ACA FINANCIAL GUARANTY CORPORATION

Management's Discussion and Analysis of Financial Condition

and Results of Operations

The following discussion and analysis should be read in conjunction with the 2015 Annual Statement of ACA Financial Guaranty Corporation (the "Company" or "ACA FG") as such Annual Statement contains important information which is helpful in evaluating the Company's net income and financial condition. The Annual Statement was prepared in accordance with the National Association of Insurance Commissioners' ("NAIC") "Statements of Statutory Accounting Principles" ("SSAP"), which have been adopted by the Maryland Insurance Administration ("MIA").

Overview of Business Operations

General

The Company 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 below (see "Restructuring Transaction"), 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 generally 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. 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. However, voting control and enterprise value of the Company resides with its surplus note holders as discussed below (see "Restructuring Transaction").

The Company, through its subsidiaries, ACA Service, L.L.C. ("ACA Service") and ACA Management L.L.C. ("ACA Management"), was historically engaged in the business of managing the assets supporting collateralized debt obligations ("CDOs"), as well as structuring and investing in CDOs. Since the third quarter of 2007, the Company and its affiliates have discontinued such business and exist solely to run-off the remaining in-force agreements to manage assets supporting CDOs that were entered into prior to the discontinuance of the aforementioned business. The Company has transferred management of the in-force agreements in exchange for a portion of the management fees. As such, ACA Management continues to receive fees related to the management of such CDOs and on a periodic basis pays dividends to ACA Service, its direct parent and direct wholly owned subsidiary of the Company. ACA Service, in turn, periodically dividends these funds to the Company.

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 by ACA FG of approximately $209 million and ACA FG's issuance of 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 Restructuring Transaction. Of such amount, the aforementioned insured credit swap counterparties' received $950 million as previously discussed 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 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.

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.

Description of Significant Risks and Uncertainties Affecting the Company and the Company's On-Going Strategic Plan

Description of Significant Risks and Uncertainties Affecting the Company

- ACA FG recognizes losses and establishes related loss reserves on bond obligations it has insured 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. However, ACA FG has policies in-force upon which it believes that it is probable that payment defaults will occur in the future. Such expected future losses (hereafter referred to as "Off-Balance Sheet Losses") are not recorded by the Company in the accompanying Statement of Assets, Liabilities, Surplus and Other Funds at December 31, 2015 and December 31, 2014 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 its ultimate Off-Balance Sheet Losses ranged from $40 million to $60 million at December 31, 2015, 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 contingency reserves that may be approved by the Maryland Insurance Administration 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 policyholders' surplus will be in excess of Maryland's required minimum policyholders' surplus over the twelve months succeeding the date of the accompanying statement of Assets, Liabilities, Surplus and Other Funds 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, as well as to the economy generally. The Company is also exposed to risks specific to its guaranteed obligations, such as political risks, operating risks and real estate markets and values. 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 below (see "Insured In-Force Portfolio Management"), the Company classifies its insured in-force portfolio in one of four credit quality categories. As noted therein, as of December 31, 2015, the Company had insured obligations with outstanding principal totaling $375.9 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 $208.1 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. 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 4 or that ACA FG will not incur losses that may be materially in excess of what it currently estimates.

- Losses incurred and reserves for losses are reported by the Company net of estimated recoveries from salvage and subrogation. Estimated salvage and subrogation are a material component of the Company's incurred losses and reserves for losses (both on-balance sheet and off-balance sheet). Pursuant to the Company's policies of insurance, should the Company pay a claim under a policy, subrogation rights enable the Company to pursue the obligor for recovery of all claims paid or losses incurred. In other cases, the Company may be assigned the rights to certain salvage as reimbursement for any claims paid or losses incurred. An important characteristic to recognize with respect to estimated salvage and subrogation recoveries is that such estimates are subject to both timing and credit risk. In many instances the timing of such recoveries is expected to occur significantly later than the associated claim payments the Company is trying to recover. In addition, in regard to subrogation, credit risk exists with respect to the obligor's ability to ultimately honor the insurer's claim for recoveries, and in respect of salvage, risk exists as to whether such salvage will ultimately be sufficient to recover all of the insurer's claims for recoveries. No assurance can be provided that estimated salvage and subrogation recoveries will be fully collected and any uncollected amount may be material to the Company's financial position and results of operations.

