

**CIFG GUARANTY LTD.**

Consolidated Financial Statements

December 31, 2007, 2006 and 2005

(With Independent Auditors' Report Thereon)

**CIFG GUARANTY LTD.**

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**INDEPENDENT AUDITORS' REPORT**

The Shareholder of  
CIFG Guaranty Ltd.

We have audited the accompanying consolidated balance sheet of CIFG Guaranty Ltd. and subsidiaries as of December 31, 2007, and the related consolidated statements of operations, shareholder's equity and comprehensive (loss) income, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The accompanying consolidated financial statements of the Company as of December 31, 2006, and for the years ended December 31, 2006 and 2005 were audited by other auditors whose report thereon dated April 6, 2007, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2007 consolidated financial statements referred to above present fairly, in all material respects, the financial position of CIFG Guaranty Ltd. and subsidiaries as of December 31, 2007, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in note 1 to the consolidated financial statements, the Company has suffered significant losses from operations in 2007, the Company's ratings have been downgraded by three rating agencies, and the Company has suspended writing all new business. These matters raise substantial doubt about its ability to continue as a going concern. Management's plan in regard to these matters is also described in note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Chartered Accountants  
Hamilton, Bermuda  
July 16, 2008

**CIFG GUARANTY LTD.**

Consolidated Balance Sheets

December 31, 2007 and 2006

(In thousands, except for per share amounts)

<b>Assets</b>	<b>2007</b>		<b>2006</b>
	<b>Euros</b>	<b>U.S. dollars (Unaudited)</b>	<b>Euros</b>
Investments:			
Fixed income securities, available for sale, at fair value (amortized cost of €686,402 and €634,193, respectively)	€ 648,502	\$ 953,687	€ 611,439
Short-term investments, at cost (approximates fair value)	983,195	1,445,887	83,007
Total investments	1,631,697	2,399,574	694,446
Cash	11,789	17,337	8,279
Premiums receivable	16,303	23,975	14,479
Investment income due and accrued	12,810	18,839	12,316
Prepaid reinsurance premiums	2,925	4,302	3,149
Reinsurance recoverable on unpaid loss and loss adjustment expense reserves	150	221	108
Intangible asset – licenses acquired in acquisition	5,134	7,550	6,339
Property and equipment, net of accumulated depreciation of €2,051 in 2007 and €1,744 in 2006	3,024	4,447	1,419
Deferred acquisition costs, net	48,468	71,277	47,313
Derivative assets	17	25	749
Income taxes recoverable	5,018	7,379	—
Other assets	2,310	3,396	116
Total assets	€ 1,739,645	\$ 2,558,322	€ 788,713
<b>Liabilities and Shareholders' Equity</b>			
Liabilities:			
Deferred premium revenue	€ 190,641	\$ 280,357	€ 198,384
Loss and loss adjustment expense reserves	125,822	185,034	5,938
Deferred income taxes	2,652	3,900	14,340
Income taxes payable	—	—	4,540
Long-term debt	68,000	100,000	—
Derivative liabilities	1,296,665	1,906,876	469
Payable for investments purchased	614	903	860
Accounts payable, accrued expenses, and other liabilities	20,789	30,572	20,998
Total liabilities	1,705,183	2,507,642	245,529
Shareholders' equity:			
Common stock, par value €10.00 per share in 2007 and 2006. Authorized 61,254,451 and 56,408,451 issued shares in 2007 and 2006 respectively.	612,545	900,809	564,085
Additional paid-in capital	886,622	1,303,866	6,400
Retained (deficit) earnings	(1,395,195)	(2,051,774)	26,319
Legal reserve	—	—	1,066
Accumulated other comprehensive (loss) (net of deferred income taxes of (€427) and €7,913, respectively)	(69,510)	(102,221)	(54,686)
Total shareholders' equity	34,462	50,680	543,184
Total liabilities and shareholders' equity	€ 1,739,645	\$ 2,558,322	€ 788,713

The financial statements are stated in euros. The translation of euros into U.S. dollars is presented solely for the convenience of the reader, using the observed exchange rate at December 31, 2007 of \$1.4706 to €1.00. This convenience translation should not be construed as representation that the euro amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any rate of exchange.

See accompanying notes to consolidated financial statements.

**CIFG GUARANTY LTD.**

Consolidated Statements of Operations

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	2007		2006	2005
	Euros	U.S. dollars (Unaudited)	Euros	Euros
<b>Revenues:</b>				
Gross premiums written	€ 83,786	\$ 123,216	€ 119,166	93,038
Ceded premiums written	(823)	(1,210)	(1,452)	(1,385)
Net premiums written	82,963	122,006	117,714	91,653
Change in net deferred premium revenue	(10,654)	(15,668)	(61,240)	(53,822)
Net premium earned (net of ceded earned premium of €1,035 in 2007, €832 in 2006, and €326 in 2005)	72,309	106,338	56,474	37,831
Net investment income	27,141	39,914	24,050	14,823
Net realized capital (losses) gains	(8,256)	(12,141)	257	2,491
Net unrealized (losses) gains on credit derivatives, net	(1,305,262)	(1,919,518)	536	(210)
Foreign exchange gain (loss), net	(981)	(1,442)	11,299	(8,285)
Other income	501	737	668	343
<b>Total Revenue</b>	<b>(1,214,548)</b>	<b>(1,786,112)</b>	<b>93,284</b>	<b>46,993</b>
<b>Expenses:</b>				
Losses and loss adjustment expenses, net	130,355	191,700	2,254	1,569
Operating expenses	36,977	54,379	30,448	22,677
Amortization of deferred acquisition costs	9,292	13,665	9,641	5,071
<b>Total expenses</b>	<b>176,624</b>	<b>259,744</b>	<b>42,343</b>	<b>29,317</b>
(Loss) income before income taxes	(1,391,172)	(2,045,856)	50,941	17,676
Provision for income tax (benefit) expense	(17,052)	(25,077)	23,447	6,186
<b>Net (loss) income</b>	<b>€ (1,374,120)</b>	<b>\$ (2,020,779)</b>	<b>€ 27,494</b>	<b>11,490</b>

The financial statements are stated in euros. The translation of euros into U.S. dollars is presented solely for the convenience of the reader, using the observed exchange rate at December 31, 2007 of \$1.4706 to €1.00. This convenience translation should not be construed as representation that the euro amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any rate of exchange.

