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ACA Financial Guaranty Corporation

Statutory-Basis Financial Statements as of and for the Years Ended December 31, 2011 and 2010, Supplemental Schedules as of December 31, 2011, and Independent Auditors' Report

ACA FINANCIAL GUARANTY CORPORATION

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Deloitte.

Deloitte & Touche LLP
Two World Financial Center
New York, NY 10281-1414
USA

Tel: +1 212 436 2000
Fax: +1 212 436 5000
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
ACA Financial Guaranty Corporation:

We have audited the accompanying statutory-basis statements of admitted assets, liabilities and surplus of ACA Financial Guaranty Corporation (the "Company") as of December 31, 2011 and 2010, and the related statutory-basis statements of income and changes in surplus, and of cash flow for the years then ended. 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 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 2 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Maryland Insurance Administration, and such practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the differences between the statutory-basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of ACA Financial Guaranty Corporation as of December 31, 2011 and 2010, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the accompanying statutory-basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of ACA Financial Guaranty Corporation as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

Our 2011 audit was conducted for the purpose of forming an opinion on the 2011 statutory-basis financial statements as a whole. The supplemental summary of investment schedule, the supplemental schedule of investment risk interrogatories, and the supplemental schedule of reinsurance risk interrogatories as of and for the year ended December 31, 2011 are presented for purposes of additional analysis and are not a required part of the 2011 statutory-basis financial statements. These schedules are the responsibility of the

Company's management and were derived from and relate directly to the underlying accounting and other records used to prepare the statutory-basis financial statements. Such schedules have been subjected to the auditing procedures applied in our audit of the basic 2011 statutory-basis financial statements and certain additional procedures, including comparing and reconciling such schedules directly to the underlying accounting and other records used to prepare the statutory-basis financial statements or to the statutory-basis financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such schedules are fairly stated in all material respects in relation to the 2011 statutory-basis financial statements as a whole.

Deloitte & Touche LLP

May 25, 2012

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY-BASIS STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS AS OF DECEMBER 31, 2011 AND 2010
(Dollars in thousands)

	2011	2010
ADMITTED ASSETS		
BONDS — At NAIC carrying value	$ 430,358	$ 434,056
CASH AND SHORT-TERM INVESTMENTS	12,856	25,999
RECEIVABLE FOR SECURITIES	20	-
OTHER INVESTED ASSETS	-	1,090
Total cash and investments	443,234	461,145
ACCRUED INVESTMENT INCOME	3,169	3,588
OTHER ASSETS	1,768	63
TOTAL ADMITTED ASSETS	$ 448,171	$ 464,796
LIABILITIES AND SURPLUS		
UNEARNED PREMIUMS	$ 174,425	$ 190,450
LOSSES AND LOSS ADJUSTMENT EXPENSES	75,889	49,743
CONTINGENCY RESERVE	73,919	96,829
PAYABLE TO SUBSIDIARIES	86	-
ACCRUED EXPENSES AND OTHER LIABILITIES	6,537	5,308
Total liabilities	330,856	342,330
COMMON STOCK — 1,000,000 shares authorized, issued and outstanding at December 31, 2011 and 2010; par value of $15 per share	15,000	15,000
GROSS PAID-IN AND CONTRIBUTED SURPLUS	363,974	363,974
UNASSIGNED DEFICIT	(261,659)	(256,508)
Surplus as regards policyholders	117,315	122,466
TOTAL LIABILITIES AND SURPLUS	$ 448,171	$ 464,796

See notes to statutory-basis financial statements.

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY-BASIS STATEMENTS OF INCOME AND CHANGES IN SURPLUS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010
(Dollars in thousands)

	2011	2010
PREMIUM EARNED	$ 16,333	$ 15,205
LOSSES AND LOSS ADJUSTMENT EXPENSES	46,670	23,865
UNDERWRITING EXPENSES INCURRED	22,969	18,930
LEASE TERMINATION COSTS	-	12,987
TOTAL UNDERWRITING DEDUCTIONS	69,639	55,782
NET UNDERWRITING LOSS	(53,306)	(40,577)
NET INVESTMENT INCOME	17,981	18,364
NET REALIZED CAPITAL GAINS	1,649	5,114
NET INVESTMENT GAIN	19,630	23,478
OTHER INCOME	7,415	8,336
LOSS BEFORE FEDERAL INCOME TAX BENEFIT	(26,261)	(8,763)
FEDERAL INCOME TAX BENEFIT	-	(34)
NET LOSS	$ (26,261)	$ (8,729)
SURPLUS AS REGARDS POLICYHOLDERS — Beginning of year	$ 122,466	$ 137,456
Net loss	(26,261)	(8,729)
Change in net unrealized capital (losss) gains	(142)	591
Change in contingency reserve	22,910	(11,190)
Change in deferred income tax	(7,946)	(6,014)
Change in non-admitted assets	6,288	10,352
Change in surplus as regards policyholders	(5,151)	(14,990)
SURPLUS AS REGARDS POLICYHOLDERS — End of year	$ 117,315	$ 122,466

See notes to statutory-basis financial statements.

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY-BASIS STATEMENTS OF CASH FLOW
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010
(Dollars in thousands)

	2011	2010
CASH FLOWS FROM OPERATIONS:		
Premiums collected net of reinsurance	$ 309	$ 487
Net investment income	19,829	19,995
Other income	7,415	8,336
Benefits and loss related payments	(17,478)	(3,282)
Commissions, expenses paid and aggregate write-ins for deductions	(26,310)	(31,232)
Federal and foreign income taxes collected	-	51,408
Net cash (used in) provided by operations	(16,235)	45,712
CASH FLOWS FROM INVESTMENTS:		
Proceeds from investments sold or matured	126,563	100,979
Cost of investments acquired	(123,712)	(160,524)
Net cash provided by (used in) investments	2,851	(59,545)
CASH FLOWS FROM FINANCING AND MISCELLANEOUS SOURCES:		
Other applications	241	2,201
Net cash provided by financing and miscellaneous sources	241	2,201
NET DECREASE IN CASH AND SHORT-TERM INVESTMENTS	(13,143)	(11,632)
CASH AND SHORT-TERM INVESTMENTS — Beginning of year	25,999	37,631
CASH AND SHORT-TERM INVESTMENTS — End of year	$ 12,856	$ 25,999

See notes to statutory-basis financial statements.

1. GENERAL

ACA Financial Guaranty Corporation (the "Company" and ACA FG) is organized and domiciled in the State of Maryland and is a licensed, authorized and accredited insurance company in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. The Company is authorized to provide financial guaranty insurance on tax-exempt and other debt obligations, as well as on certain obligations related to asset-backed and corporate financings. As further discussed in Note 2, since December 2007, the Company has not issued any new financial guaranty insurance policies and is currently operating as a run-off insurance company.

Financial guaranty insurance provides an unconditional and irrevocable guaranty to the holder of a valid debt obligation with an enforceable guaranty of full and timely payment of the guaranteed principal and interest thereon when due. Financial guaranty insurance adds another potential source of repayment of principal and interest for an investor, namely the credit quality of the financial guarantor. Generally, in the event of any default on an insured debt obligation, payments made pursuant to the applicable insurance policy may not be accelerated by the holder of the insured debt obligation without the approval of the insurer. While the holder of such an insured debt obligation continues to receive guaranteed payments of principal and interest on schedule, as if no default had occurred, and each subsequent purchaser of the obligation generally receives the benefit of such guaranty, the insurer normally retains the option to pay the debt obligation in full at any time. Also, the insurer generally has recourse against the issuer of the defaulted obligation and/or any related collateral for amounts paid under the terms of the insurance policy as well as pursuant to general rights of subrogation. The issuer of an insured debt obligation generally pays the premium for financial guaranty insurance, either in full at the inception of the policy, as is the case in most public finance transactions, or in periodic installments funded by the cash flow generated by related pledged collateral, as is the case in most structured finance and international transactions. Typically, premium rates paid by an issuer are stated as a percentage of the total principal (in the case of structured finance and international transactions) or principal and interest (in the case of public finance transactions) of the insured obligation. Premiums are almost always non-refundable and are invested upon receipt.

The Company's common stock is owned 76.6% by ACA Holding, L.L.C. (ACAH), a Delaware limited liability company, and 23.4% by KPR Ltd, (KPR), a company with limited liability organized under the laws of the Cayman Islands. KPR is a wholly owned subsidiary of ACAH and ACAH is a wholly owned subsidiary of Manifold Capital Corp. (ACACH), formerly ACA Capital Holdings, Inc., a Delaware corporation. Effective at the closing of the Restructuring Transaction discussed in Note 2, ACACH and its wholly owned subsidiaries disclaimed control over the Company and voting control of the Company became vested in the surplus notes issued in connection with the restructuring. This disclaimer of control was approved by the Maryland Insurance Administration (MIA).

The Company through its subsidiaries, ACA Service, L.L.C. and ACA Management L.L.C., was historically engaged in the business of providing asset management services within targeted sectors of the fixed income capital markets. ACA FG's affiliates participated in this market by structuring and managing and investing in collateralized debt obligations (CDO) in collaboration with investment banks which market the corresponding CDO securities to investors worldwide. The Company and its affiliates are no longer engaged in the CDO asset management business, except for a limited number of pre-existing arrangements, and have not originated any CDOs since the third quarter of 2007. The Company's indirect wholly owned subsidiary, ACA Management, L.L.C., continues to receive fees related to these contracts from third parties to whom they assigned rights and obligations to manage these contracts and on a periodic basis pays dividends to ACA Service, L.L.C., its direct parent and direct wholly owned subsidiary of the Company. ACA Service, in turn, passes on these funds to the Company, also in the form of a dividend.