- 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 severity of loss 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 do not represent 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, willingness of the obligor or sponsor to honor its commitments, changes in the expected timing of claims payments and recoveries, changes in the amounts of expected claims payments and recoveries and ability to purchase insured bonds in the marketplace. 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 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 "Summary of In-force Exposure at December 31, 2015" below.

- 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 has caused the Company to incur significant expenses. The Company expects to continue to incur significant expenses in this regard in the near term. In addition, such expenses may continue to be significant beyond the near term and may cause diversion of resources from other matters. See "Commitments and Contingencies" below.

- 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 rolling 3-year period. Accordingly, the aggregate ownership change ("Aggregate Ownership Change") at any particular date represents the summation of the amount of ownership change resulting from all transactions in a corporation's stock occurring during the three year period ended on such date. 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.

Under Section 382, the transfer of ACA FG's surplus notes can cause an ownership change that would limit ACA FG's ability to utilize its NOLs and recognize certain built-in losses. Depending on the resulting limitation, a significant portion of ACA FG's NOLs could be deferred or could expire before ACA FG would be able to use them to offset positive taxable income in current or future tax periods.

ACA FG experienced an ownership change for purposes of Section 382 in 2014. As a consequence of the ownership change, ACA FG's ability to use its NOLs will be limited to approximately $5.3 million on an annual basis.

Since the ownership change mentioned above, the Company has generated significant net operating losses in 2014 and 2015. As a result of continuing transfers of surplus notes since the previous ownership change, ACA FG's current aggregate percentage is again approaching a significant amount. Another ownership change may further limit the initial NOL limitation and will impact the ability to fully utilize NOLs generated in 2014 and 2015.

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 losses, (ii) increase the Company's capital, surplus, liquidity and claims paying resources, (iii) realize maximum value from various legal proceedings 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. The Company has taken steps to reduce operating expenses and expects to take further steps in the future as the insured portfolio and remediation activities decrease. 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.

Summary of In-Force Exposure at December 31, 2015

While the Company establishes reserves for losses and loss adjustment expenses on obligations on which it has received a claim notice, 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. The tables below reflect certain information regarding the Company's in-force par exposure at December 31, 2015.

	December 31, 2015		December 31, 2014	
($ in millions)	Net Par Outstanding	% of Net Par Outstanding	Net Par Outstanding	% of Net Par Outstanding
Tax-exempt obligations:				
Healthcare	$ 172	7.7%	$ 203	7.5%
Tax backed	210	9.4%	276	10.2%
Higher education	468	20.9%	575	21.2%
Long-term care	116	5.2%	139	5.1%
General obligations	624	27.9%	732	27.0%
Utilities	55	2.5%	63	2.3%
Transportation	185	8.3%	191	7.0%
Housing	64	2.9%	118	4.3%
Not for Profit	194	8.7%	260	9.6%
Other	146	6.5%	152	5.6%
Total municipal obligations	**2,234**	**99.7%**	**2,709**	**99.8%**
Taxable obligations				
Other	6	0.3%	6	0.2%
Total	$ 2,240	100.0%	$ 2,715	100.0%

For the year ended December 31, 2015, the Company reported a decrease in net par outstanding of $475 million, of which $394 million was attributable to Refundings, including early retirement due to cancellation (see "Detailed

Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014 – Net Premiums Earned").

($ in millions)	PAR EXPOSURE BY STATE	December 31, 2015 Net Par Outstanding	December 31, 2015 % of Net Par Outstanding	December 31, 2014 Net Par Outstanding	December 31, 2014 % of Net Par Outstanding
New York		$ 510	22.8%	$ 548	20.2%
California		403	18.0%	490	18.1%
Massachusetts		109	4.9%	190	7.0%
Florida		123	5.5%	175	6.5%
Washington		92	4.1%	100	3.7%
Other states		997	44.6%	1,206	44.5%
	Total municipal obligations	$ 2,234	100.0%	$ 2,709	100.0%

NET PAR OUTSTANDING BY MATURITY

($ in millions) **Terms of Maturity**	**December 31, 2015 Net Par Outstanding**
0 to 5 years	$ 456
5 to 10 years	634
10 to 15 years	562
15 to 20 years	469
20 and above	119
Total	**$ 2,240**

Insured In-Force Portfolio Management

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. Credit quality classifications of insured transactions 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.