See accompanying notes to consolidated financial statements.

**CIFG GUARANTY LTD.**

Consolidated Statements of Changes in Shareholder's Equity and  
Comprehensive (Loss) Income

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	<u>Common shares</u>	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained earnings (accumulated deficit)</u>	<u>Legal reserve</u>	<u>Accumulated other comprehensive (loss) income, net of tax</u>	<u>Total shareholder's equity</u>
Balance at December 31, 2004	56,408	€ 564,085	€ 2,867	€ (12,117)	€ 518	€ (46,849)	€ 508,504
Stock options	—	—	1,551	—	—	—	1,551
Transfer reserve legal	—	—	—	(268)	268	—	—
Other comprehensive income:							
Net income	—	—	—	11,490	—	—	11,490
Net change in unrealized depreciation of securities, net of deferred tax benefit of (€1,799)	—	—	—	—	—	6,574	6,574
Change in currency translation	—	—	—	—	—	11,295	11,295
Total comprehensive income							29,359
Balance as of December 31, 2005	56,408	564,085	4,418	(895)	786	(28,980)	539,414
Stock options	—	—	1,982	—	—	—	1,982
Transfer reserve legal	—	—	—	(280)	280	—	—
Other comprehensive income:							
Net income	—	—	—	27,494	—	—	27,494
Net change in unrealized depreciation of securities, net of deferred tax benefit of €9,211	—	—	—	—	—	(18,427)	(18,427)
Change in currency translation	—	—	—	—	—	(7,279)	(7,279)
Total comprehensive (loss)							1,788
Balance as of December 31, 2006	56,408	564,085	6,400	26,319	1,066	(54,686)	543,184
Capital contribution	4,846	48,460	877,194	—	—	—	925,654
LTI expense	—	—	3,028	—	—	—	3,028
Stock dividend	—	—	—	(48,460)	—	—	(48,460)
Transfer reserve legal	—	—	—	1,066	(1,066)	—	—
Other comprehensive loss:							
Net loss	—	—	—	(1,374,120)	—	—	(1,374,120)
Net change in unrealized depreciation of securities, net of deferred tax benefit of €(7,486)	—	—	—	—	—	(42,203)	(42,203)
Change in currency translation	—	—	—	—	—	27,379	27,379
Total comprehensive loss							(1,388,944)
Balance as of December 31, 2007	61,254	€ 612,545	€ 886,622	€ (1,395,195)	€ —	€ (69,510)	€ 34,462
	<u>2007</u>	<u>2006</u>	<u>2005</u>				
Disclosure of reclassification amounts:							
Unrealized depreciation arising during the period, net of taxes	€ (51,045)	(18,431)	6,572				
Less reclassification adjustment for net (losses) gains included in income net of taxes	(8,842)	(4)	(2)				
Net unrealized (depreciation) appreciation of securities, net of taxes	€ (42,203)	(18,427)	6,574				

See accompanying notes to consolidated financial statements.

**CIFG GUARANTY LTD.**

Consolidated Statements of Cash Flows

Years ended December 31, 2007, 2006 and 2005

(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:			
Net (loss) income	€ (1,374,120)	27,494	11,490
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Amortization of bond premium	6,572	5,974	3,399
Depreciation	514	423	402
Intangible asset	531	—	—
Increase in loss and loss adjustment expense reserves, net	124,481	2,254	1,355
Decrease in deferred premium revenue	10,522	66,058	55,007
Decrease (increase) in prepaid reinsurance premiums	224	(611)	(1,050)
Increase in deferred acquisition costs	(1,155)	(6,078)	(16,909)
Increase in stock-based compensation	3,028	1,982	1,551
Increase in premium receivable	(2,825)	(5,697)	(2,987)
Increase (decrease) in ceded reinsurance balances payable	38	(522)	645
(Decrease) increase in accounts payable and accrued expenses	(4,023)	2,050	4,577
Increase in investment income due and accrued	(645)	(1,122)	(9,836)
(Decrease) increase in deferred income tax	(19,140)	6,587	7,502
Current taxes receivable/payable	(9,546)	638	3,477
Net realized losses on investments	8,256	(257)	(2,491)
Net realized and unrealized losses (gains) on credit derivatives, net	1,305,262	(536)	210
(Decrease) increase in intercompany payable to affiliates	(14)	394	(184)
Effect of foreign exchange	8,458	(7,040)	6,454
Other, net	5,174	5,505	460
Net cash provided by operating activities	<u>61,592</u>	<u>97,496</u>	<u>63,072</u>
Cash flows from investing activities:			
Purchase of fixed income securities, net	(146,647)	(106,588)	(477,778)
Proceeds from the sale of fixed income securities	37,149	42	6,854
Proceeds from the maturity of fixed income securities	31,422	42,314	39,412
(Purchase) sale of short-term investments, net	(922,374)	(33,063)	369,988
Capital expenditures, net	(2,239)	(1,123)	(150)
Net cash used in investing activities	<u>(1,002,689)</u>	<u>(98,418)</u>	<u>(61,674)</u>
Cash flows from financing activities:			
Capital contributions	925,654	—	—
Stock dividends	(48,460)	—	—
Net proceeds from the issuance of long-term debt	68,000	—	—
Net cash provided by financing activities	<u>945,194</u>	<u>—</u>	<u>—</u>
Effect of exchange rate changes on cash	<u>(587)</u>	<u>(450)</u>	<u>1,014</u>
Increase (decrease) in cash	3,510	(1,372)	2,412
Cash at beginning of period	<u>8,279</u>	<u>9,651</u>	<u>7,239</u>
Cash as of end of year	€ <u><u>11,789</u></u>	<u><u>8,279</u></u>	<u><u>9,651</u></u>
Supplemental disclosures of cash flow information:			
Taxes paid	€ 7,309	8,304	460

See accompanying notes to consolidated financial statements.

