1996 and again as of December 31, 2009. Pursuant to the agreement, the companies share in the net retained risks insured by each of the companies, after cessions to other reinsurers, on a pro-rata basis in proportion to each company's relative surplus as regards policyholders and contingency reserves as reported in the most recently filed statutory statements at the time the business is written. At December 31, 2011, the pooling percentages were approximately 64.79% for AGM, 30.29% for the Company and 4.92% for AG Bermuda. The latest amended and restated Pooling Agreement was non-disapproved by the Department on March 1, 2010.

The Company utilized reinsurance accounting as defined in Statement of Statutory Accounting Principle ("SSAP") No. 62 for all of its assumed reinsurance business.

There was no ceded reinsurance as of December 31, 2011.

D. Holding Company System

The Company is a member of the Assured Guaranty Group and is 100% wholly-owned subsidiary of AGM. The ultimate parent is AGL, a Bermuda based publicly traded holding company (NYSE: AGO) with worldwide operations.

A review of the Holding Company Registration Statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2011:

At December 31, 2011, the Company was a party to the following agreements with other members of its holding company system:

Net Worth Maintenance Agreement

On September 23, 1997, AGM amended a net worth maintenance agreement originally dated April 27, 1994. The amendment replaced Financial Security Assurance of Maryland Inc. as a party to the agreement with the Company. AGM agrees to maintain the Company's policyholders' surplus of \$66,400,000 as determined under the laws of the State of New York or such greater amount subject to certain limits.

The agreement was non-disapproved on April 11, 1997 by the Department pursuant to Section 1505 of the New York Insurance Law.

Agreement for Cooperative and Joint Use of Personnel, Property and Services

The agreement originally effective July 11, 1997 was terminated and replaced by a new agreement effective July 1, 2005. Pursuant to the agreement, AGM agrees to provide and furnish the Company with personnel, property, equipment, and services with respect to administrative, audit, underwriting, accounting, legal, marketing, claims, compliance, surveillance, reinsurance and electronic data processing to enable the Company to conduct an insurance business and other corporate functions.

Tax Allocation Agreement

Effective July 1, 2009, the Company entered into a tax allocation agreement with other members of the Assured Guaranty Group. Under the terms of the agreement, the Company filed a consolidated federal income tax return with its indirect parent, Assured Guaranty US Holding Inc. and its subsidiaries. The agreement was filed and non-disapproved by the Department on June 24, 2009. The Company amended the agreement on June 1, 2012 to add MAC as a party. However, the Company did not file the amendment with the Department pursuant to Circular Letter 33 (1979). The Company subsequently filed the amendment with the Department on February 7, 2013.

Trust Agreement

The Company entered into a Trust Agreement, dated December 23, 2004, with its parent, AGM, and the Bank of New York. This Agreement established a trust account into which the Company posts

collateral for the benefit of AGM, in order for AGM to take credit under California insurance law for its reinsurance cessions to the Company under the Pooling Agreement.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2011, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	12%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	89%
Premiums in course of collection to surplus as regards policyholders	2%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$748,472,380	128.49%
Other underwriting expenses incurred	205,775,808	35.33
Net underwriting loss	<u>(371,741,444)</u>	<u>(63.82)</u>
Premiums earned	<u>\$582,506,744</u>	<u>100.00%</u>

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2011 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u> Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$1,447,929,344	\$ 0	\$1,447,929,344
Common stocks (stocks)	371,483,805	12,140,377	359,343,428
Cash, cash equivalents and short-term investments	83,418,582	0	83,418,582
Other invested assets	8,318,345	0	8,318,345
Investment income due and accrued	17,410,776	0	17,410,776
Uncollected premiums and agents' balances in the course of collection	11,452,503	0	11,452,503
Funds held by or deposited with reinsured companies	17,650,864	0	17,650,864
Current federal and foreign income tax recoverable and interest thereon	7,000,289	0	7,000,289
Net deferred tax asset	80,919,443	57,692,835	23,226,608
Prepaid Expenses	<u>63,609</u>	<u>63,609</u>	<u>0</u>
Totals	<u>\$2,045,647,560</u>	<u>\$69,896,821</u>	<u>\$1,975,750,739</u>

Liabilities, surplus and other funds	<u>Examination</u>
Losses	\$ 89,152,455
Reinsurance payable on paid losses and loss adjustment expenses	38,988,508
Loss adjustment expenses	6,329,630
Other expenses (excluding taxes, licenses and fees)	649,390
Taxes, licenses and fees (excluding federal and foreign income taxes)	(1,643)
Unearned premiums	653,083,515
Payable to parent, subsidiaries and affiliates	624,598
Miscellaneous liability	13,824
Contingency reserve	<u>585,142,122</u>
Total liabilities	\$1,373,985,399
 <u>Surplus and Other Funds</u>	
Common capital stock	\$ 15,000,000
Gross paid in and contributed surplus	826,673,420
Unassigned funds (surplus)	<u>(239,908,080)</u>
Surplus as regards policyholders	\$ <u>601,765,340</u>
 Totals	 <u>\$1,975,750,739</u>