The Company's credit quality classifications are:

Category 1: Fully Performing

Credits are fully performing. Covenants have been met, financial reporting is timely and complete, and there have been no significant negative deviations from expected performance.

Category 2: Watch

Credits are performing below expected levels. Some covenants have been violated, projected budget and/or cash flow has not been achieved, operating performance or financial position is weakened. Although operating results are below underwriting expectations, current and projected revenues are adequate to service debt.

Category 3: Deteriorating

Credits show significant performance declines. Covenant violations are recurring and material; cashflow is significantly below projections, operating results are materially impaired. Corrective action is required to arrest credit deterioration and avert a longer-term risk of payment default.

Category 4: Paid or Expected Claim

Credits show material decline in creditworthiness and ability to pay. Operating results are increasingly negative, unreimbursed draws on debt service reserves have been made; payment defaults have occurred or are expected, and loss reserves have been established or are expected to be established in the financial statements.

Set forth below is a schedule of the Company's insured in-force guaranties at December 31, 2015 by credit quality classification:

	Credit Quality Categories				
	1	2	3	4	Total
Number of policies	116	42	16	36	210
Remaining weighted-average contract period (in years)	11	9	9	11	11
Insured contractual payments outstanding:					
Principal	$ 1,309,506,897	$ 346,075,884	$ 208,072,909	$ 375,923,699	$ 2,239,579,389
Interest	783,774,658	182,016,160	165,896,972	335,887,051	1,467,574,841
Total	$ 2,093,281,555	$ 528,092,044	$ 373,969,882	$ 711,810,750	$ 3,707,154,231
Gross claim and LAE liability	$ -	$ 56,000	$ 323,000	$ 171,558,914	$ 171,937,914
Less:					
Gross potential recoveries	-	-	-	57,419,501	57,419,501
Discount, net	-	-	-	(312,374)	(312,374)
Net claim and LAE liability	$ -	$ 56,000	$ 323,000	$ 114,451,787	$ 114,830,787
Unearned premium revenue	$ 27,353,909	$ 14,133,881	$ 9,482,807	$ 23,292,080	$ 74,262,678
Claim and LAE liability reported in the balance sheet	$ -	$ 56,000	$ 323,000	$ 114,451,787	$ 114,830,787
Reinsurance recoverables	$ -	$ -	$ -	$ -	$ -

The Company purchases ACA FG insured bonds periodically in the marketplace when available and the price meets internal prescribed limits for category 4 rated credits. For accounting purposes, the Company reflects the purchase as a loss payment and carries the bond at a zero value. Unless the bond is cancelled with the trustee, the par value remains outstanding. At December 31, 2015, the par value outstanding of category 4 bonds purchased and not cancelled is $31.5 million.

Results of Operations

The following table presents the Company's results of operations for the years ended December 31, 2015 and 2014, as well as the year over year variances.

($ Amounts in Thousands)	Years Ended December 31, 2015	Years Ended December 31, 2014	2015 Results Over (Under) 2014
Net premiums earned	$ 18,444	$ 27,021	$ (8,577)
Losses incurred	47,902	41,890	6,012
Loss adjustment expenses incurred	1,323	2,029	(706)
Other underwriting expenses	9,556	16,489	(6,933)
Net underwriting loss	(40,337)	(33,387)	(6,950)
Net investment income earned	12,660	15,314	(2,654)
Net realized capital gains	2,203	495	1,708
Net investment gain	14,863	15,809	(946)
Other income	-	3,305	(3,305)
Loss before federal income tax benefit	(25,474)	(14,273)	(11,201)
Federal income tax benefit	-	-	-
Net loss	$ (25,474)	$ (14,273)	$ (11,201)

The Company reported a net loss of $25.5 million for the year ended December 31, 2015, as compared to a net loss of $14.3 million for the year ended December 31, 2014. The increase in net loss of $11.2 million was primarily attributable to a decrease of net premiums earned of $8.6 million, an increase of losses incurred of $6.0 million, a decrease of other income of $3.3 million, a decrease of net investment income earned of $2.7 million, offset in part by a decrease of other underwriting expenses of $6.9 million and an increase of net realized capital gains of $1.7 million.

Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014

Net Premiums Earned

Premiums charged in connection with the issuance of the Company's guaranties are received either upfront or in installments. Such premiums are recognized as written when due. Installment premiums written are earned ratably over the installment period, generally one year or less, which is consistent with the expiration of the underlying risk or amortization of the underlying insured principal. Upfront premiums written are earned based on the proportion of principal and interest 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. In addition, when an insured issue is retired early, is called by the issuer or is, in substance, paid in advance through a refunding accomplished by placing U.S. Government securities in escrow (hereafter referred to collectively as "Refundings"), the remaining unearned premium revenue is earned at that time since there is no longer risk to the Company. Unearned premiums, net of prepaid reinsurance premiums, represent the unearned portion of upfront and installment premiums written. Premiums for substantially all of the Company's remaining insured in-force guaranties were written on an upfront basis. Accordingly, net premiums earned primarily represent a non-cash revenue item.

Net premiums earned were $18.4 million for the year ended December 31, 2015, a decrease of $8.6 million from $27.0 million reported for the year ended December 31, 2014. Included in net premiums earned were Refundings of $15.4 million and $21.6 million recorded by the Company during 2015 and 2014, respectively. The level of refundings is the primary reason for the variance.

Net Investment Income Earned

Net investment income was $12.7 million for the year ended December 31, 2015, a decrease of $2.6 million, from $15.3 million reported for 2014. Included in the investment income for the year ended December 31, 2015 and 2014 were dividends received from its wholly owned subsidiary, ACA Service, in the amount of $2.2 million and $3.3 million, respectively. ACA Service derives its earnings from its wholly owned subsidiary, ACA Management. ACA Management receives management fees on asset management contracts which were sold on a forward revenue sharing basis in connection with the termination of ACA FG's prior CDO/CLO asset management business. Management fees have declined substantially and will continue to decrease as the assets underlying managed deals run-off or are called and terminated. Net investment income for the year ended December 31, 2015 and 2014 was net of investment expenses of $0.5 million and $0.6 million, respectively.

The following table present net investment income, average invested assets, and the effective yield on the Company's average invested assets for the years ended December 31, 2015 and 2014. The average duration of the Company's invested assets at December 31, 2015 was 3.34 years, as compared to 2.89 years at December 31, 2014.

	Year Ended December 31,	
($ amounts in thousands)	2015	2014
Net investment income [1]	$ 10,415	$ 12,014
Average invested assets [2]	$ 348,323	$ 376,616
Effective yield [3]	3.0%	3.2%

[1] Excludes dividends of $2,245 thousand and $3,300 thousand received from ACA Service in 2015 and 2014, respectively.

[2] Represents the annual average of the amortized cost of bonds, cash, cash equivalents, and short-term investments.

[3] Effective yield represents net investment income as a percentage of average invested assets.

Net realized capital gains were $2.2 million and $0.5 million for the years ended December 31, 2015 and 2014, respectively. Included in the net realized capital gains, the Company recorded other than temporary impairment charges of $0 million and $1.7 million in 2015 and 2014, respectively.

Other Income

The Company recorded no other income for the year ended December 31, 2015. For the year ended December 31, 2014, the Company recorded other income of $3.3 million which primarily consisted of a settlement agreement received from one of the Company's former insurance carriers with respect to claims for coverage for certain investigations and lawsuits in the amount of $3.1 million. Also included were fees earned from consents granted to obligors of the Company's insured debt obligations pursuant to the Company's rights under its insurance contracts.