## CIFG GUARANTY LTD.

### Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(Amounts in thousands)

#### (1) Business and Organization

CIFG Guaranty Ltd. is a financial guaranty reinsurance company which was established in France in 2001, and which is a wholly-owned subsidiary of CIFG Holding Ltd. (“CIFG Holding”). Effective October 1, 2007 CIFG Guaranty changed its place of domicile from France to Bermuda and as part of the redomiciliation, changed its name to CIFG Guaranty Ltd. (“CIFG Guaranty” or, together with its consolidated subsidiaries, the “Company”). As of September 30, 2007 and prior, CIFG Guaranty was a French *société anonyme*. CIFG Guaranty is now licensed as a Class 3 insurer in Bermuda, under the Insurance Act of 1978, amendments thereto, and related regulations (“Act”).

CIFG Holding was formed by CDC Finance – CDC IXIS (CDC IXIS) in France during 2001. On October 1, 2007 CIFG Holding changed its place of domicile from France to Bermuda, and, as part of the redomiciliation, changed its name to CIFG Holding Ltd. From inception through June 2004, CIFG Holding was a wholly-owned subsidiary of CDC IXIS. In June 2004, a majority interest in CIFG Holding’s ownership was transferred to Caisse Nationale des Caisses d’Epargne (CNCE). Prior to November 2006, CIFG Holding was wholly-owned by CNCE. From November 2006 until December 20, 2007, CIFG Holding was a wholly-owned subsidiary of Natixis, a French *société anonyme*. Natixis is owned by Banque Fédérale des Banques Populaires (BFBP) and CNCE, with a portion also owned by public float and institutional investors.

In September 2007, Natixis contributed \$100.0 (€8.0) million to CIFG Holding.

On December 20, 2007, BFBP and CNCE invested \$1.296 billion (€881.0) million in cash as equity capital in CIFG Holding and became the primary shareholders. In addition, BFBP and CNCE provided a \$204 million capital support facility to CIFG Holding. At the same time, Natixis agreed to sell substantially all of its equity investment in CIFG Holding to BFBP and CNCE, which sale was closed on January 31, 2008. On December 20, 2007, CIFG Holding contributed \$1.29 billion of cash as equity capital in CIFG Guaranty, and on December 28, 2007, contributed \$100 (€8.0) million in cash to CIFG Guaranty in the form of a subordinated note.

CIFG Guaranty and its subsidiaries (the CIFG Group) constitute a monoline financial guaranty group engaged solely in the financial guaranty business.

The consolidated financial statements of the CIFG Group are comprised of CIFG Guaranty Ltd. (CIFG Guaranty), CIFG Europe, a French *société anonyme* that is a wholly-owned subsidiary of CIFG Guaranty, CIFG Services, Inc. (CIFG Services), also a wholly-owned subsidiary of CIFG Guaranty, CIFG Assurance North America, Inc. (CIFG NA), which is wholly-owned by CIFG Services, and certain variable interest entities (VIEs) (described below).

CIFG Guaranty provides reinsurance primarily to CIFG Europe and CIFG NA. CIFG Europe, established in 2001, is a monoline financial guaranty company domiciled in France that is licensed to conduct business in certain member states of the European Union. CIFG NA, established in 2002, is a monoline financial guaranty company domiciled in the State of New York that is licensed to transact financial guaranty insurance in 47 U.S. states, the District of Columbia, the U.S. Virgin Islands, and the Commonwealth of Puerto Rico.

## CIFG GUARANTY LTD.

### Notes to Consolidated Financial Statements

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(Amounts in thousands)

In 2003, in order to comply with certain U.S. state restrictions regarding the ownership or control of U.S. insurance companies by a foreign government or any agency or instrumentality thereof, CIFG Services transferred all of the outstanding shares of CIFG NA to a voting trust. However, due to the ownership change with Natixis, which occurred in late 2006 as described above, the voting trust was terminated in 2007 with the approval of the New York State Insurance Department (NYSID) and CIFG Services became the sole shareholder of CIFG NA.

In the ordinary course of business, the Company's subsidiaries CIFG Europe and CIFG NA have issued financial guaranty contracts in respect of obligations of certain VIEs. Specifically, CIFG Europe has issued financial guaranty contracts in respect of obligations of Mogador Ltd., a VIE that is a corporation established in Jersey, which is owned by the Mogador Trust, a Jersey-based charitable trust. CIFG NA has issued financial guaranty contracts in respect of certain obligations entered into by multiple New York state business trusts, collectively known as the New Generation Funding Trusts. These financial guaranty contracts guarantee the payment of obligations of the respective VIEs to investors under credit default swap contracts (CDS). Other than the transactions described above, the VIEs own no assets and have no outstanding debt, and by virtue of the credit support provided by the financial guaranty contracts, CIFG Europe and CIFG NA are considered to be the primary beneficiaries of these VIEs. Accordingly, these VIEs are consolidated by these subsidiaries.

#### *Recent Developments*

As of December 31, 2007, each of CIFG Guaranty, CIFG Europe, and CIFG NA (collectively, the rated subsidiaries) had an insurer financial strength rating of "Aaa" from Moody's Investor Services, Inc. (Moody's), an insurer financial strength rating and financial enhancement rating of "AAA" from Standard and Poor's Rating Services (S&P), and an insurer financial strength of "AAA" from Fitch Ratings (Fitch).