2. RESTRUCTURING TRANSACTION

As a result of adverse developments in the credit markets generally and the mortgage market specifically that began in the second half of 2007 and continued to deepen in 2008 and thereafter, the Company experienced material adverse effects on its business, results of operations, and financial condition, which resulted in significant downgrades of the Company's financial strength ratings by Standard & Poor's Ratings Services (S&P) and, ultimately, a restructuring of the Company to avoid a regulatory proceeding (the "Restructuring Transaction"), The Restructuring Transaction, which was consummated on August 8, 2008, was comprised of three main components.

The first component of the Restructuring Transaction consisted of a Global Settlement Agreement whereby insured credit swap counterparties' claims were settled in consideration for a cash payment of approximately $209 million and surplus notes with a face value of approximately $950 million. In the aggregate $1 billion face amount of surplus notes were issued in connection with the Restructing Transction. Of such amount, the aforementioned insured credit swap counterparties received $950 million and the balance of $50 million was issued to ACACH. While certain of the surplus notes issued to the insured credit swap counterparties were issued to be non-voting at the request of certain of such counterparties, the surplus notes issued to the counterparties, in the aggregate, represent a 100% voting interest in the Company. The surplus notes issued to ACACH are are all non-voting.

The second component of the Restructuring Transaction provided for the settlement of a $100 million medium term note guaranteed by the Company. This obligation was settled by a cash payment of approximately $48 million to the note holders in 2008 and the relinquishment by the Company of investments in CDO equity with an estimated value of $2.5 million. Of the total cash settlement, approximately $32 million was paid out of a cash collateral account supporting the issued note while the remaining amount of approximately $16 million was funded by cash from the Company and its other subsidiaries.

The third component of the Restructuring Transaction centered on the Intercompany Agreement which treated ACACH and its non-ACA FG subsidiaries as one sub-group and ACA FG and its subsidiary as a separate sub-group. By its terms, the Intercompany Agreement provided for the cancellation of a previously issued intercompany surplus note as well as intercompany balances between the Company's sub-group and the ACACH sub-group. It also provided for a global release of liability among the two sub-groups. In general, the release discharges the entities from any and all actions, cause of action, suits, debts, liens, contracts, rights and other legal obligations against each other, except those provided for in the Intercompany Agreement. In addition, ACACH has provided an indemnification for claims against ACA FG and its subsidiaries, including employee claims, up to a maximum of $10 million for claims made prior to August 8, 2010, as well as a second indemnification collateralized with a $5.0 million escrow, for certain other claims.

Subsequent to the closing of the Restructuring Transaction, the Company is required to and has operated under an order issued by the MIA, Case No.: MIA: 2008-08-011 dated August 7, 2008 (the "Order"). The Order provides, among other things, that the Company operate as a run-off company. In connection with the Order, following the Restructuring Transaction, the Company wound down all subsidiaries no longer necessary for the conduct of its ongoing business, including 73 special purpose entities created for the insured credit swap and CDO asset management businesses.

3. DESCRIPTION OF SIGNIFICANT RISKS AND UNCERTAINTIES AND THE COMPANY'S ON-GOING STRATEGIC PLAN

Description of Significant Risks and Uncertainties

- As further discussed in Note 4, ACA FG recognizes losses and establishes related loss reserves on bond obligations it has insured only upon the initial payment default by the issuer of such bond obligations (under the Company's accounting policy, the initial payment default is generally considered the incident which gives rise to a claim and triggers loss recognition relating to the incident). The loss recognized by ACA FG upon a payment default represents the Company's best estimate of its ultimate loss over the life of the policy, discounted to reflect the time value of money (not the amount of the claim under the policy received upon the initial payment default which generally reflects the shortfall by the obligor of the scheduled principal and/or interest payment then due under the terms of the bond indenture). However, ACA FG has policies in-force upon which it expects that payment defaults will occur in the future resulting in losses that will be incurred by the Company. Such expected future losses are not recorded by the Company in the accompanying Statements of Admitted Assets, Liabilities and Surplus at December 31, 2011 and 2010, because a payment default has not yet occurred. With consideration of the inherent uncertainty of estimating losses discussed further below, the Company's estimate of the ultimate losses that it will incur in the future on such policies (where payment defaults have not yet occurred but are expected) ranged from \$100 million to \$125 million at December 31, 2011, on a discounted basis. Accordingly, the Company believes it will incur material losses in the future which will materially adversely affect its policyholders' surplus. Notwithstanding the de-recognition of the Company's contingency reserves approved by the Maryland Insurance Commissioner discussed in Note 4 and any further de-recognition of contingency reserves that may be approved by the Maryland Insurance Commissioner in the future, no assurance can be given that the recognition of such losses in the future will not cause the Company to fail to comply with its regulatory required minimum policyholders' surplus requirement of \$750,000. However, the Company believes that its surplus will be in excess of the required minimum surplus over the twelve months succeeding the date of the accompanying Statement of Admitted Assets, Liabilities and Surplus and, that it has sufficient liquidity resources to satisfy its financial obligations as they come due for the foreseeable future.

- The Company is materially exposed to risks associated with deterioration in the tax exempt bond market through its insurance guaranties (see Note 10), as well as to the economy generally. The extent and duration of any future deterioration in the tax exempt bond market is unknown, as is the effect, if any, on potential claim payments and the ultimate amount of losses the Company may incur on obligations it has guaranteed. As discussed in Note 19, the Company classifies its insured in-force portfolio in one of four credit quality categories. As noted therein, as of December 31, 2011, the Company had insured obligations with outstanding principal totaling \$385.4 million classified in category 4, which means that it either has paid claims on such exposures or expects to pay claims on such exposures in the future. In addition, as of such date, the Company had insured obligations with outstanding principal totaling \$374.7 million classified in category 3, which means those credits have materially violated financial and operational covenants and require remedial action to avoid further performance deterioration. As discussed in Note 10, the risk of loss under the Company's guaranties extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed. No assurance can be provided that further deterioration in ACA FG's insured guaranties will not occur resulting in a further migration of insured exposure to categories 3 and/or 4 or that ACA FG will not incur losses that may be materially in excess of what it currently estimates.

- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on the Company's insured guaranties requires the use and exercise of significant judgment by management, including estimates regarding the probability of default, the severity of loss upon default and the amount and timing of claim payments and recoveries on a guaranteed obligation. Case basis reserves reflect management's best estimate of the present value of the Company's ultimate loss and not the worst possible outcome. 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, and changes in the expected timing of claims payments and recoveries, and the amounts of expected claims payments and recoveries. Both qualitative and quantitative factors are used in making such estimates. Each quarter, in connection with the preparation of its financial statements, the Company reevaluates all such estimates. Changes in these estimates may be material and may result in material changes in the Company'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 Company is involved in a number of legal proceedings, both as plaintiff and defendant, as well as regulatory inquiries and investigations. Management cannot predict the outcomes of these proceedings and other contingencies with certainty. In addition, it is not possible to predict whether additional suits will be filed or whether additional inquiries or investigations will be commenced. The outcome of some of these proceedings and other contingencies could require the Company to take or refrain from taking actions which could have a material adverse effect on its business, financial position or cash flows or could require the Company to pay (or fail to receive) substantial amounts of money. Additionally, prosecuting and defending these lawsuits and proceedings may involve significant expense and diversion of resources from other matters. See Note 16.

- ACA FG has experienced and likely will continue to experience substantial tax losses in the conduct of its business.

  Section 382 of the Internal Revenue Code ("Section 382") contains rules that limit the ability of a corporation that experiences an "ownership change" to utilize its net operating loss carryforwards (NOLs) and certain built-in losses recognized in periods following the ownership change. An ownership change is generally any change in ownership of more than 50 percentage points of a corporation's stock over a 3-year period. These rules generally operate by focusing on ownership changes among 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. For purposes of the aforementioned test, ACA FG's surplus notes are considered stock and ACA FG's surplus note holders are considered shareholders.

  If ACA FG undergoes an ownership change for purposes of Section 382 as a result of future transactions involving its surplus notes, ACA FG's ability to utilize its NOLs and recognize certain built-in losses would be subject to further limitations under Section 382. Depending on the resulting limitation, a significant portion of ACA FG's NOLs could be deferred or could expire before it would be able to use them to offset positive taxable income in current or future tax periods. ACA FG's inability to utilize its NOLs could have a significant adverse affect on its financial position and results of operations.

Description of the Company's On-Going Strategic Plan

- Management is actively seeking to (i) remediate deteriorated insured exposures to minimize claim payments, maximize recoveries and mitigate ultimate expected losses, (ii) increase the Company's capital, surplus, liquidity and claims paying resources, (iii) realize maximum value from various legal proceedings described in Note 16 and from any other rights and remedies the Company may have, and (iv) take other actions to enhance its financial position (hereafter collectively referred to as "Strategic Actions"). In regard to the Strategic Actions, the Company is actively pursuing or exploring a number of options available to it to enhance the Company's policyholders' surplus 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 MIA.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying financial statements of the Company are presented in accordance with the National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual Statement of Statutory Accounting Principles (SAP) which has been adopted as a component of prescribed or permitted practices by the MIA effective January 1, 2001. The differences between NAIC SAP and MIA SAP are not material to the Company. These practices differ in certain material respects from accounting principles generally accepted in the United States of America (GAAP), as described in Note 5. Set forth below is a description of the SAP accounting policies which are significant to the preparation of the accompanying financial statements.

Estimates and Assumptions — The preparation of financial statements in conformity with SAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Short-Term Investments — Cash and short-term investments include cash on hand, demand deposits with banks and short-term investments purchased with an original maturity of one year or less. Short-term investments are carried at amortized cost, which approximates market value.

Investments — Investments are valued in accordance with the valuation procedures of the NAIC. Investment grade bonds are generally carried at amortized cost and the amortization of premium or accretion of discount is determined using the constant yield method. Non-investment grade bonds, as determined by the Securities Valuation Office (SVO) division of the NAIC or management, are carried at the lower of amortized cost or fair value.