Losses Incurred

Losses incurred are comprised of:

(i) estimates of the ultimate net losses the Company expects to incur on insured transactions that have experienced an initial payment default[1],

(ii) changes in the aforementioned estimates from period to period (also known as "adverse loss development" or "favorable loss development") and which may arise from credit deterioration or credit improvement, among other things,

(iii) the actual consideration paid by the Company in satisfaction of its obligations under an insured transaction, such as in a commutation agreement, less any corresponding reduction in reserves for losses relating to such transaction,

(iv) the actual amount of consideration paid by the Company to acquire category 4 securities in the marketplace that it insures (commonly referred to as "Buy Backs" and, which effectively extinguishes its guaranty) less any corresponding reduction in reserves for losses relating to such purchased securities,

(v) Changes in the discount rate used to determine an adjustment to reserves reflecting the time value of money. As of December 31, 2015 and 2014 incurred losses reflect the application of discount rates of 3.07% and 3. 12%, respectively, and

(vi) Changes due to the accretion of discount over time.

For the year ended December 31, 2015, the Company recorded a provision for losses of $47.9 million, of which $42.9 million related to the 2015 accident year and $5.0 million of which related to accident years prior to 2015. As of December 31, 2015, the Company's liability for unpaid losses was $111.0 million, which related to twenty-six insured transactions, with a remaining aggregate in-force par outstanding of $144.6 million, excluding the aforementioned case reserves. The aggregate in-force par outstanding of $144.6 million represents the remaining maximum amount of exposure to loss the Company has in regard to these twenty-six insured transactions.

For the year ended December 31, 2015, incurred losses included $33.2 million representing the consideration paid by the Company to purchase certain of its insured securities in the market. Of the $33.2 million, approximately $32.7 million related to On-Balance Sheet losses and $0.5 million related to Off-Balance Sheet losses. As a result of the purchase of these securities, the Company was able to reduce its expected losses by approximately $55.1 million (which consisted of On-Balance Sheet losses of losses of approximately $54.2 million and Off-Balance Sheet losses of approximately $0.9 million).

---

[1] Estimates of the ultimate net loss are generally determined by estimating the amount of funds (prior to any claim on the Company's insurance) that will be available over the life of the bond obligation to fund scheduled debt service payments on a timely basis, as required under the bond indenture. The amount and timing of any resultant shortfall represents the amount and timing of claim payments. Salvage and Subrogation recoveries are then estimated based on a similar analysis of the funds available to pay such amounts. The net shortfall (gross claims less salvage and subrogation recoveries) is then discounted for the time value of money resulting in the ultimate net incurred loss recorded by the Company at any point in time.

The Company's estimate of its ultimate Off-Balance Sheet Losses at December 31, 2015 ranged from $40 million to $60 million. This range of Off-Balance Sheet Losses related to thirteen insured transactions, with a remaining aggregate in-force par outstanding of approximately $77.8 million, excluding the aforementioned Off-Balance Sheet Losses.

For the year ended December 31, 2014, the Company recorded a provision for losses of $41.9 million, of which $30.6 million related to the 2014 accident year and $11.3 million of which related to accident years prior to 2014. As of December 31, 2014, the Company's liability for unpaid losses was $105.6 million, which related to twenty-four insured transactions, with a remaining aggregate in-force par outstanding of $135.3 million, excluding the aforementioned case reserves. The aggregate in-force par outstanding of $135.3 million represents the remaining maximum amount of exposure to loss the Company has in regard to these twenty-four insured transactions.

For the year ended December 31, 2014, incurred losses included $6.2 million representing the consideration paid by the Company to purchase certain of its insured securities in the market. Of the $6.2 million, approximately $5.6 million related to On-Balance Sheet losses and $0.6 million related to Off-Balance Sheet losses. As a result of the purchase of these securities, the Company was able to reduce its expected losses by approximately $8.9 million (which consisted of On-Balance Sheet losses of losses of approximately $8.0 million and Off-Balance Sheet losses of approximately $0.9 million).