Adverse developments in the credit markets in 2007 that rapidly accelerated in the fourth quarter have had, and continue to have, a material adverse impact on the Company and its subsidiaries' results of operations and financial condition, as reflected by the recognition of unrealized losses on contracts accounted for as derivatives and the establishment of loss reserves on financial guaranty contracts. The impact of the deterioration in the credit markets and the estimated effect on the obligations guaranteed by the Company have resulted in a substantial increase to the capital requirements necessary to maintain the triple-A ratings of the rated subsidiaries. For this and other reasons, in 2008, the three major rating agencies lowered their financial strength ratings. The Company's financial strength ratings as of July 14, 2008 are summarized in the table below.

<u>Rating agency</u>	<u>Insurance financial strength rating</u>	<u>Outlook</u>
S&P	A-	Credit watch negative
Moody's	Ba2	Uncertain
Fitch	CCC	Rating watch evolving

In March 2008, management requested that Fitch withdraw its ratings of the rated subsidiaries.

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The financial strength ratings downgrades have negatively impacted the Company's ability to generate new business and will affect the Company's future business, operations, and financial results.

Due to a combination of market conditions, a reconsideration of strategic alternatives, and a result of the ratings actions noted above, CIFG NA and CIFG Europe ceased writing new business for a period of time in order to preserve capital and evaluate strategic alternatives to enhance its capital position and mitigate anticipated losses. In that regard, CIFG Holding, on behalf of the companies in the CIFG Group, has engaged financial advisors to assist in the evaluation of strategic alternatives, which may include, but not necessarily be limited to, decreasing capital requirements through the use of reinsurance and/or the commutation of certain in-force policies, raising new capital, and the pursuit of new markets for financial guaranty products which may be different than those that have traditionally been served by CIFG Holding and its subsidiaries. There can be no assurance that the strategies being evaluated by CIFG Holding will not evolve or change over time, will be successfully implemented, or will address the requirements of the rating agencies to either avoid further rating downgrades or improve ratings that would facilitate the resumption of new business origination activities.

The extent and duration of any continued deterioration in the credit markets is unknown, as is the effect, if any, on potential claim payments and the ultimate losses the Company may incur on obligations it has guaranteed. As a result, material adverse development of the Company's loss reserves could cause the Company and or its operating subsidiaries to be out of compliance with regulatory minimum solvency requirements and risk limits. In the event that the Company and or its subsidiaries should suffer material additional losses that cause them to be out of compliance with regulatory capital requirements and risk limits, and CIFG Holding is unable to secure additional capital for its subsidiaries or it is not successful in improving their capital position by reducing their potential liabilities and these entities remain out of regulatory capital compliance, the insurance regulators could take regulatory action to intervene in the subsidiaries' operations.

Although the Company has not been able to write new business and there can be no assurance that the Company will be able to recommence writing new business in the near term or at all, the Company believes its liquid resources are sufficient to fund its obligations as they come due for at least the next twelve months.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The aforementioned factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

## **(2) Significant Accounting Policies**

### **(a) Basis of Presentation**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The

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Notes to Consolidated Financial Statements

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(Amounts in thousands)

preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. As additional information becomes available or actual amounts become determinable the recorded estimates are revised and reflected in operating results.

Certain prior year balances have been reclassified to conform to the current year presentation.

The translation of euros into U.S. dollars in the following footnotes is presented solely for the convenience of the reader, using the observed exchange rate at December 31, 2007 of \$1.4706 to €1.00.

Significant accounting policies are as follows:

**(b) Consolidation**

The consolidated financial statements include the accounts of CIFG Guaranty, CIFG Europe, CIFG Services, CIFG NA, and certain VIEs for which the Company is the primary beneficiary. The Company determines whether it has a controlling financial interest in an entity by first evaluating whether an entity is a voting interest entity under U.S. GAAP. All intercompany balances have been eliminated.

**(c) Investments**

The Company's investment portfolio is accounted for on a trade-date basis. Investments in fixed income securities that are considered available for sale (AFS) are carried at fair value, with unrealized gains and losses, net of deferred taxes, reflected in other comprehensive income (OCI). Fair value is based on quotes obtained from independent market sources; for instances where market quotes are not available, observable market inputs are used to estimate fair value. Unrealized gains and losses are calculated using amortized cost as the basis. AFS investments denominated in currencies other than euros are accounted for at their euro equivalent using exchange rates in effect at the consolidated balance sheets date. Unrealized foreign exchange gains or losses on AFS, net of deferred taxes, are recorded in OCI. Short-term investments are carried at cost, which approximates fair value.

For purposes of computing amortized cost, premiums and discounts are accounted for using the effective yield method over the remaining terms of securities acquired. For bonds purchased at a premium that do not have call features, such premiums are amortized over the remaining terms of the securities. Premium and discounts on mortgage-backed and asset-backed securities are adjusted for the effects of actual and anticipated prepayments.

The Company's process for identifying declines in the fair value of investments that are other than temporary involves consideration of multiple factors. These factors include current economic conditions, market prices, issuer-specific developments, the time period during which there has been a significant decline in value, and the Company's intent and ability to hold the investment for a

## **CIFG GUARANTY LTD.**

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(Amounts in thousands)

sufficient period of time for the value to recover. If the Company's analysis of these factors results in the determination that the decline is other than temporary, the Company writes down the carrying value of the investment to fair value and records a realized loss. As of December 31, 2007, the Company recognized impairment losses. Impaired investments are written down to the current market value and a corresponding capital loss is recognized in the accompanying consolidated statement of operations. In 2005 and 2006, there were no declines in fair values deemed to be other than temporary.

Realized gains and losses on the sale of investments are determined on the basis of first in, first out. Investment income is recorded when earned.

#### **(d) *Deferred Acquisition Costs***

Certain costs incurred, primarily related to and varying with the production of new financial guaranty business, excluding financial guaranty contracts accounted for as derivatives, have been deferred. These costs include direct and indirect expenses related to underwriting and contract origination expenses, rating agency fees, and premium taxes.