Bonds and loan-backed securities assigned an NAIC Designation of 1 or 2 are valued at cost, adjusted for amortization of premium and accretion of discount which is calculated using the constant yield method. Bonds and loan-backed securities assigned an NAIC rating of 3 or lower are valued at the lower of amortized cost, adjusted for amortization of premium and accretion of discount which is calculated using the constant yield method, or fair value. The prospective method is used to value loan-backed securities. The cost of bonds is adjusted for impairments in value deemed to be an other-than-temporary impairment (OTTI). These adjustments are recorded as realized capital losses.

Realized capital gains and losses on dispositions of investments are determined on the basis of specific identification and are included in net income. Declines in fair values, which are determined to be other than temporary, are recorded as realized capital losses. In 2011 and 2010, the Company recognized $1.4 million and $0.6 million, respectively, in other than temporary impairments for bonds.

The Company continuously monitors securities that have an estimated fair value that is below amortized cost in order to determine if there is any evidence that the decline in estimated fair value is other-than-temporary. Factors considered in evaluating whether a decline in value is other-than-temporary include: 1) whether the decline is attributable to credit related of interest rate related factors, 2) whether the decline is substantial; 3) the amount of time that the fair value has been continuously less than cost; 4) the financial condition and near-term prospects of the issuer; and 5) the Company's ability and intent to retain the investment for the period of time sufficient to allow for an anticipated recovery in value.

For loan-backed bonds and structured securities, anticipated prepayments at the date of purchase are considered when determining the amortization of discount or premium. The cash flows of loan-backed and structured securities are reviewed to ensure that any movement in the expected prepayment assumptions of a security are reflected in the adjusted book value of the asset. An external service is used to determine the average prepayment speed adjustments. Significant changes in estimated cash flow from the original purchase assumptions are generally accounted for using the retrospective method. The prospective method is used for interest only securities or securities where the yield becomes negative, if any.

Premium Revenue Recognition — Typically, financial guaranty premium is received either on an upfront or installment basis. In general, premiums from insured tax-exempt obligations are received on an upfront basis. Upfront premiums are earned based on the proportion of principal and interest scheduled to be paid on the underlying insured obligation during the period, as compared to the total amount of principal and interest to be paid over the contractual life of the insured debt obligation. Unearned premiums represent that portion of premiums which is applicable to coverage of risk to be provided in the future on policies in force. Installment premiums are earned over each installment period, which is generally one year or less. When an insured issue is retired or defeased prior to the end of the expected period of coverage (hereafter referred to as "Refundings"), the remaining unearned premium relating to such insured issue is earned at that time since there is no longer risk to the Company. The amounts earned from refundings were $6.7 million and $7.0 million in 2011 and 2010, respectively.

Other Income Revenue Recognition — The Company collects dividends from its subsidiary, ACA Service, L.L.C. related to its prior CDO asset management business. These dividends are recorded as other income. The Company also collects fees in connection with the granting of waivers and consents in connection with insured tax-exempt transactions. These fees are recognized by the Company as other income when the cash is received.

Losses and Loss Adjustment Expenses — The Company records a loss with respect to an insurance guaranty upon a payment default by the issuer of the insured obligation (a payment default is generally considered the incident which gives rise to a claim under the Company's insurance policies and triggers loss recognition relating to the incident). The loss recorded by the Company represents its best estimate of the present value of its ultimate claim payments under the policy, net of its best estimate of the present value of any recoveries from salvage or subrogation rights under the policy. The Company's liability for losses reported on the accompanying Statement of Admitted Assets, Liabilities and Surplus (and also known as "loss reserves" "reserves for unpaid losses", "case reserves", or "case basis reserves") represents the present value of the Company's estimated ultimate losses that remain unpaid at the balance sheet date with respect to policies meeting the aforementioned criteria for loss recognition.

Loss adjustment expenses (LAE) are recorded by the Company in regard to insurance guaranties when costs are incurred or expected to be incurred to remediate losses under its policies. Accordingly, LAE may be recorded on policies for which claims have been paid or losses have been recognized, as well as on policies where no claim payments have been made or losses have been recorded but may be incurred in the future. LAE represents the estimated ultimate cost of remediating losses or potential losses under policies. The Company does not discount LAE.

Losses on the Company's insurance guaranties and related case reserves are determined using cash flow models to estimate the net present value of the anticipated shortfall between (i) scheduled payments on the insured obligation and (ii) anticipated cash flow from the obligor or the collateral supporting the obligation and other anticipated recoveries or cash flows. At December 31, 2011 and 2010, the weighted average discount factor used by the Company to present value its loss reserves was 4.15% and 4.5%, respectively. A number of quantitative and qualitative factors are considered when determining whether the Company will incur a loss and the amount of any case 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 recoveries from such assets. Other factors that may affect the actual ultimate loss include the state of the economy, market conditions for municipal bond issuance, changes in interest rates, rates of inflation and the salvage values of specific collateral. Such factors and management's assessment thereof will be subject to the specific facts and circumstances associated with the specific insured transaction being considered for loss recognition. Loss reserves are discounted at a rate equal to the average rate of return on admitted assets. Recognition of losses and related case reserves requires the use and exercise of significant judgment by management, including estimates regarding the amount and timing 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 guaranteed obligations, changes in the value of specific assets supporting guaranteed obligations, and changes in the expected timing of claims payments and recoveries, and the amounts of expected claims payments and recoveries. 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 LAE will vary, perhaps materially, from any estimate.

See Note 2 for further information regarding the Company's accounting policy for loss recognition on its in-force insurance guaranties, as well as in regard to losses expected to be incurred by the Company on its insurance guaranties which have not yet been recorded in the accompanying Statement of Admitted Assets, Liabilities and Surplus because a payment default by the issuer of the insured obligation has not yet occurred. In addition, see Note 7 for a reconciliation of the beginning and ending balances of the reserve for losses and loss adjustment expenses as of December 31, 2011 and 2010.

Surplus Notes —As discussed in Note 2, as part of the Restructuring Transaction, surplus notes of $1 billion were issued to former structured credit counterparties, and the existing shareholders. These notes have been recorded in the surplus notes section of the Statements of Admitted Assets, Liabilities and Surplus with an offsetting $1.0 billion contra account since any payment of principal or interest on the surplus notes may not be recognized until approved by the MIA. Upon the MIA's approval of the payment of principal (which includes accreted discount), the amount of the Company's surplus notes and the contra account will be reduced by the amount of such payment. In addition, any other distributions (including dividends or interest) relating to the surplus notes will only be recognized upon the approval by the MIA for such payment. As the accounting for interest accretion described above deviates from NAIC SAP, the Company requested and received approval from the MIA for such accounting. Under NAIC SAP, the accretion of the discount is recorded in the Company's income statement. This represents the only deviation from NAIC SAP and does not have a net impact on the Company's financial statements.

Contingency Reserve —A statutorily mandated contingency reserve is established net of reinsurance by an appropriation of unassigned surplus and is reflected in "Aggregate write-ins for liabilities" in the Statements of Admitted Assets, Liabilities and Surplus. This reserve is calculated as the greater of a prescribed percentage applied to original insured principal or 50% of premiums written, net of ceded reinsurance. The prescribed percentage varies by the type of business. Once the reserve is calculated, as described above, it is incrementally recognized in the financial statements over a prescribed time period based on type of business. Reductions in the contingency reserve may be recognized under certain stipulated conditions, subject to the approval of the Maryland Insurance Commissioner.

On February 17, 2011, the Maryland Insurance Commissioner approved a request by the Company to derecognize, under certain circumstances, contingency reserves on policies which were terminated or on which case reserves have been established. Such contingency reserves aggregated approximately $42.2 million at December 31, 2010. Pursuant to the approval, the Company may release the aforementioned contingency reserves in amounts equal to future adverse loss development recorded by the Company, but up to no more than the approved aggregate amount. The Company released $34.0 million of such contingency reserves during the year ended December 31, 2011. Accordingly, as of December 31, 2011, the Company had $8.2 million of approved contingency reserve release remaining available to it to offset future adverse loss development.

Federal Income Taxes — Deferred tax assets and liabilities are provided for the expected future tax consequences of temporary differences between the carrying amount and tax basis of assets and liabilities. The change in the deferred tax assets and liabilities are charged or credited to surplus. Deferred tax assets are non-admitted to the extent they exceed factors such as taxes paid in prior years and 10% of surplus.

New Accounting Pronouncements —Effective December 31, 2011, the Company adopted the revised SSAP No. 5R, *Liabilities, Contingencies and Impairments of Assets* ("SSAP 5R"). SSAP 5R adopts, with modification, guidance from Financial Accounting Standards Board ("FASB") Accounting Standard Codification 460, *Guarantees.* The substantive revisions require entities to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee, even if the likelihood of having to make payments under the guarantee is remote. Under the new guidance, a liability is required to be recognized at the inception of a related party guarantee. The guidance does exempt from measurement guarantees made to or on behalf of wholly-owned subsidiaries, as well as intercompany and related party guarantees that are considered "unlimited". The Company's adoption of SSAP 5R did not have a significant impact on its statutory-basis financial statements.

In December 2009, the NAIC issued SSAP No. 100, Fair Value Measurements ("SSAP 100"). This pronouncement defines fair value, establishes a framework for measuring fair value and establishes disclosure requirements about fair value. This statement was effective for the year ended December 31, 2010. The adoption of SSAP 100 did not have an impact on the Company's statutory financial statements.

In November 2011, the NAIC issued SSAP No. 101, Income Taxes ("SSAP 101"). SSAP 101 establishes statutory accounting principles for current and deferred federal income taxes and current state income taxes. In addition, SSAP 101 establishes statutory accounting principles for accounting for uncertainty in income taxes and defines recognition and measurement criteria that must be met for a reporting entity to recognize any benefit of any tax position in the reporting entity's financial statements. SSAP 101 provides statutory guidance on measurement, recognition, derecognition, reporting, interest and penalties, accounting in interim periods, disclosure, and transition. SSAP 101 is effective January 1, 2012 and is not expected to have a significant impact on the Company's statutory financial statements.