Loss Adjustment Expenses Incurred

For the year ended December 31, 2015, the Company recorded a provision for loss adjustment expenses of $1.3 million, a decrease of $0.7 million from $2.0 million recorded during 2014. The 2015 provision related to 35 insured transactions, of which six transactions constituted substantially all of the provision. The 2014 provision related to 35 insured transactions, of which eight transactions constituted substantially all of the provision. As of December 31, 2015 and 2014, the Company's reserve for loss adjustment expenses was $3.9 million and $4.6 million, respectively.

Other Underwriting Expenses Incurred

For the year ended December 31, 2015, the Company incurred other underwriting expenses of $9.6 million, a decrease of $6.9 million from $16.5 million incurred in 2013. The decrease reflected the operating plan reductions implemented by management and primarily resulted from lower legal and compensation costs.

Federal Income Tax Benefit

The Company recorded no current federal income tax provision for 2015 and 2014. As of December 31, 2015, the Company has a net operating loss carryforward of $216.6 million. See ***Description of Significant Risks and Uncertainties Affecting the Company and the Company's On-Going Strategic Plan*** for further information regarding a limitation on the Company's ability to utilize its net operating loss carryforwards as a deduction against future taxable income.

Liquidity and Financial Condition

The Company's liquidity resources are comprised of its investments in bonds, cash, other invested assets, and short-term investments. As of December 31, 2015, the fair value of the Company's liquidity resources aggregated $329.6 million. The Company uses its liquidity resources to pay claims and operating expenses, and continues to generate liquidity resources from earnings from its investments and dividends it receives from its subsidiaries, which earn fees from the management of a run-off portfolio of CDOs. The Company's liquidity resources can be affected (favorably or unfavorably) by the amount and timing of claim payments, changes in the level of interest rates, changes in the credit quality of its investments, and changes in general market conditions. The Company believes it has sufficient liquidity resources to satisfy its obligations as they become due for the foreseeable future (inclusive of claim payments on insured transactions which have not yet had a payment default but in respect of which management currently believes that claim payments are probable). Expected resources from the Company's investment portfolio through maturities and principal pay-downs are more than adequate to meet the Company's future cash used in operations.

Cash Flow

For the year ended December 31, 2015, the Company reported net cash used in operations of $40.9 million, an increase in cash used of $22.3 million, compared to $18.6 million used in operations in 2014. The increase is primarily attributable to: (i) higher cash outflows for loss payments of $22.8 million (see "Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014–Losses Incurred"), (ii) lower cash inflows for other income of $3.3 million (see "Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014–Other Income"), (iii) lower net investment income of $2.8 million in 2015, (see "Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014–Net Investment Income Earned"), and offset in part by (iv) lower cash outflows for other underwriting expenses of $5.4 million (see "Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014–Other Underwriting Expenses"), and (v) lower cash outflows for LAE payments of $1.4 million (see "Detailed Line by Line Discussion of Results of Operations for the Year Ended December 31, 2015, as Compared to 2014–Loss Adjustment Expenses Incurred").

Substantially all the Company's cash inflows from operations are derived from its investment income. If investment income is not sufficient to fund its cash outflows from claims, LAE payments and operating expenses, the Company will utilize cash flow from regular payments or maturities of investment securities or sell its invested assets to fully fund such outflows. Net cash from investments for the years ended December 31, 2015 and 2014, was $44.5 million and $14.8 million, respectively.

Investment Portfolio

At December 31, 2015, the market value of the Company's investment portfolio was $327.4 million, compared to a statutory carrying value of $324.5 million.

The following table summarizes the Company's long-term and short-term bonds and loan-backed securities by NAIC Designation at December 31, 2015 and 2014:

($ amounts in millions)	Carrying Value December 31, 2015	Carrying Value December 31, 2014
NAIC Designation		
1	$ 232.5	$ 287.9
2	78.0	63.5
3	2.6	0.1
4	-	-
5	9.7	12.2
6	1.7	2.5
	$ 324.5	$ 366.2

At December 31, 2015, the portfolio, inclusive of cash, has an average duration of 3.3 years. The Company continues to monitor all of its holdings to determine if write-downs are required or positions should be sold.