The Company recognizes a premium deficiency if the sum of expected losses and loss adjustment expenses, maintenance costs, and unamortized policy acquisition costs exceeds the related unearned premiums, the anticipated present value of future installment contracts written, and anticipated investment income. When the Company has a premium deficiency that is greater than unamortized acquisition costs, the unamortized acquisition costs are reduced by a charge to expense, and a liability (if necessary) will be recorded for any remaining deficiency.

The Company receives ceding commissions under the ceded reinsurance contracts as compensation for acquisition costs incurred. Ceding commissions are deferred and offset against deferred acquisition costs (DAC). DAC and deferred ceding commissions, net, are amortized into the accompanying consolidated statements of operations over the periods in proportion to the earnings of the related premiums. DAC is presented in the accompanying consolidated balance sheet net of deferred ceding commissions.

#### **(e) *Premium Revenue Recognition***

Premiums received at the inception of the policy, or otherwise "up-front" premiums, are earned pro rata over the duration of the underlying risk in proportion to the amount of risk outstanding over the expected period of coverage. The amount of risk outstanding is equal to the sum of the par amount of the debt insured. Installment premiums written are recognized on a straight-line basis over each installment period. If a guaranteed issue is retired early, the remaining deferred premium will be earned and any related unamortized DAC will be expensed immediately. Deferred premium revenue and prepaid reinsurance premiums represent the portion of gross and ceded premium written, respectively, which has been allocated to the unexpired underlying risk.

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**(f) *Losses and Loss Adjustment Expenses Reserves***

Losses and loss adjustment reserves are established for financial guaranty contracts subject to Statement of Financial Accounting Standards (SFAS) No. 60, *Accounting and Reporting by Insurance Enterprises* (FAS 60). The reserve for losses and loss adjustment expenses consists of active credit reserves and case basis loss and loss adjustment expense reserves (case basis reserves). The development of active credit reserves is based upon the historical loss experience for the financial guaranty industry and management's judgment based on the Company's insured portfolio. The active credit reserve is an estimate of probable losses that are not specific to an insured obligation, but represents credit deterioration on guaranteed issues that are not presently or imminently in default. The determination of the active credit reserve is primarily based on an analysis of expected losses as a percentage of expected premium on the outstanding insured portfolio, pursuant to which, active credit reserves are provided on a periodic basis as a function of financial guaranty premiums earned. The active credit reserve is recorded on an undiscounted basis. When an insured obligation matures or is defeased or refunded, the active credit reserve is not reversed, because the reserve is not specific to an insured obligation.

The Company monitors the active credit reserves on an ongoing basis and may adjust these reserves based on industry loss trends, actual loss experience, consideration of changes in the mix of business written, characteristics of the insured portfolio, and economic conditions. The active credit reserve is available to be applied against future case basis loss reserves and loss adjustment expenses. If the case basis reserves in a given year exceed the active credit reserve, management may consider adjusting the active credit reserve directly or adjusting the loss ratio applied to earned premium. Additionally, management may also determine, if severe market conditions exist and the magnitude of the case basis reserves are very significant, a direct charge to the consolidated statements of operations may be taken rather than transferring the active credit reserve to the case basis reserves.

Case basis loss reserves are recorded for financial guaranty policies when it is probable that a loss has been incurred and it can be reasonably estimated. When losses occur, case basis loss reserves are established in an amount that is sufficient to cover the present value of the anticipated defaulted debt service payments over the expected period of default and estimated expenses associated with settling the claims, less estimated recoveries under salvage or subrogation rights. Case basis reserves are discounted at a rate that is commensurate with the performance of the Company's investment portfolio.

The Company has developed internal models that are used to estimate case basis reserves. The case basis reserve models require management to make assumptions on the outcome of future events, based on historical and current transaction data, and external market inputs. For example, assumptions for structured finance case basis reserves may entail estimates of prepayment speeds, loss severity, monthly loss rates, monthly draw rates, recovery rates, etc. Changes in any significant assumptions may materially impact the Company's case basis reserves. The results of the case reserve models are presented to the Company's Loss Reserve Committee by the Surveillance Department. The Loss Reserve Committee determines the case basis reserve levels based upon their review and assessment of the model results.

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Management believes that the Company's reserves are adequate to cover the ultimate net cost of claims. However, because the reserves are based on management's judgment and estimates, there can be no assurance that the ultimate liability will not exceed such estimates.

The Company's loss reserving policy, described above, is based on guidance provided in FAS 60, SFAS No 5, *Accounting for Contingencies* (FAS 5) and analogies to Emerging Issues Task Force Issue No. 85-20, *Recognition of Fees for Guaranteeing a Loan*. FAS 60 requires that, for short-duration contracts, a liability for unpaid claim costs relating to insurance contracts, including estimates of costs relating to incurred but not reported claims, be accrued when insured events occur. Additionally, FAS 5 requires that a loss be recognized where it is probable that one or more future events will occur confirming that a liability has been incurred at the date of the consolidated financial statements and the amount of loss can be reasonably estimated. (See recent accounting developments section of this note for discussion of the Financial Accounting Standards Board's (FASB) SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60* (FAS 163)).

#### (g) *Income Taxes*

As of September 30, 2007 and prior, CIFG Guaranty, and CIFG Europe each file separate French tax returns, while CIFG Services and CIFG NA file a consolidated U.S. tax return. Effective October 1, 2007, CIFG Guaranty is no longer subject to taxation due to the redomiciliation to Bermuda. CIFG Guaranty received tax assurance from the Bermuda Ministry of Finance that in the future, if legislation is enacted in Bermuda to levy taxes, those entities will be exempt from taxation until 2016. Current income taxes are calculated in accordance with the local income tax rules applicable to each entity within their respective jurisdiction.