5. SUMMARY OF SIGNIFICANT DIFFERENCE BETWEEN SAP AND GAAP

The accompanying statutory-basis financial statements have been prepared in conformity with NAIC SAP, which differs in some respects from GAAP. Following is a description of the differences between the Company's significant SAP accounting policies and pertinent GAAP.

- Under SAP, upfront premiums are earned in proportion to current scheduled principal and interest payments due pursuant to the debt service schedule in the bond indenture to the total principal and interest payments scheduled to be paid over the life of the debt obligation. Additionally, under SAP, installment premiums are earned on a straight-line basis over each installment period (which periods are generally one year or less). Under GAAP, premium revenue is recognized over the period of the contract in proportion to the amount of insurance protection provided. Upfront and installment premium revenue is earned by applying a constant rate to the insured principal amount outstanding in a given period to recognize a proportionate share of the premium received or expected to be received on a financial guaranty insurance contract. Additionally, under GAAP, installment premiums receivable are recorded at the present value of the premiums due or expected to be collected over the period of the insurance contract using a discount rate which reflects the risk-free rate at the inception of the contract, whereas under SAP no recieveable is recorded unless the amounts are due pursuant to the insurance contract;

- under SAP, acquisition costs are charged to operations as incurred rather than GAAP's requirement to defer and amortize the costs as the related premiums are earned;

- under SAP, a mandatory contingency reserve is computed and recorded on the basis of statutory requirements, whereas under GAAP such reserves are not permitted;

- under SAP, losses on financial guaranty insurance policies are recognized upon a payment default by the issuer of the insured obligation whereas, under GAAP, losses on financial guaranty insurance policies are recognized based on the weighted average probability of net cash outflows to be paid under the insurance contract. In addition, under SAP, reserves for losses are discounted at a rate equal to the average rate of return on admitted assets, whereas under GAAP loss reserves are discounted using a risk-free rate as of the measurement date and are reported net of the liability at such date for unearned premium revenue;

- under SAP, certain assets which are determined to be non-admissable under SAP (such as furniture and equipment, leasehold improvements, deferred income taxes in excess of certain limitations, prepaid expenses and any other assets deemed non-admittable) are excluded from the balance sheet and charged directly to unassigned surplus whereas, under GAAP, these amounts are reflected as assets;

- investments in bonds are generally carried at amortized cost under SAP. Accordingly, unrealized changes in fair value are not reflected in the statutory-based statements of income and changes in capital and surplus or the statutory statements of admitted assets, liabilities and surplus. Bonds not qualified to be carried at amortized cost under SAP are carried at fair value as required by the NAIC with the differences between these values recorded directly to unassigned surplus net of an adjustment for deferred federal income taxes. Under GAAP, investments in bonds are classified at the time of purchase as "held to maturity" and reported at amortized cost, or "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported in a separate component of shareholders' equity net of an adjustment for deferred federal income taxes;

- under SAP, investment in the Company's wholly owned subsidiaries are accounted for under the statutory equity method of accounting, whereas under GAAP such subsidiaries are consolidated into the financial statements of the Company;

- under SAP, reserves for unpaid losses and unearned premiums are presented net of reinsurance, whereas under GAAP such amounts are presented gross of reinsurance and corresponding assets for reinsurance recoverable on unpaid losses and prepaid reinsurance premiums are recorded;

- under SAP, surplus notes are treated as equity and reported as part of capital and surplus, whereas under GAAP surplus notes may be recorded either as as liabilities or equity depending upon whether the characterisitcs, or economic substance, of such securities are deemed to be more like debt or equity, respectively.

Although the net effect of the adjustments required to convert the accompanying statutory-basis financial statements to be in accordance with GAAP is not reasonably determinable, it is presumed that such adjustments would have a material effect on net income and surplus as regards policyholders for the years ended December 31, 2011 and 2010, respectively.

6. INVESTMENTS

Bonds, with an amortized cost of $4.7 million were on deposit with various state regulatory authorities as required by insurance regulations at December 31, 2011 and 2010. Net investment income consisted of the following (dollars in thousands) for the years ended December 31, 2011 and 2010:

	2011	2010
Income from fixed-maturity securities	$ 18,770	$ 19,073
Income from cash equivalents and short-term investments	4	54
Investment expenses	(793)	(763)
Investment income	$ 17,981	$ 18,364

The amortized cost and estimated fair value of bonds as of December 31, 2011 and 2010, were as follows (dollars in thousands):

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. — Treasury securities	$ 4,035	$ 23	$ -	$ 4,058
Federal-agency securities	1,430	27	-	1,457
Obligations of states and political subdivisions	4,965	313	(16)	5,262
Corporate securities	174,825	7,597	(2,116)	180,306
Asset-backed securities	42,020	3,350	(818)	44,552
Mortgaged-backed securities	203,271	12,540	(267)	215,544
	$ 430,546	$ 23,850	$ (3,217)	$ 451,179

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. — Treasury securities	$ 4,893	$ 287	$ -	$ 5,180
Federal-agency securities	8,127	537	-	8,664
Obligations of states and political subdivisions	3,397	174	(57)	3,514
Corporate securities	182,199	9,705	(603)	191,301
Asset-backed securities	30,812	1,292	(734)	31,370
Mortgaged-backed securities	204,628	7,712	(927)	211,413
	$ 434,056	$ 19,707	$ (2,321)	$ 451,442

The amortized costs and estimated fair value of bonds at December 31, 2011, by contractual maturity, are shown below (dollars in thousands). Actual maturities could differ from contractual maturities because borrowers have the right to call or prepay certain obligations which may or may not include call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 9,675	$ 9,768
Due after one year through five years	115,896	118,089
Due after five years through ten years	41,404	43,762
Due after ten years	18,280	19,464
Sub-totals	185,255	191,083
Asset-backed securities	42,020	44,552
Mortgaged-backed securities	203,271	215,544
Totals	$ 430,546	$ 451,179

Proceeds from sales of bonds during 2011 and 2010 were $62.5 million and $58.1 million, respectively. Gross gains of $3.2 million and $5.7 million and gross losses of $1.6 million and $0.6 million were realized on those sales in 2011 and 2010, respectively.

The following table summarizes, for all securities in an unrealized loss position at December 31, 2011, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position (dollars in thousands):

	Less than 12 Months		12 Months or More		Total	Total
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. — Treasury securities	$ -	$ -	$ -	$ -	$ -	$ -
Federal agency securities	275	(16)	-	-	275	(16)
Obligations of states and political subdivisions	-	-	-	-	-	-
Corporate securities	44,047	(2,116)	-	-	44,047	(2,116)
Asset-backed securities	18,874	(800)	1,255	(18)	20,129	(818)
Mortgage-backed securities	20,981	(211)	1,748	(56)	22,729	(267)
Total	$ 84,177	$(3,143)	$ 3,003	$ (74)	$ 87,180	$(3,217)

The following tables set forth certain information regarding other than temporary impairment charges recorded during the years ended December 31, 2011 and 2010, respectively.

		Year Ended December 31, 2011			
CUSIP	Security Name	Amortized Cost Prior to Impairment	Impairment	Fair Value	Amortized Cost After the Impairment
1248MBAJ4	Credit-Based Asset Sevicing	$ 1,449,000	$ 302,700	$ 1,051,280	$ 1,146,300
76110W2X3	Residential Asset Securities C	2,928,640	76,450	2,852,190	2,852,190
81375WDS2	Securitized Asset Backed Rec	1,593,466	61,353	1,532,113	1,532,113
06050TJN3	Bank Of America NA	2,298,842	279,792	2,019,050	2,019,050
172967BU4	Citigroup Inc	1,338,412	292,824	1,048,438	1,045,588
693483AB5	POSCO	1,991,753	130,013	1,936,740	1,861,740
91913YAE0	Valero Energy Corp	499,073	31,053	468,020	468,020
61746BDC7	Morgan Stanley	1,800,917	243,837	-	1,557,080
	Total	$ 13,900,103	$ 1,418,022	$ 10,907,831	$ 12,482,081

		Year Ended December 31, 2010			
CUSIP	Security Name	Amortized Cost Prior to Impairment	Impairment	Fair Value	Amortized Cost After the Impairment
852060-AT-9	Sprint Capital	$ 1,100,307	$ 241,807	$ 858,500	$ 858,500
26156F-AA-1	Dresdner Fndg Trust I	642,782	212,782	430,000	430,000
126671-R4-0	Countrywide Asset-Backed Certs	398,133	139,328	258,805	258,805
	Total	$ 2,141,222	$ 593,917	$ 1,547,305	$ 1,547,305

7. LOSSES AND LOSS ADJUSTMENT EXPENSES

The following table is a reconciliation of the beginning and ending balances of the reserve for losses and loss adjustment expenses as of December 31, 2011 and 2010 (dollars in thousands):

	2011	2010
Balance — January 1	$ 49,743	$ 31,229
Less reinsurance recoverable	-	-
Net balance — January 1	49,743	31,229
Incurred related to:		
Current year	39,047	20,607
Prior years	7,623	3,258
Total incurred	46,670	23,865
Paid related to:		
Current year	3,804	1,462
Prior years	16,720	3,889
Total paid	20,524	5,351
Net balance — December 31	75,889	49,743
Plus reinsurance recoverables	-	-
Balance — December 31	$ 75,889	$ 49,743

For the year ended December 31, 2011, the Company recorded a provision for losses of $34.0 million, which consisted of $29.3 million of incurred losses related to payment defaults that occurred in 2011 ("current accident year claims") and $4.7 million of incurred losses related to adverse development on reserves established in years prior to 2011 ("prior accident year claims"). As of December 31, 2011, the Company's liability for unpaid losses was $64.4 million, which related to nine insured transactions, with a remaining aggregate in-force par outstanding of $54.3 million, excluding the aforementioned case reserves. The Company recorded LAE incurred of $12.7 million in 2011 and unpaid LAE of $11.5 million as of December 31, 2011.