The Company's investment strategy is to maintain a highly liquid quality investment portfolio while continually evaluating cash flow and liquidity to meet the operating needs of the Company. The Company uses a third party asset manager, JP Morgan Asset Management, to manage the investment portfolio.

Liabilities and Policyholders' Surplus

Liabilities –

Set forth in the table below is a summary of the Company's recorded liabilities as of December 31, 2015 and 2014 followed by certain commentary relevant thereto:

($ amounts in thousands)	Year Ended December 31, 2015	2014
Losses	$ 110,965	$ 105,552
Loss adjustment expenses	3,866	4,565
Unearned premiums	74,263	92,644
Contingency reserves	95,926	95,926
Other	3,832	5,276
Total liabilities	$ 288,852	$ 303,963

Management expects future adverse loss development as discussed above (see "Overview of Business Operations–Description of Significant Risks and Uncertainties Affecting the Company").

Unearned premiums will continue to decrease in proportion to the decrease in in-force insured principal and interest exposure as the Company, pursuant to an order issued by the MIA, is in run-off and not writing new business (see "Overview of Business Operations–Restructuring Transaction").

Under SSAP 60, contributions to the contingency reserve may be discontinued if the total contingency reserve already recorded exceeds a calculated amount based upon unpaid principal guaranteed and prescribed percentages by bond category. The established contingency reserve is in excess of this calculated amount. The Company has discontinued its contributions in the fourth quarter of 2014. Reductions in the contingency reserve may be recognized under certain stipulated conditions, subject to the approval of the MIA. In May 2015, the Company requested the MIA's approval to release contingency reserves equal to the amount in excess of the calculated maximum amount at December 31, 2014. The MIA denied the request in November 2015.

Policyholders' Surplus –

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 its policyholder surplus shown on its last filed statement, or net income, as defined, for such twelve-month period. The Company has negative earned surplus and therefore, is not able to pay dividends in 2015 other than extraordinary dividends as allowed by the MIA. Furthermore, as part of the Restructuring Transaction, the MIA Order restricts the Company from paying dividends without the prior approval of the Maryland Insurance Commissioner. No dividends were paid during 2015 or 2014.

Commitments and Contingencies

ACA FG subleases office space at 600 Fifth Avenue, New York, New York. The term of the lease begins on April 12, 2010 and ends on September 29, 2016. The Company is actively looking to lease new office space. The term and conditions of the new lease have not yet been determined. The Company is required to make minimum lease payments under the lease as follows:

($ amounts in millions)

Year	Minimum Lease Payments
2016	$ 0.5
	$ 0.5

Except for that discussed below, the Company has no gain contingencies.

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 ("ABACUS"). On April 25, 2011, the Company filed its First Amended Complaint. On June 3, 2011, Goldman moved to dismiss the First Amended Complaint. On April 23, 2012, the Court issued an order denying Goldman's motion to dismiss ACA FG's fraud claims and granting Goldman's motion to dismiss ACA FG's unjust enrichment claim (the "Order"). On May 29, 2012, Goldman served notice of its intent to appeal the Order. Also on May 29, 2012, Goldman served its answer, asserting counterclaims for breach of contract and fraudulent inducement, together with a third-party complaint against ACA Management LLC ("ACAM"), asserting claims for breach of contract, unjust enrichment and indemnification. Goldman does not specify the amount of damages it seeks. Oral arguments were heard on Goldman's appeal of the Order on January 2, 2013. Also on January 2, 2013, the Company filed for leave to amend its First Amended Complaint to add Paulson & Co. ("Paulson") as an additional defendant, incorporating new allegations of fraud against both parties. On January 30, 2013 the Court granted ACA FG's motion for leave to file a second amended complaint. On January 31, 2013 the Company filed its Second Amended Complaint. The Second Amended Complaint adds Paulson as an additional defendant and alleges that Paulson and Goldman conspired to fraudulently induce the Company to provide financial guaranty insurance for ABACUS by deceiving ACA FG into believing that Paulson was to be the equity investor in the product. On March 18, 2013 Paulson moved to dismiss the Second Amended Complaint. On April 17, 2013 Goldman answered the Second Amended Complaint. On May 14, 2013, the Appellate Division of the Supreme Court of the State of New York ordered the dismissal of ACA FG's legal action against Goldman. The decision reversed the lower court's order of April 23, 2012 denying Goldman's motion to dismiss. Following a motion for reargument with the Supreme Court that was denied December 17, 2013, ACA FG filed a motion for leave to appeal the decision to the Court of Appeals, which motion was fully briefed as of February 14, 2014. All lower court action was stayed pending that motion. On May 2, 2014, the Appellate Division granted ACA FG's motion for leave to appeal. Briefing began in July 2014 and oral arguments took place on March 26, 2015. On May 7, 2015, the Court of Appeals issued its decision reversing the dismissal by the Appellate Division. On August 18, 2015 the Appellate Division remanded the case to the Supreme Court. ACA FG's motion to dismiss Goldman's counterclaims against it and its third-party complaint against ACAM has been briefed, as has Paulson's motion to dismiss the ACA FG's claims against it. Oral argument on such motions is scheduled for April 2016. The various parties continue to seek discovery to the extent not yet obtained. The Company intends to vigorously pursue its claims, and defend those asserted against it, in this case.

