Statutory Loss Reserve Methodology Summary[1]

Set forth below is a discussion of case basis reserves carried by the Company at September 30, 2015 and 2014. The Company's reserves for unpaid losses and loss adjustment expenses represent its best estimate of: (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 the net present value of installment premiums due from the counterparties to such guarantees subsequent to the balance sheet date. The Company's best estimate of claims and recoveries was based on assumptions and estimates extending over many years into the future. Such assumptions and estimates are subject to the inherent limitation on the Company's ability to predict the aggregate course of future events and, as a result, differences between estimated and actual results may be material. Reference should be made to "Defeased Transactions" below for information regarding the effect on the Company's reserves for unpaid losses resulting from transactions which effectively defeased or, in-substance, commuted (in whole or in part) substantially all its guarantees on which it previously carried case reserves.

The Company estimates claims based on its surveillance department's best estimate of net cash outflows under a contract, on a present value basis. In some cases, the surveillance department will engage an outside consultant with appropriate expertise in the underlying collateral assets and respective industries to assist management in examining the underlying collateral and determining the projected loss frequency and loss severity. In such cases, the surveillance department will use that information to run a cash flow model that includes enhancement levels and debt service to determine whether a claim is probable, possible or not likely.

The surveillance department focuses its review on monitoring lower rated bond sectors and potentially troubled sectors, which have included certain subsectors within the ABS, CDO, Public Finance and Structured Single Risk portfolios. For the ABS and CDO portfolios, it tracks performance monthly to determine whether or not covenants have been breached. If a covenant is breached, the Company may have the right to put the transaction into rapid amortization so that all cash flow generated from that transaction is used to pay down principal and stay current with interest or take other remedial action. Typically, the surveillance department reviews periodic servicing and trustee reports to track coverage levels, enhancement levels, delinquency levels, loss frequency, loss severity and total losses and compares such performance metrics with the metrics that were made available at the time the transaction was closed. If losses are above projections, the surveillance department will analyze the reasons for the deviation. In some cases, it may be an indication of servicing problems, where loans are delinquent and are not put into foreclosure in time to maximize recovery. Typically once per year, the surveillance department will audit servicers of loans and other assets supporting the Company's insured obligations to better understand their servicing practices and to identify potential servicing problems, if any. For the Public Finance portfolio, the surveillance department uses a Frequency of Review Schedule to prioritize reviews to ensure lower rated and larger exposure credits are being looked at more frequently. In addition, the surveillance department uses screening tools to review the entire Public Finance portfolio based upon news feeds, trade data, material event notices and other third party information. For the Structured Single Risk portfolio, the surveillance department will retain technical consultants as needed to track construction and operational risk and reviews this portfolio based upon reports it receives on a monthly, quarterly or annual basis.

[1] For a complete description, refer to the Company's 2014 Annual Statement and Quarterly Statement for the period ending September 30, 2015

Specific Disclosure Related to Asset-Backed Securities

The Company's estimates of reserves are determined based on an analysis of results of cash flow models. The models project expected cash flows from the underlying mortgage notes. The model output is dependent on, and sensitive to, key assumptions regarding default rates, draw rates, draw periods, recoveries and prepayment rates, among others. The cash flow from the mortgages is then run through the payment "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, except when the principal balance is due for payment on the scheduled maturity date. 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.

The Company generally observed peak defaults for the second lien transactions in 2009 and 2010. Default rates at September 30, 2015 are mostly forecasted with steady state default rates. Exceptions to this may include transactions for which there is an excessive build-up of severely delinquent loans for which defaults are anticipated or transactions whose collateral includes loans whose interest-only periods will end, at which point temporary increases to default rates are expected.

The Company assumes a steady state constant default rate at a rate well above historical norms. Net losses will be greater if the time it takes the mortgage performance to stabilize is longer than currently anticipated or if ramp down periods are extended beyond the Company's current assumption. The constant default rate is a function of several factors, one of which is the state of the economy and unemployment.

The Company's default assumptions for the first lien transactions at September 30, 2015 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 43.0% to 68.0% 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 sponsor of such securities and/or the originator of mortgage loans backing such securities to repurchase mortgage loans backing such securities that breached certain representations and warranties and/or to pay damages, and in the case of claims against GreenPoint Mortgage Funding, Inc. ("GreenPoint"), these claims are now being pursued by U.S. Bank as indenture trustee. While a sponsor and GreenPoint have disputed, and may in the future dispute, their obligations to repurchase all or a portion of these mortgages and/or to pay damages, if the Company or the indenture trustee 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 September 30, 2015 and December 31, 2014, the Company estimated that it would realize a net benefit for certain of these cases from such recoveries, which are subject to material discounts for uncertainty, timing and collectability. This benefit is recorded in the Company's financial statements through a reduction in reserves for losses that it would otherwise have had to carry. Given the inherent uncertainty of litigation, no assurance can be given that the Company or indenture trustee will be successful in enforcing its rights to require a sponsor or GreenPoint to repurchase the mortgages and/or pay damages discussed above or, if successful, in collecting. If the Company or indenture trustee were successful in enforcing these rights, the ability of the Company to realize a financial benefit from the repurchase of mortgages loans and/or damages paid by a sponsor or originator 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 sponsor or GreenPoint to honor their obligations. As a result, and due to the risks involved in any litigation, the actual recoveries and therefore benefit to the Company may vary materially (favorably or unfavorably) from the Company's estimates. In addition, no benefit is available to the Company to the extent it defeased such insured RMBS through the acquisition of Insurance Cash Flow Certificates or the use of alternative structures which mirror the economics of the Insurance Cash Flow Certificates (see defeased transactions below).

Defeased Transactions

In connection with the 2009 MTA, the Company invested in a fund (the "RMBS Fund") that executed certain transactions designed to effectively defease or, in-substance, commute the Company's 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 the Company'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 the Company. The Company will, should the cash flows from the underlying RMBS transaction be sufficient, receive certain reimbursement payments in respect of insurance payments previously made by the Company on such RMBS.

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

The NYDFS granted the Company a permitted practice to de-recognize reserves for unpaid losses, unearned premium reserves and contingency reserves relating to, and expense payments (which are reflected in "Losses incurred" on the Statement of Income) made to effect, certain transactions which effectively defeased or, in-substance, commuted, in whole or in part, the policies relating thereto, whereas under NAIC SAP such reserves would continue to be carried until such time the underlying contracts were legally extinguished and the payments made to effect the transactions would have resulted in the recording of an asset, as such payments were made in exchange for the assignment to the Company of all rights under the aforementioned policies.

Discount Rate

The Company's case basis reserves for unpaid losses are discounted on a non-tabular basis. The discount rate used at SGI at September 30, 2015 and December 31, 2014 was 5.01%. The discount rate used at SCAI at September 30, 2015 and December 31, 2014 was 4.47%.The discount rates are based on a duration-weighted average return on the Company's average invested assets.