For the year ended December 31, 2010, the Company recorded a provision for losses of $20.8 million, which consisted of $19.1 million of incurred losses related to current accident year claims and $1.7 million of incurred losses related to adverse development on prior accident year claims. As of December 31, 2010, the Company's liability for unpaid losses was $46.9 million, which related to six insured transactions, with a remaining aggregate in-force par outstanding of $90.6 million, excluding the aforementioned case reserves. The Company recorded LAE incurred of $3.0 million in 2010 and unpaid LAE of $2.8 million as of December 31, 2010.

8. REINSURANCE

The Company ceded a portion of its business to other non-affiliated insurance and reinsurance companies and reduced its estimated or potential liabilities for unpaid losses and loss adjustment expenses and unearned premiums accordingly. A contingent liability exists relating to such reinsurance in the event that the reinsurer becomes unable to meet its obligations under the terms of the reinsurance agreement; in which event the Company would be liable for any amount of losses or LAE ceded to such reinsurer. There were no unpaid losses and loss adjustment expenses ceded to non-affiliated insurance and reinsurance companies at December 31, 2011 and 2010, while unearned premiums ceded were $0.3 million and $0.4 million at December 31, 2011 and 2010, respectively.

As of and for the years ended December 31, 2011 and 2010, amounts reinsured were as follows (dollars in thousands):

	2011	2010
Income and expenses:		
Written premiums ceded	$ -	$ -
Written premiums assumed	-	-
Earned premiums ceded	63	46
Earned premiums assumed	216	830
Loss and loss-adjustment-expense payments ceded	-	-
Loss and loss-adjustment-expense payments assumed	-	-
Assets and liabilities:	-	-
Unearned-premium reserve ceded	312	375
Unearned-premium reserve assumed	5,765	5,981
Loss and loss-adjustment-expense reserves ceded	-	-
Loss and loss-adjustment-expense reserves assumed	-	-
Off balance sheet balances:	-	-
Principal outstanding ceded	11,986	16,852
Principal outstanding assumed	819,823	829,873

9. INCOME TAXES

The actual tax expense on income from operations differs from tax expense calculated at the U.S. statutory tax rate. A reconciliation of the Company's income tax expense together with the significant book to tax adjustments for the years ended December 31, 2011 and 2010, is set forth below (dollars in thousands):

	2011	2010
Loss before income taxes	$ (26,261)	$ (8,763)
Expected tax benefit at 35%	$ (9,191)	$ (3,067)
Change in contingency reserve	8,019	(3,917)
Dividends from subsidiaries	87	(429)
Tax exempt interest — net of proration	(75)	(45)
Change in statutory valuation allowance	(12,537)	15,633
Capital loss carryforward	21,957	(345)
Prior year tax adjustment and other	(314)	(1,850)
Total statutory tax expense	$ 7,946	$ 5,980

On November 6, 2009 the "Worker, Homeownership, and Business Assistance Act of 2009" was enacted that, in addition to other provisions, extended the carryback period from two years to up to five years for net operating losses (NOL's) incurred in 2008 or 2009. As a result thereof, in January 2010 the Company filed an NOL carryback claim to recoup $51.4 million. The refund was received in February 2010.

At December 31, 2011, the Company had net operating loss carryfowards expiring through the year 2030 of $76.8 million, capital loss carryforwards expiring through the year 2014 of $9.8 million and AMT credit carryforwards, which do not expire, in the amount of $0.6 million.

The Company files its tax return on a standalone basis.

The components of the net deferred tax assets and deferred tax liabilities are as follows (dollars in thousands):

	December 31,	
Description	**2011**	**2010**
Gross deferred tax assets	$ 64,444	$ 84,999
Gross deferred tax liabilities	-	(140)
Net deferred tax asset	64,444	84,859
Statutory Valuation Allowance Adjustment	(38,572)	(51,109)
Non-admitted deferred tax asset	25,872	33,750
Net admitted deferred tax asset	-	-
Decrease in non-admitted deferred tax assets	$ 7,878	$ 6,014

The components of federal income tax benefits are as follows (dollars in thousands):

Description	December 31, 2011	December 31, 2010
Prior year under accrual	$ -	$ (34)
Current income tax benefit	$ -	$ (34)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows (dollars in thousands):

	December 31, 2011	December 31, 2010	Change
Deferred tax assets:			
Ordinary:			
Net operating loss carryforward	$ 26,873	$ 17,803	$ 9,070
Contingency reserve	25,872	33,890	(8,018)
Unearned premiums reserve	6,105	6,666	(561)
Loss reserve discounting	-	55	(55)
Tax credit carryforward	615	615	-
Other temporary differences	990	374	616
Gross ordinary deferred tax assets	60,455	59,403	1,052
Statutory valuation adjustment - ordinary	(34,583)	(25,513)	(9,070)
Non-admitted ordinary deferred tax assets	(25,872)	(33,750)	7,878
Gross ordinary admitted deferred tax assets	-	140	(140)
Capital:			
Net capital loss carryforward	3,425	25,596	(22,171)
Investments	496	-	496
Unrealized capital losses	68	-	68
Gross capital deferred tax assets	3,989	25,596	(21,607)
Statutory valuation adjustment - capital	(3,989)	(25,596)	21,607
Non-admitted capital deferred tax assets	-	-	-
Gross capital admitted deferred tax assets	-	-	-
Gross ordinary deferred tax liabilities — fixed assets	-	(140)	140
Net admitted deferred tax assets	$ -	$ -	$ -

The Company has not elected to admit deferred tax assets pursuant to paragraph 10.e. of SSAP 10R for 2011 and 2010.

The change in net deferred income taxes is comprised of the following (exclusive of non-admitted assets, dollars in thousands):

	December 31,	
	2011	**2010**
Total deferred tax assets — January 1	$ 33,750	$ 39,767
Total deferred tax liabilities — January 1	-	3
Net deferred tax asset — January 1	33,750	39,764
Net deferred tax asset — December 31	25,872	33,750
Change in net deferred asset	(7,878)	(6,014)
Tax effect of unrealized losses	(68)	-
Change in net deferred income tax	$ (7,946)	$ (6,014)

There were no reserves for tax contingencies as required under SSAP 5, *Liabilities, Contingencies and Impairments of Assets*, as of December 31, 2011 and 2010.

10. OUTSTANDING EXPOSURE UNDER IN-FORCE FINANCIAL GUARANTY INSURANCE CONTRACTS

While the Company establishes reserves for losses and loss adjustment expenses on obligations on which it has received a claim notice (see Note 4), the risk of loss under the Company's guaranties extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed (see description of financial guaranty insurance in Note 1). The tables below reflect certain information regarding the Company's in-force par exposure at December 31, 2011 and 2010 (dollars in millions):

	2011		2010	
	Net Par Outstanding	% of Net Par Outstanding	Net Par Outstanding	% of Net Par Outstanding
Tax-exempt:				
Healthcare	$ 559	10.8 %	$ 708	11.9 %
Tax backed	620	11.9	663	11.2
Education	1,136	21.9	1,241	20.9
Long-term care	474	9.1	461	7.8
General obligations	1,032	19.9	1,047	17.6
Utilities	106	2.0	118	2.0
Transportation	390	7.5	419	7.1
Not for profit	407	7.8	444	7.5
Housing	260	5.0	283	4.8
Other	207	4.0	238	4.0
Total public finance obligations	5,191	99.9	5,622	94.8
Taxable obligations — other	6	0.1	311	5.2
Total	$ 5,197	100.0 %	$ 5,933	100.0 %

The following table sets forth, by state, those states in which the Company has the largest net par outstanding of insured tax-exempt obligations (dollars in millions):

	December 31, 2011		December 31, 2010	
	Net Par Outstanding	% of Net Par Outstanding	Net Par Outstanding	% of Net Par Outstanding
California	$ 1,029	19.8 %	$ 1,036	18.4 %
New York	765	14.7	827	14.7
Texas	338	6.5	358	6.4
Washington	296	5.7	329	5.9
Massachusetts	292	5.6	301	5.4
Other states	2,471	47.6	2,771	49.3
Total tax-exempt obligations	$ 5,191	100.0 %	$ 5,622	100.0 %

The principal amount of insured obligations as of December 31, 2011, in the insured portfolio, net of amounts ceded, and the terms to maturity were as follows (dollars in millions). Actual maturities could differ from final maturities because borrowers have the right to refund or prepay certain obligations.

Terms to Maturity	
0 to 5 years	$ 930
5 to 10 years	1,068
10 to 15 years	1,263
15 to 20 years	1,133
20 and above	803
Total	$ 5,197

Debt service on insured obligations for 2012 is approximately $448 million.

11. RELATED PARTY TRANSACTIONS

The payable to subsidiaries at December 31, 2011 and 2010, are as follows (dollars in thousands):

	2011	2010
Payable to Tactical Risk Management, LLC	$ 86	$ -
Net intercompany payables	$ 86	$ -

12. BENEFIT PLANS

The Company sponsors a defined contribution plan, which covers all full time employees as of their start date. Eligible participants may contribute a percentage of their salary, subject to IRS limitations. The Company's contributions are based on a fixed percentage of employees' contributions subject to IRS limitations. The Company's expense for the plan was $0.2 million for the years ended December 31, 2011 and 2010. As of December 31, 2011 and 2010, the fair value of the plan assets was $5.4 million and $6.1 million, respectively.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Measurements — Pursuant to SSAP No. 100, *Fair Value Measurements*, the fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality (matrix pricing). In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that management believes market participants would use to determine a current transaction price. These valuation techniques involve some level of management estimation and judgment which becomes significant when valuing increasingly complex instruments or pricing models. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used.

The hierarchy defined by SSAP No. 100 gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1 — Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

Level 2 — Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.

Level 3 — Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

With the exception of certain investments in bonds and loan-backed securities that are reported at the lower of cost or fair value, or such securities on which an other than temporary impairment has been recognized as of the balance sheet date, the Company has no assets or liabilities reported in the accompanying Statement of Admitted Assets, Liabilities and Surplus at December 31, 2011, that are measured at fair value. The aforementioned securities which are reported at fair value in the accompanying financial statements represent securities that are reported at fair value on a non-recurring basis.