As a result of actions taken by the trustee in one particular ACA FG insured transaction, ACA FG expects to ultimately recognize salvage and subrogation recoveries in excess of its expected aggregate claim payments on the transaction. As a result, as of December 31, 2015, ACA FG expects to recognize a gain aggregating approximately $13.2 million on a net present value basis, with recoveries expected to begin decades in the future. In addition, ACA FG was negotiating a settlement agreement with one of its former insurance carriers which was finalized in 2014, resulting in payments to ACA FG with respect to claims for coverage for certain investigations and lawsuits. Pursuant to ACA FG's accounting policy, any estimated gains must be deferred and recognized only when the actual receipts of such recoveries occur, or in the case of losses related to ACA FG's own insurance policies, they exceed the cumulative amounts paid out pursuant to claims. Accordingly, no assurance can be given that any or all expected recoveries will be received or that the amount of actual recoveries will not differ materially from that expected.

Set forth below are descriptions of lawsuits where the Company is currently defending itself which could possibly result in loss payments.

The Company was one of several defendants in a lawsuit in the Superior Court of the State of California (Los Angeles County) brought in December 2008 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 in December 2007, the plaintiffs were forced to refinance their securities. On December 18, 2014, the court granted summary judgment in favor of the Company. Plaintiffs filed notice of appeal on March 19, 2015 and filed their opening appellate brief on October 6, 2015. The appeal was fully briefed as of February 2016 and oral arguments are expected by the end of 2016. The other defendants reached confidential settlements with Retirement Housing Foundation. The Company believes that the issues raised in Plaintiffs' appeal are without merit and intends to defend itself vigorously.

The Company (specifically, ACA Management, LLC) is one of many defendants in an action pending in New Mexico First Judicial District Court, in Santa Fe, filed in 2008 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 two 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 the plaintiffs assert raise the claim to several hundred million dollars under certain New Mexico statutes, including the Fraud Against Taxpayers Act ("FATA"). Further, the complaint seeks to impose joint and several liability on all defendants. In April 2010, the then-presiding judge ruled that the retroactive nature of FATA was unconstitutional. The ruling was affirmed by the New Mexico Court of Appeals. However, on June 25, 2015, the Supreme Court of the State of New Mexico reversed and held that FATA is constitutional. The New Mexico Supreme Court also consolidated multiple related cases and reassigned the consolidated proceeding to a new district judge. Briefing by the various parties currently is focused on the New Mexico Attorney General's motion to dismiss and Vanderbilt's motion to confirm its settlement with the Attorney General. If either motion is granted, it is likely the Company will be dismissed from the suit. Early in the proceeding, ACA FG moved to dismiss the complaint for lack of personal jurisdiction and the then-presiding judge deferred ruling on the Company's jurisdictional motion pending jurisdictional discovery. The Company's jurisdictional motion remains pending while the other motions are adjudicated. To the extent activity directly involving the Company resumes in the case, the Company intends to continue to defend itself vigorously.

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