Deferred income taxes are provided with respect to the temporary differences between the tax bases of assets and liabilities and the reported amounts in the accompanying consolidated financial statements that will result in deductible or taxable amounts in future years when the reported amount of the asset or liability is recovered or settled. Such temporary differences relate principally to premium revenue recognition, deferred acquisition costs, derivatives assets and liabilities, loss reserves, net operating losses (NOLs), and unrealized appreciation or depreciation of investments. A valuation allowance is established, by taxing jurisdiction, when management believes it is more likely than not (a likelihood of more than 50%) that some portion or the entire net deferred tax asset will not be realized.

As of September 30, 2007, CIFG Guaranty released deferred tax liabilities of approximately €15.0 (\$22.0) million because it was no longer a taxpayer in France.

#### (h) *Reinsurance*

In the normal course of business, the Company may reduce its guaranteed exposure by reinsuring certain levels of risk with other insurance enterprises or reinsurers. Reinsurance premiums ceded and related commissions recorded are deferred and recognized in earnings on a prorata basis over the

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period the related financial guaranty coverage is provided. Deferred ceding commissions are netted against DAC.

**(i) Property and Equipment**

Property and equipment consists of office furniture, fixtures, computer equipment, software, and leasehold improvements that are reported at cost less accumulated depreciation. Office furniture and fixtures are depreciated straight line over seven years. Leasehold improvements are amortized over their estimated service life or over the life of the lease, whichever is shorter. Computer equipment and software are depreciated over five years. Maintenance and repairs are charged to expense as incurred.

**(j) Rent Expense**

Rent expense, net of lease incentives, is recognized on a straight-line basis over the lives of the leases.

**(k) Intangible Assets**

Intangible assets have been established for the fair value of the insurance licenses acquired in prior years. The Company has determined that these licenses have an indefinite life and, therefore, are not being amortized. The recoverability of the carrying value of the intangible asset is evaluated at least annually based on a review of forecasted discounted cash flows and by referencing other available information.

In 2007, approximately €31 (\$781) thousand of the intangible asset was written off as a charge to earnings, as an impairment loss. In 2006, there were no adjustments to the carrying value of the intangible asset.

**(l) Derivative Contracts**

Under SFAS No. 133 *Accounting for Derivative Instruments and Hedging* and SFAS No. 149 Amendment of Statement 133 and *Derivative Instruments and Hedging Activities*. (FAS 133), all derivative instruments are recognized on the consolidated balance sheets at fair value and changes in fair value are recognized immediately in earnings unless the derivatives qualify for cash flow hedges. The Company has issued some insurance policies that do not qualify for the financial guaranty scope exception under FAS 133. The Company's insured credit default swap (CDS) portfolio mainly comprises financial guarantees insuring structured pools of obligations such as multisector collateralized debt obligations (CDOs), synthetic corporate CDOs, commercial real estate CDOs (CRE CDO's), collateralized loan obligations (CLOs), consumer asset-backed securities and direct residential mortgage-backed securities (RMBS). Accordingly, these insured credit derivative contracts are recognized in the accompanying consolidated balance sheets at fair value, with unrealized gains and losses for the changes in fair value credited or charged to the accompanying consolidated statements of operations, respectively. These contracts are considered by the Company to be, in substance, financial guaranty contracts, and the Company generally intends to hold them to maturity. Usually, pursuant to the terms of the CDS, the Company cannot transfer such contracts to

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market participants. Under certain circumstances, the Company may choose to terminate or restructure an insured credit derivative prior to maturity for risk management purposes or to preserve capital to manage rating agency requirements.

The Company's CDS contracts are customized, as compared to standardized CDS transactions, which are traded in the marketplace that are liquid financial instruments, which may reference tradable securities such as corporate bonds. Standardized CDS contracts will generally have observable market prices and may involve collateral posting and cash settlement upon default of a referenced obligation. The customized CDS contracts the Company insures are structured so that in substance they replicate financial guaranty contracts, but do not require the Company to post collateral. If an insured CDS transaction defaults and the subordination before the Company's insured layer in the structure has been depleted, the Company will make payments on a "pay-as-you-go" basis or at final maturity. These insured CDS contracts cannot be accelerated against the Company except upon winding up of the related financial guarantor or upon commencement of rehabilitation or similar regulatory action with respect to the related financial guarantor; however, the Company at its own discretion may elect to make accelerated payments.

Fair value is defined as the amount at which an asset or liability could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Fair value is determined based on quoted market prices, if available. If quoted market prices have not been available, fair value can be estimated using valuation techniques. Historically, there has not been a market for highly customized CDS contracts; therefore, quoted market prices are generally not available. The Company believes that there is no relevant "third-party" observable exit price for these contracts. As a result, valuation techniques are used that incorporate assumptions made by management as well as observable market inputs. The Company's valuation models are internally developed. The level of fair value adjustments is dependent upon a number of factors including changes in credit spreads, liquidity, and other market factors. The fair value model considers the amount of subordination in the transaction before the Company's attachment point, third-party collateral classifications, credit ratings and credit spread indices, estimates of expected losses, yield curves, dealer quotes, remaining average life of the CDS contract, correlation assumptions, and an assumption of the change in the level of risk premium that would be captured by the Company today as compared to the inception of the contract. Because it is the Company's policy to consider all relevant evidence in forming its best estimate of fair value of its CDS contracts, as new information becomes available or existing information becomes more or less available, the Company may consider new or different factors than those listed above in its fair value estimates in the future.

The valuation represents management's best estimate of fair value as of the consolidated balance sheets date. However, the valuation results from these models could differ materially from amounts that might actually be realized in the market. There may be volatility in the market-based inputs as a result of the lack of liquidity for CDS transactions, particularly the highly customized transactions the Company guarantees, and the significant uncertainty in the credit and mortgage markets. In addition, the fair value models are dependant upon assumptions and subjective judgments by management. Small changes in any significant assumptions may materially impact the fair value

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results. If market conditions remain volatile, it is likely to cause future valuations to differ significantly from the fair value estimates recorded in these consolidated financial statements.