The tables below present the estimated fair value of investments carried by the Company at December 31, 2011 and 2010, by the SSAP No. 100 fair value hierarchy:

December 31, 2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets at fair value on a nonrecurring basis — bonds	$ -	$ 7,833,320	$ -	$ 7,833,320
Total assets at fair value	$ -	$ 7,833,320	$ -	$ 7,833,320

December 31, 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets at fair value on a nonrecurring basis — bonds	$ -	$ 1,547,305	$ -	$ 1,547,305
Total assets at fair value	$ -	$ 1,547,305	$ -	$ 1,547,305

The following methods and assumptions were used by the Company in estimating its fair value disclosure for financial instruments. These determinations were based on available market information and valuation methodologies. Considerable judgment is required to interpret market data to develop estimates and therefore, estimates may not necessarily be indicative of the amount the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair-value amounts.

Bonds —The estimated fair value of bonds as discussed in Note 4 is generally based on independent market quotations. The estimated fair value approximates the SVO market value

Cash and Short-Term Investments — The carrying amounts of these items are reasonable estimates of their fair value (dollars in thousands).

	As of December 31, 2011		As of December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Bonds	$ 430,358	$ 451,179	$ 434,056	$ 451,442
Short-term investments	9,873	9,873	17,059	17,059
Cash on hand and on deposit	2,983	2,983	8,940	8,940

14. RESTRICTED BALANCES

As mentioned in Note 6, Investments, the Company has assets on deposit with various regulatory authorities. In addition, as of December 31, 2011 and 2010, the Company had approximately $60 thousand on deposit with its landlord as collateral under its office lease obligations (see Note 17), which was non-admitted.

15. REGULATORY MATTERS

As of December 31, 2011, the Company's policyholders' surplus, as determined in accordance with statutory-basis accounting practices, was $117.3 million. Such amount was in excess of the minimum capital and surplus level required by the MIA.

In addition to the MIA, the insurance departments of certain other states have various requirements relating to the maintenance of certain minimum statutory-basis capital and reserves, single risk limits and limits on non-investment grade obligations. As a runoff company, the Company is reviewing its compliance with each of the state's various requirements and may not be in compliance with all state requirements.

As disclosed in Note 2, Restructuring Transaction, the Company is currently operating under the Order issued by the MIA. Pursuant to this Order, the Company is restricted from paying dividends without the prior approval of the Commissioner of the MIA. In addition, under Maryland insurance law, the Company may pay a dividend without the prior approval of the Commissioner of the MIA from earned surplus, as defined, subject to the maintenance of a minimum-capital requirement, and the dividend, which, together with all dividends declared or distributed by it during the preceding twelve months, may not exceed the lesser of 10% of policyholders' surplus shown on its last annual statement, or net investment income, as defined, for such twelve-month period. In addition, as part of the Company's restructuring discussed in Note 2, the surplus notes restrict the Company from paying dividends without the prior approval of the surplus note holders. The Company has negative earned surplus and therefore, is not able to pay dividends in 2011 other than extraordinary dividends as allowed by the MIA. No dividends were paid during 2010 or 2009.

The portion of unassigned surplus increased (reduced) by each item below at December 31, 2011 and 2010, is as follows (dollars in thousands):

	2011	2010
a. Unrealized losses on bonds, net of deferred tax of $68	$ (142)	$ -
b. Non-admitted asset values	(28,070)	(34,357)

As of December 31, 2011, the Company's investments in the securities of foreign issuers exceeded the maximum permissible under Maryland Insurance Law (10% of admitted assets) by approximately $19 million. The Company has discussed this matter with the MIA and the MIA has informed the Company that it will take no action provided it complies with the aforementioned limitation by December 31, 2012.

16. CONTINGENCIES

The Company is one of two defendants in a lawsuit in the Superior Court of the State of California (Los Angeles County) brought by Retirement Housing Foundation and several affiliates relating to the plaintiffs' issuance of auction-rate securities insured by the Company. The plaintiffs allege that the Company's insurance of securities backed by sub-prime mortgages was not financially responsible and was contrary to the Company's statement about its investment practices, and that when the Company's credit rating was downgraded from "A" to "CCC" after the collapse of the sub-prime market, the plaintiffs were forced to refinance their securities. On October 22, 2009, the Company filed a demurrer seeking to have the case dismissed. In response, plaintiffs filed a second amended complaint. The Company filed a demurrer to dismiss that complaint on June 25, 2010 and argument was held on August 16, 2010. On November 22, 2010, the Court dismissed the contract, implied contract and negligence claims on the theory that the parties' insurance contract did not contain a requirement that ACA maintain an "A" rating, but did not dismiss the fraud, negligent misrepresentation and unfair competition claims. The plaintiffs filed a third amended complaint on January 12, 2011. On March 29, 2011, the Court again dismissed plaintiffs' contract and implied contract claims, this time with prejudice. On April 19, 2011, the plaintiffs filed a fourth amended complaint, asserting causes of action for fraud, negligent misrepresentation and violations of California's unfair competition law. The Company responded on May 10, 2011. Discovery was ongoing until it was stayed by the Court due to plaintiffs filing of the motion to strike a cross-claim asserted by Cain Brothers LLC (the other defendant in the lawsuit) against plaintiffs. That motion was denied on January 25, 2012; the Court has indicated that it will continue the stay of discovery pending the plaintiffs' appeal of that ruling.

The Company (specifically, ACA Management, LLC) is one of several defendants in an action pending in New Mexico state court brought by Frank Foy on behalf of the State of New Mexico. The complaint alleges that Vanderbilt Capital Advisors (and certain affiliates) engaged in an unlawful "pay to play" scheme with various New Mexico state officials, causing New Mexico state agencies to purchase certain worthless CDO investments, including some with which the Company was allegedly connected. The complaint seeks compensatory damages in excess of $90 million, plus interest and civil penalties which plaintiff asserts raise the claim to several hundred million dollars, under certain New Mexico statutes, including the Fraud Against Taxpayers Act ("FATA"). The Company moved to dismiss the complaint for lack of jurisdiction. On April 28, 2010, without ruling on the Company's jurisdictional motion, the Court dismissed the complaint in its entirety on a number of grounds including constitutionality and lack of standing. Just before this dismissal was issued, the plaintiff filed an amended complaint which added a number of additional plaintiffs and legal theories. The Court subsequently entered an order striking all portions of the amended complaint inconsistent with the April 28 dismissal. The only surviving portions of the amended complaint are allegations of FATA violations occurring after July 1, 2007. The Company has renewed its motion to dismiss for lack of personal jurisdiction, and has also joined in a motion by all defendants to dismiss the amended complaint for failure to state a claim and for lack of subject matter jurisdiction. The Company's jurisdictional motion has been stayed pending jurisdictional discovery, which is currently underway. The group motion to dismiss for failure to state a claim was denied. Independently, the New Mexico Attorney General has asked the Court to dismiss portions of the lawsuit relating to "pay to play" allegations concerning the New Mexico State Investment Council in favor of lawsuits filed by the New Mexico Attorney General relating to the underlying "pay to play" scheme (the Company is not named in those lawsuits). That motion has been granted, narrowing the case to claims for other conduct associated with the State Investment Council's investment with Vanderbilt. The plaintiffs' claims as to the New Mexico Employee Retirement Board's investment with Vanderbilt were unaffected by the grant of the Attorney General's motion.

The Company is named as a defendant in a putative class-action in the United States District Court for the Northern District of Mississippi. The putative class purports to consist of all owners and/or holders of Connector 2000 Association, Inc. Toll Road Revenue Bonds (the "Connector Bonds") insured by the Company. The issuer of the Connector Bonds, Connector 2000 Association, Inc. (the "Issuer"), successfully confirmed a Chapter 9 plan (the "Plan") and emerged from its bankruptcy proceeding on April 1, 2011. Pursuant to the terms of the Plan and by operation of law, the Connector Bonds were exchanged for new obligations of the Issuer (the "New Obligations") and were effectively cancelled. As a result, the Company asserts that the Connector Bonds are no longer enforceable obligations, and as such, neither is the guaranty obligation originally provided by the Company under its secondary market insurance policies. Because the Connector Bonds are no longer effective or enforceable obligations by virtue of the exchange effected under the Plan, and because the original guaranty issued by the Company in connection with the Connector Bonds under the Policy was not extended under the Plan or otherwise to the New Obligations, the Company asserts that it has no further liability or obligation under its policies. The Company also contends that, by reason of the cancellation of the Connector Bonds, the Company no longer has any liability under its policies pursuant to the plain language thereof. Based on the foregoing, the Company filed a motion to dismiss the complaint in its entirety, which motion was fully briefed on October 11, 2011. On November 21, 2011, before the Court ruled on the Company's motion to dismiss, the plaintiff filed a motion to amend his complaint to, inter alia, add another plaintiff, Francois Kohlman, add more specific allegations and add a claim for breach of fiduciary duty. The Court granted the plaintiff's motion to amend on January 5, 2012, and plaintiffs filed their amended complaint on January 10, 2012. On January 26, 2012, the Company moved to dismiss plaintiffs' amended complaint in its entirety, which motion was fully briefed on March 21, 2012. No decision has yet been rendered by the Court on the Company's motion.

Subsequent to the commencement of the above-referenced putative class-action pending in the United States District Court for the Northern District of Mississippi, the Company has been named as a defendant in an action filed in the Supreme Court of the State of New York in and for New York County, in which the plaintiffs therein seek a declaration of the Company's obligations under certain of the secondary market insurance policies the Company issued in connection with the Connector Bonds. The Company's position on its lack of any continuing obligation under these secondary market insurance policies is essentially the same in both lawsuits. On December 19, 2011, the Company moved for summary judgment seeking, inter alia, an order denying the declaratory relief sought by the plaintiffs in their complaint and declaring that the Company is relieved of liability of any further payment obligations under its secondary market insurance policies. On January 18, 2012, the plaintiffs opposed the Company's motion for summary judgment and cross-moved for summary judgment on their claims for declaratory relief. The Company's motion and plaintiffs' cross-motion are now fully briefed and oral argument is currently scheduled for April 18, 2012.