Note: The Internal Revenue Service has requested an extension through July 2014 for the audit of 2009 tax year. The IRS has not commenced an audit for the 2010 tax year. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders decreased \$217,047,493 during the five-year examination period January 1, 2007 through December 31, 2011, detailed as follows:

Underwriting Income

Premiums earned		\$582,506,744
Deductions:		
Losses and loss adjustment expenses incurred	\$748,472,380	
Other underwriting expenses incurred	<u>205,775,808</u>	
Total underwriting deductions		<u>954,248,188</u>
Net underwriting gain or (loss)		\$(371,741,444)

Investment Income

Net investment income earned	\$350,120,157	
Net realized capital gain	<u>813,331</u>	
Net investment gain or (loss)		\$350,933,488

Other Income

Miscellaneous income	<u>1,952,111</u>	
Total other income		<u>\$1,952,111</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$(18,855,845)
Federal and foreign income taxes incurred		<u>26,517,141</u>
Net Income		\$ <u>(45,372,986)</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2006			\$ 818,812,833
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$ 45,372,986	
Net unrealized capital gains or (losses)		5,094,147	
Change in net unrealized foreign exchange capital gain (loss)	\$ 13,822,037		
Change in net deferred income tax	84,721,770		
Change in nonadmitted assets		68,800,821	
Capital changes transferred from surplus (stock dividend)	12,500,000		
Surplus adjustments paid in	250,000,000		
Surplus adjustments transferred to capital (stock dividend)		12,500,000	
Dividends to stockholders		95,000,000	
Change in contingency reserve		325,529,246	
Other adjustment		21,260	
Tax and loss bonds	<u>0</u>	<u>25,772,840</u>	
Net increase (decrease) in surplus	<u>\$361,043,807</u>	<u>\$578,091,300</u>	<u>\$(217,047,493)</u>
Surplus as regards policyholders per report on examination as of December 31, 2011			<u>\$ 601,765,340</u>

4. LOSSES AND CONTINGENCY RESERVES

The examination liabilities for losses and contingency reserves are \$89,152,455 and \$585,145,122, respectively, as of December 31, 2011. These are the same as the amounts reported by the Company in its 2011 filed annual statement.

In addition to case reserves, the Company is required to establish and maintain contingency reserves for the protection of insureds and claimants against the effect of excessive losses occurring during adverse economic cycles. The amount required for these reserves depends on the type of bonds being insured and are established pursuant to the provisions of Section 6903(a) of the New York Insurance Law.

A review of the Company's case reserve losses methodology, surveillance and modeling was conducted. Losses were evaluated for selected liabilities in Public Finance, RMBS, CMBS, CRE CDO, CLO and other structured credit securities. It was found the surveillance and reserve setting processes adequate and largely in line with accepted market practices.

The Company's estimate of reserves for losses on its exposures is based on certain assumptions. Changes in such assumptions could materially adversely affect such reserve estimates, including those as a result of more adverse macroeconomic conditions, the bankruptcies of issuers of bonds insured or swap counterparties, and 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 estimates (that may or may not result in an increase in such loss reserves) against the Company. In addition, the value of its investment portfolio could change and have material adverse affect.

5. SUBSEQUENT EVENTS

Restructuring Plan

AGL has proposed an internal reorganization, which includes the capitalization of its indirect, 100% owned insurance company subsidiary, MAC, and certain related transactions. As part of this reorganization, the Company is expected to merge with and into AGM, with AGM continuing as the surviving company, and AG Bermuda is also expected to cease to exist. Following completion of the entire reorganization transaction, AGM and/or AGC will indirectly own 100% of MAC. The proposed reorganization, including the foregoing transactions, is subject to regulatory approval which is pending.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

This is the first financial examination of the Company by the Department. The last regulatory financial examination of the Company was conducted by the Oklahoma Insurance Department covering the period January 1, 2004 through December 31, 2006. There were no material exceptions noted requiring adjustments to the Company's financial statements, based upon the procedures performed by that Oklahoma Department.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A	<u>Management</u> It is recommended that the Company holds its annual shareholders' meetings in accordance with the schedule stipulated in its bylaws and maintain minutes for the meetings.	5

Respectfully submitted,

_____/s/
Ian Martin,
Senior Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

Ian Martin, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____/s/
Ian Martin

Subscribed and sworn to before me
this _____ day of _____, 2013.

APPOINTMENT NO. 30850

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Ian Martin

as a proper person to examine the affairs of the

ASSURED GURANTY MUNICIPAL INSURANCE COMPANY

and to make a report to me in writing of the condition of said

COMPANY

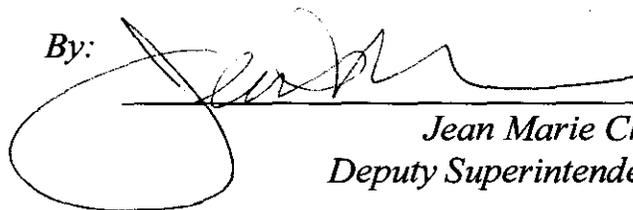
with such other information as he shall deem requisite.

*In Witness Whereof, I have hereunto subscribed my name
and affixed the official Seal of the Department
at the City of New York*

this 8th day of May, 2012

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:



Jean Marie Cho
Deputy Superintendent