The Company presents derivative revenues in the consolidated statements of operations as premiums written when installments are received, as premiums earned over the installment period, with changes in fair value recorded as net unrealized gains (losses) on derivatives. Derivative contracts are recorded on a gross basis in the accompanying consolidated balance sheets for both gross and ceded transactions.

**(m) VIEs**

From time to time, the Company guarantees payment obligations of counterparties, including VIEs that may enter into CDS with third parties. The Company provides financial guarantees covering certain obligations incurred by these entities at market rates and consolidates those VIEs when they are determined to be the primary beneficiaries. The Company does not hold any equity positions or debt in these VIEs. The financial guarantees of CDS contracts are generally for structured transactions backed by pools of assets of specified types.

**(n) Foreign Currency Translation**

Functional currencies are generally the currencies of the local operating environment. At December 31, 2007 the only subsidiaries within the consolidated group with a functional currency other than euros are CIFG Services and CIFG NA, whose functional currency is the U.S. dollar. The consolidated financial statements include translation adjustments for the conversion of the CIFG Services and CIFG NA balance sheets from U.S. dollars to euros at exchange rates in effect at the consolidated balance sheets dates, with the consolidated statements of operations accounts translated using daily exchange rates averaged on a year-to-date basis. The related translation adjustments are included as a component of OCI in accordance with SFAS No. 52, *Foreign Currency Translation* (FAS 52).

Foreign currency transaction gains and losses arising from the revaluation of assets (except for AFS investments) and liabilities denominated in nonfunctional currencies are reflected in net income.

**(o) Incentive Stock Plans**

Certain employees of CIFG Services and CIFG Europe participate in incentive stock plans of CIFG Holding that provide for equity-based compensation, including stock options and restricted stock awards. Both stock options and restricted stock are granted for a fixed number of shares with an exercise price equal to the fair value of the shares at the grant date. The Company accounts for these incentive stock plans in accordance with the fair-value method prescribed by SFAS No. 123, *Accounting for Stock-Based Compensation* (FAS 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure* (FAS 148). As prescribed under FAS 123, the compensation expense for options granted to employees is based on the minimum value of the option at the grant date, which is determined using an option pricing model.

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The Company adopted FAS 123R *Share-Based Payments* on January 1, 2006. FAS 123R requires the Company to expense the fair value of employee stock options and other forms of stock-based compensation. In addition, SFAS 123(R) classifies share-based payment awards as liability awards, which are remeasured at fair value at each balance sheets date, or equity awards, which are measured on the grant date and not subsequently remeasured. The Company has classified the 2007 and 2006 awards as liability awards; the awards from 2005 and prior are classified as equity awards.

For liability awards, the Company currently remeasures these awards at each consolidated balance sheets date. In addition, SFAS 123(R) requires the use of a forfeiture estimate and a volatility assumption for estimating the stock option's value. The Company uses historical employee termination information to estimate the forfeiture rate, and an average industry volatility factor is applied to current stock-based awards to determine the stock option's value.

Incentive grants awarded subsequent to January 1, 2006 are accounted for by using the fair value based method that will include an expected volatility assumption. The Company used a zero volatility assumption (minimum value method) when pricing incentive awards granted before 2006 because those awards are grand-fathered under the pronouncement. Compensation expense is recognized in earnings ratably over the requisite service period in which the options vest. In accordance with FAS 123 and FAS 123R, the compensation expense related to the stock option and restricted stock plans have been "pushed down" to the subsidiaries which employ the beneficiaries of the plan.

**(p) *Other Long-Term Compensation***

Certain employees of CIFG Services and CIFG Europe participate in the Performance Unit Plan (PUP Plan). The PUP Plan provides for long-term incentive awards to employees, and the amount payable is adjusted upward or downward depending on the cumulative three-year or five-year pretax income of the CIFG Group as compared to a baseline target. At the end of the three-year or five-year performance period, the sum of the income before income taxes is divided by the target amount and multiplied by an interest factor, resulting in a final unit value, which is subject to a cap and a floor, as defined in the PUP Plan. Vesting of PUPs is over a three-year or two-year period following the grant date. Cash payments are made at the end of each three-year or five-year measurement period. The first payout occurred during the second quarter of 2007 and occurs annually thereafter, if necessary. The compensation expense relating to this plan is recognized in earnings ratably over the vesting period.

The PUP Plan compensation expense incurred is reflected in the financial statements of the respective subsidiary that employs the beneficiaries.

**(q) *Legal Reserve***

The legal reserve is established by noninsurance entities for regulatory purposes in France. CIFG Guaranty was required to establish the legal reserve by taking 5% net income determined using French generally accepted accounting principles and reclassifying that amount from retained earnings into the legal reserve in 2006 and prior. The legal reserve cannot be used for shareholder

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distributions until it is equal to 10% of capital. As of December 31, 2006, the Company had not met the 10% threshold and was therefore ineligible to make a distribution to shareholders. Under U.S. GAAP the legal reserve is treated as appropriated retained earnings. Effective October 1, 2007, the Company redomiciled in Bermuda; accordingly, the legal reserve was released as of that date since it is no longer subject to regulations by French authorities.