The Company was initially a third-party defendant in a suit filed in the Fourth Judicial Circuit in Duval County, Florida. The Company insured $11.65 million of bonds issued for the construction of a hospital and nursing facility in Macclenny, Florida. The bond documents required the hospital (i.e., the entity responsible for servicing the bonds insured by the Company) to procure and maintain a certain type of professional liability insurance. The hospital failed to comply with the professional liability insurance requirements under the bond documents and had initially commenced this action against the bond trustee to, among other things, be relieved of such obligation. In response, the bond trustee commenced a third party action against the Company demanding that the Company indemnify it for any liability the bond trustee may have to the hospital. The Company, in turn, brought a third-party action against the hospital and others seeking a declaration, inter alia, that the Company is either excused from its obligation under the bond insurance policy or that the hospital must procure professional liability insurance as required by the bond documents. Thereafter, the Company successfully moved to strike a number of the hospital's affirmative defenses to the Company's third-party complaint and successfully defended against the bond trustee's motion to dismiss certain claims in the Company's third-party complaint. On November 23, 2011, the Court granted the hospital's motion to amend its complaint to assert claims directly against the Company for breach of contract, tortious interference and negligence. On January 6, 2012, the Company moved to dismiss the hospital's claims for tortious interference and negligence, answered the remainder of the hospital's amended complaint, and asserted counterclaims against the hospital, cross-claims against the bond trustee and a third-party complaint against the Baker County Hospital Authority for declaratory judgment regarding the Company's rights and obligations under the bond documents, and alternatively for breach of contract. The Court heard argument on the Company's motion to dismiss on February 28, 2012 and took the motion under advisement. On January 31, 2012, the trustee, inter alia, answered the hospital's amended complaint and amended its cross-claims against the Company. On February 15, 2012, the trustee, inter alia, answered the Company's cross-claims and moved to dismiss and/or strike certain claims asserted therein. The Company intends to vigorously oppose the trustee's motion to dismiss and/or strike. On February 16, 2012, the hospital and the authority answered the Company's counterclaims and third-party complaint. On March 2, 2012, the Company answered the trustee's claims against the Company as asserted in the trustee's answer to the hospital's amended pleading. On March 16, 2012, the Company answered the trustee's claims against the Company as asserted in response to the Company's cross-claims against the trustee. The parties are currently engaged in discovery regarding the parties' outstanding claims.

Various lawsuits against the Company have arisen in the course of the Company's business. Contingent liabilities arising from such litigation and other matters are not considered material in relation to the financial position or the results of operations of the Company.

On January 6, 2011, the Company commenced a lawsuit against Goldman, Sachs & Co. ("Goldman") in the Supreme Court of the State of New York, County of New York (the "Lawsuit"). The lawsuit seeks compensatory damages against Goldman in the amount of at least $30 million and punitive damages in the amount of at least $90 million in connection with the development of a structured finance product, a synthetic collateralized debt obligation called ABACUS 2007-AC1. On April 25, 2011, the Company filed its First Amended Complaint. On June 3, 2011, Goldman moved to dismiss the First Amended Complaint, which the Company has opposed. Goldman's motion to dismiss is fully briefed. Oral argument took place on October 25, 2011. Goldman's motion to dismiss remains sub judice.

17. LEASES

During 2010 ACA FG finalized negotiations with a new tenant for all of its office space at 140 Broadway, New York, New York. Under the terms of the transaction, ACA FG was released from its obligations under the lease, its security deposit of $2.7 million was returned and it made cash payments of $11.7 million. As a result of the lease termination, ACA FG recognized a loss of approximately $13 million during 2010, which includes a charge-off of the carrying value of leasehold improvements and furniture and fixtures related to the aforementioned leased space. Also, during 2010, ACA FG leased new office space at 600 Fifth Avenue, New York, New York through September 30, 2016.

At December 31, 2011, expected future minimum lease payments under its lease at 600 Fifth Avenue are as follows (dollars in thousands):

Years Ending December 31	Operating Leases
2012	$ 548
2013	548
2014	594
2015	624
2016	479
	$ 2,793

The Company's rental expense for the years ended December 31, 2011 and 2010, was $0.3 million and $1.0 million, respectively.

18. SURPLUS NOTES

Interests in the surplus notes issued in connection with the Restructuring Transaction (see Note 2) are either in the form of voting interests or non-voting interests. Surplus notes issued to the former insured swap counterparties represent voting and non-voting interests (at each counterparty's individual discretion) while notes issued to ACAH represent non-voting interests. By their terms the surplus notes are subordinate to the claims of policyholders, claimant and beneficiary claims, and to all other classes of creditors other than surplus note holders. However, claims under the surplus notes are superior to claims of preferred and common shareholders of the Company. Payments under the surplus notes of either principal or interest can only be paid out of the surplus of the Company after the Company provides for all reserves and other liabilities and only with the prior written approval of the MIA. The surplus note holders can request that the Company seek such approval.

Among others, holders of the surplus notes with voting interests have rights regarding the appointment of directors and amendments to the surplus notes. Each holder with greater than 10% voting rights has disclaimed control over the Company. This disclaimer has been approved by the MIA.

Pursuant to the surplus notes, the Company provides certain covenants which generally limit the activities of the Company and its subsidiaries to operating as a run-off business.

19. FINANCIAL GUARANTY INSURANCE

As discussed in Note 4, the Company does not record premiums recieveable on installment premium paying contracts unless such amounts are due, nor is any corresponding unearned premium recorded until such amounts are due.

The future expected earned premium revenue on upfront premium paying contracts as of December 31, 2011, are as follows:

Period	Amount
1st Quarter 2012	$ 2,099,169
2nd Quarter 2012	1,858,401
3rd Quarter 2012	2,661,577
4th Quarter 2012	2,239,050
Year 2012	8,858,197
Year 2013	8,748,855
Year 2014	8,822,878
Year 2015	8,591,472
Year 2016	8,802,546
2017 through 2021	43,020,090
2022 through 2026	37,560,580
2027 through 2031	29,856,255
2032 through 2036	18,359,893
2037 through 2041	1,604,655
2042 through 2046	200,165
Total	$ 174,425,586

Significant components of the change in the claim liability for the period are as follows:

Components	Amounts
Reserves for losses and LAE at December 31, 2010	$ 49,742,930
Change in reserves	
Prior accident years	(9,097,063)
Current accident year	35,243,301
Sub-total change in reserves	26,146,238
Reserves for losses and LAE at December 31, 2011	$ 75,889,168

The Company’s credit quality classifications are as follows:

Category 1: Fully Performing

Covenants have been met and there have been no significant negative deviations from expected performance.

Category 2: Watch

Performing below expected levels but current and projected revenues are adequate to service debt.

Category 3: Deteriorating

Performing significantly below expected levels; corrective action is required to avert a longer-term risk of payment default.

Category 4: Paid or Expected Claim

Material decline in creditworthiness and ability to pay debt service; unreimbursed draws on debt service reserves and/or payment defaults have occurred or are probable.

Risk management activities are performed by ACA FG's portfolio management department. Portfolio analysts monitor all insured transactions in the portfolio to determine whether their financial performance is consistent with underwriting expectations and to identify any deterioration in the obligor's ability or willingness to pay insured debt service. Portfolio management staff are also responsible for recommending and undertaking remedial actions to prevent or mitigate losses.

All transactions in the insured portfolio are assigned one of four internal credit quality classifications that reflect the current and expected performance of the obligor. Ratings are reviewed and updated on a regular basis as analysts obtain more current financial and market information from the obligor, the trustee, or from public sources such as rating agencies and fixed income analysts. The frequency with which individual obligors are reviewed is based on ACA FG's judgment of potential performance volatility and varies according to credit classification, sector, geography, size of exposure, and exogenous events.

Insured financial obligations as of December 31, 2011, are as follows:

	Credit Quality Categories				
	1	**2**	**3**	**4**	**Total**
Number of policies	329	96	24	31	480
Remaining weighted-average contract period (in years)	12	12	14	13	
Insured contractual payments outstanding:					
Principal	$3,521,111,135	$ 915,937,753	$ 374,698,165	$ 385,387,104	$ 5,197,134,157
Interest	2,358,849,185	605,860,374	329,203,012	344,781,146	3,638,693,717
Total	$5,879,960,320	$1,521,798,127	$ 703,901,177	$ 730,168,250	$ 8,835,827,874
Gross claim and LAE liability	$ 60,000	$ 174,000	$ 282,000	$ 146,733,845	$ 147,249,845
Less:					
Gross potential recoveries	-	-	-	56,509,685	56,509,685
Discount — net	-	-	-	14,850,992	14,850,992
Net claim and LAE liability	$ 60,000	$ 174,000	$ 282,000	$ 75,373,168	$ 75,889,168
Unearned premium revenue	$ 95,889,809	$ 34,865,264	$ 18,452,183	$ 25,218,330	$ 174,425,586
Claim and LAE liability reported in the balance sheet	$ 60,000	$ 174,000	$ 282,000	$ 75,373,168	$ 75,889,168
Reinsurance recoverables	$ -	$ -	$ -	$ -	$ -

20. ADJUSTMENTS TO AMOUNTS REFLECTED IN THE ACCOMPANYING FINANCIAL STATEMENTS TO THE FINANCIAL STATEMENTS IN THE COMPANY'S 2011 ANNUAL STATEMENT

The accompanying financial statements as of and for the year ended December 31, 2010, differ from the financial statements as of and for the year ended December 31, 2010, as presented in the 2011 Annual Statement as follows:

(Dollars in thousands) Financial Statement Line Item	As Reported in the Annual Statement	Adjustment	As Reported in the Audited Financial Statement
December 31, 2010:			
Total admitted assets	$ 464,796	$ -	$ 464,796
Total liabilities	357,595	(15,265)	342,330
Total surplus	107,201	15,265	122,466
Net loss	(23,994)	15,265	(8,729)

The adjustments indicated above relate to a correction made to the Company's recorded loss reserves subsequent to the filing of the 2010 Annual Statement.

There are no differences between the accompanying 2011 financial statements and the corresponding financial statements included in the Company's 2011 Annual Statement.

21. SUBSEQUENT EVENTS

The Company has evaluated all subsequent events through May 25, 2012, the date the statutory-basis financial statements were available to be issued. Except for that discussed below, there were no other events that required adjustment to or disclosure in the statutory-basis financial statements.

In January 2012, the Company made a claim payment on an insured debt obligation on which reserves for losses had not previously been established. As a result, the Company expects to record approximately $7.6 million of incurred losses and $7.3 million of related reserves relating thereto during the quarterly period ended March 31, 2012. The aggregate par insured exposure on this debt obligation at December 31, 2011 was $49.5 million.

In April 2012, the Company made a claim payment on an insured debt obligation on which reserves for losses had not previously been established. As a result, the Company expects to record approximately $13.3 million of incurred losses and $12.6 million of reserves relating thereto during the quarterly period ended June 30, 2012. The aggregate par insured exposure on this debt obligation at December 31, 2011 was approximately $13.5 million.

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SUPPLEMENTAL SCHEDULES

ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SUMMARY OF INVESTMENT SCHEDULE
AS OF DECEMBER 31, 2011

Investment Categories	Gross Investment Holdings Under NAIC		Admitted Assets as Reported in the Annual Statement	
Bonds:				
U.S. treasury securities	$ 4,034,658	0.9 %	$ 4,034,658	0.9 %
U.S. government agency and corporate obligations (excluding mortgage-backed securities) — issued by U.S. government sponsored agencies	1,429,912	0.3	1,429,912	0.3
Securities issued by states, territories and possessions and political subdivisions in the U.S.:				
States, territories and possessions general obligations				
Political subdivisions of states, territories and possessions and political subdivisions general obligations				
Revenue and assessment obligations	4,948,825	1.1	4,948,825	1.1
Mortgage-backed securities (includes residential and commercial MBS) pass-through securities:				
Issued or guaranteed by GNMA	79,591,244	18.0	79,591,244	18.0
Issued or guaranteed by FNMA and FHLMC	25,087,146	5.7	25,087,146	5.7
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	45,338,775	10.2	45,338,775	10.2
Issued by non-U.S. government issuers and collateralized by mortgage-backed securities issued or guaranteed by GNMA, FNMA, FHLMC or VA				
All other	53,253,673	12.0	53,253,673	12.0
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	154,122,201	34.8	154,122,201	34.8
Unaffiliated foreign securities	62,551,820	14.1	62,551,820	14.1
Receivable for securities	20,378	-	20,378	-
Cash, cash equivalents and short-term investments	12,855,729	2.9	12,855,729	2.9
Total invested assets	$ 443,234,361	100.0 %	$ 443,234,361	100.0 %

ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SCHEDULE OF INVESTMENT RISK INTERROGATORIES
AS OF DECEMBER 31, 2011

Answer the following interrogatories by reporting the applicable U.S. dollar amounts and percentages of the reporting entity's total admitted assets held in that category of investments.

Reporting entity's total admitted assets as reported on Page 3 of this annual statement

1. $448,171,431

2. Ten largest exposures to a single issuer/borrower/investment.

	Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
2.01	Citigroup Inc.	Other Debt/Unaffiliated Domestic	$ 15,358,429	3.4 %
2.02	Goldman Sachs Group Inc.	Other Debt/Unaffiliated Domestic	11,782,684	2.6
2.03	Bear Stearns Commercial Mortgage	MBS CMO/REMIC/Other Prvt Issued	11,021,752	2.5
2.04	Bank of America	Other Debt/Unaffiliated Domestic	9,971,827	2.2
2.05	Commercial Mortgage Pass-Through	MBS CMO/REMIC/Other Prvt Issued	9,006,043	2.0
2.06	Morgan Stanley	Other Debt/Unaffiliated Domestic	7,676,514	1.7
2.07	First American Funds Inc.	Other Debt/Unaffiliated Domestic	7,375,457	1.6
2.08	Coca Cola Co	Other Debt/Unaffiliated Domestic	6,774,596	1.5
2.09	HSBC Finance Corp	Other Debt/Unaffiliated Domestic	6,634,148	1.5
2.10	Time Warner Inc	Other Debt/Unaffiliated Domestic	5,905,784	1.3

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

	Bonds				Stocks		
3.01	NAIC-1	$ 376,627,537	84.0 %	3.07	P/RP-1	$ -	- %
3.02	NAIC-2	59,465,487	13.3	3.08	P/RP-2		
3.03	NAIC-3	-	-	3.09	P/RP-3		
3.04	NAIC-4	687,438	0.2	3.10	P/RP-4		
3.05	NAIC-5	3,330	0.0	3.11	P/RP-5		
3.06	NAIC-6	3,447,534	0.8	3.12	P/RP-6		

4. Assets held in foreign investments:

4.01 Are assets held in foreign investments less than 2.5% of the reporting entity's total admitted assets? Yes ( ) No(X)

4.02 Total admitted assets held in foreign investments: $60,944,403 13.6%

4.03 Foreign-currency-denominated investments: $__________ _____%

4.04 Insurance liabilities denominated in that same foreign currency: $__________ _____%

If response to 4.01 is yes, responses are not required for interrogatories 5–10.

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:

Countries rated NAIC-1	$60,994,403	13.6%

6. Two largest foreign investment exposures to a single country, categorized by NAIC sovereign rating:

Country: United Kingdom	$21,671,947	4.8%
Country: Cayman Islands	$10,985,276	2.5%

7. Aggregate unhedged foreign currency exposure $_________ _____%

8. Aggregate unhedged foreign currency exposure categorized by the country's NAIC sovereign rating: N/A

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign rating: N/A

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

1 **Issuer**	2 **NAIC Rating**	3	4
ACA ABS 2007-3	1	5,302,215	1.2 %
Standard Chartered Plc	1	4,194,396	0.9
Telecom Italia Capital	2	4,082,035	0.9
Abbey Natl Treasury Serv	1	3,999,302	0.9
BBVA US Senior SA Uniper	1	3,496,825	0.8
Anglo America Capital	2	3,276,671	0.7
Credit Suisse New York	1	3,130,345	0.7
Macquarie Group Ltd	1	3,096,598	0.7
Barclays Bank Plc	1	3,090,479	0.7
BPCE	1	2,976,943	0.7

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure.

    11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions.

    12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )

    12.02 If response to 12.01 is yes, responses are not required for the remainder of Interrogatory 12.

13. Amounts and percentages of admitted assets held in the largest 10 equity interests:

    13.01 Are assets held in equity interests less than 2.5% of the reporting entity's total admitted assets?
    Yes (X) No ( )

    If response to 13.01 above is yes, responses are not required for the remainder of interrogatory 13.

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

    14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )

    If response to 14.01 is yes, responses are not required for remainder of Interrogatory 14.

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

    15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )

    If response to 15.01 is yes, responses are not required for the remainder of Interrogatory 15.

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

    16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )

    If response to 16.01 above is yes, responses are not required for the remainder of Interrogatory 16 and Interrogatory 17.

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date — N/A

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

    18.01 Are assets held in real estate in less than 2.5% of the reporting entity's total admitted assets?
    Yes (X) No ()

    If response to 18.01 above is yes, responses are not required for the remainder of Interrogatory 18.

19 Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans:

    19.01 Are assets held in investments held in mezzanine real estate loans less than 2.5% of the reporting entities total admitted assets? Yes (X) No ( )

    If response to 19.01 above is yes, responses are not required for the remainder of Interrogatory 19.

20 Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At End of Each Quarter			
	At Year-End	**1st Qtr**	**2nd Qtr**	**3rd Qtr**
19.01 Securities lending agreements (do not include assets held as collateral for such transactions)	$ -	$ -	$ -	$ -
19.02 Repurchase agreements				
19.03 Reverse repurchase agreements				
19.04 Dollar repurchase agreements				
19.05 Dollar reverse repurchase agreements				

21 Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:

	Owned		**Written**	
20.01 Hedging	$ -	- %	$ -	- %
20.02 Income generation				
20.03 Other				

22 Amounts and percentages of the reporting entity's admitted assets of potential exposure for collars, swaps, and forwards:

	At End of Each Quarter				
	At Year-End		**1st Qtr**	**2nd Qtr**	**3rd Qtr**
21.01 Hedging	$ -	- %	$ -	$ -	$ -
21.02 Income generation					
21.03 Replications					
21.04 Other					

23. Amounts and percentages indicated below of the reporting entity's total admitted assets of potential exposure for futures contracts:

	At End of Each Quarter				
	At Year-End		**1st Qtr**	**2nd Qtr**	**3rd Qtr**
21.01 Hedging	$ -	- %	$ -	$ -	$ -
21.02 Income generation					
21.03 Replications					
21.04 Other					

24. State the amounts and percentages of 10 largest investments included in the Write-ins for Invested Assets category included on the Summary Investment Schedule

23.01	Not applicable	$	-	- %
23.02				
23.03				
23.04				
23.05				
23.06				
23.07				
23.08				
23.09				
23.10				

ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SCHEDULE OF REINSURANCE INTERROGATORIES AS OF DECEMBER 31, 2011

7.1 Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)?
Yes [ ] No [X]

9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior yearend surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

(a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;

(b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

(c) Aggregate stop loss reinsurance coverage;

(d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

(e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or

(f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [ ] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling agreements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:

(a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty–five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract.

Yes [ ] No [X]