#### (r) *Recent Accounting Developments*

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (FAS 155), which amends FAS 133, and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. FAS 155 permits an election for hybrid instruments that contain an embedded derivative that otherwise would require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of operations and comprehensive income. The fair value election may be applied on an instrument-by-instrument basis. FAS 155 also eliminates a restriction on qualifying special-purpose entities from holding passive derivative instruments. The Company adopted FAS 155 on January 1, 2007, and it had no effect on the Company's accompanying consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*, and interpretation of SFAS No. 109, *Accounting for Income Taxes* (FAS 109) (FIN 48). FIN 48 requires that the Company determine whether a tax position is more likely than not to be sustained under examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. If a tax position does not meet the more-likely-than-not threshold, the benefit is not recognized in the accompanying consolidated financial statements. If the Company determines that a position meets the recognition threshold, the position is measured to determine the amount of the benefit that may be recognized in the accompanying consolidated financial statements based on criteria set forth in the pronouncement. FIN 48 also provides guidance on derecognition, classification of interest and penalties, accounting in interim periods, and disclosure. For nonpublic entities, FIN 48 is applicable for fiscal years beginning after December 15, 2007. The Company is in the process of evaluating the impact of FIN 48 on its accompanying consolidated financial statements.

The FASB issued SFAS No. 157, *Fair Value Measurement* (FAS 157) in September 2006. This pronouncement defines fair value, establishes a framework for measuring fair value, and enhances the footnote disclosures pertaining to fair value. Fair values are evaluated using a hierarchy (Levels 1, 2, and 3), which is based on the type of inputs used for the valuation. The input levels range from quotable market prices to unobservable inputs such as an entity's own internal data. The disclosure requirements vary amongst the fair value hierarchy levels. FAS 157 is applicable to financial statements issued for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years. The Company is in the process of evaluating the impact of FAS 157 on its accompanying consolidated financial statements.

In February 2007 the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB No. 115* (FAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value. The objective

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of this pronouncement is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. FAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. FAS 159 is applicable for fiscal years beginning after November 15, 2007. At this time the Company does not contemplate changing the measurement of any financial instruments not already measured at fair value.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling interests in Consolidated Financial Statements, an amendment of ARB No. 51* (FAS 160). FAS 160 requires reporting entities to present a noncontrolling minority interest as equity, rather than as a liability or mezzanine equity, and provides guidance on the accounting for transactions between an entity and noncontrolling interests. FAS 160 is effective for fiscal years beginning on or after December 15, 2008, and earlier adoption is prohibited. The Company is in the process of evaluating the impact of FAS 160 on its consolidated financial statements.

In April 2007, the FASB issued FASB Staff Position (FSP) FIN 39-1, *Amendment of FASB Interpretation No. 39*. FSP FIN 39-1 permits a reporting entity that is a party to a master netting agreement to offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments that have been offset under the same master netting agreement. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007 and is required to be applied retrospectively for all financial statements presented unless it is impracticable to do so. The Company is in the process of evaluating the impact of FSP FIN 39-1 on its consolidated financial statements.

In May 2008, the FASB issued SFAS 163. This pronouncement clarifies the accounting treatment for financial guaranty contracts and is effective for fiscal years beginning after December 15, 2008 and for interim periods with in that fiscal year. This guidance changes current industry practices for premium and claim recognition.

Under the statement, premium revenue will be based on applying a fixed percentage of the premium to the amount of the outstanding exposure at each reporting date (a level yield approach). The term of the financial guaranty contract would be the contractual term; however, prepayment assumptions can be used to determine the expected term of the financial guaranty contract if certain conditions exist. Prepayment assumptions can be used if a homogenous pool of assets underlying the insured obligation are subject to prepayments, and those prepayments are both probable and can be reasonably estimated. An unearned premium reserve and premiums receivable will be established at contract inception for financial guarantees with installment premiums, the recognition of that liability and asset, respectively, would reflect prepayment assumptions, if the criteria noted above are met.

Under the statement, a claim liability on a financial guaranty insurance contract would be recognized when the financial guarantor expects that a claim loss will exceed the deferred premium revenue (liability) for that contract based on expected cash flows. The discount rate used to measure the claim liability would be based on the risk-free market rate and updated each quarter. Claim recognition

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under this proposed guidance would result in the release of the active credit reserve and preclude the Company from establishing an active credit reserve in the future. In addition, the Company will be required to provide disclosures for financial guarantees that are being monitored for credit deterioration.

As a result of FAS 163, the current accounting model used by the financial guaranty industry will change significantly. Altogether, the Company is in the process of evaluating the impact of FAS 163 on its consolidated financial statements, it anticipates that the initial impact of applying this guidance will be material to the Company's consolidated financial statements. Until the implementation of FAS 163, the Company intends to continue to apply its existing accounting policies.

**(3) Losses and Loss Adjustment Expenses Reserves**

The Company's reserve for losses and loss adjustment expenses consists of active credit reserves and case basis reserves. There were no case basis reserves recorded during 2006 and prior. Activity in the losses and loss adjustment expenses reserves, gross of reinsurance, is summarized as follows:

	<b>December 31</b>	
	<b>2007</b>	<b>2006</b>
Active credit reserves:		
Balance, beginning of year	€ 5,938	3,412
Incurred losses and loss adjustment expenses	36,188	2,275
Foreign exchange	1,383	251
Balance, end of year	<u>43,509</u>	<u>5,938</u>
Case basis reserves:		
Balance, beginning of year		—
Incurred losses and loss adjustment expenses	88,388	—
Less paid losses	(5,874)	—
Foreign exchange	(201)	—
Balance end of year	<u>82,313</u>	<u>—</u>
Total gross losses and loss adjustment expenses reserves	<u>€ 125,822</u>	<u>5,938</u>

The active credit reserve approximated €43.5 (\$63.9) million as of December 31, 2007, which is an estimate of probable losses that are not specific to an insured obligation, but represents credit deterioration on guaranteed issues that are not presently or imminently in default. As a result of the severe market conditions, management believed that active credit reserve required a provision for probable losses that have yet to emerge on RMBS exposures and other mortgage-related exposures. Therefore, a one-time adjustment of approximately €9.5 (\$43.4) million was established in addition to the usual provision established based on a percentage of earned premium; this one-time adjustment is included in the total active credit reserve noted above. This adjustment to the active credit reserve is based upon expected losses for transactions types within the insured portfolio that have experienced downward migrations in their

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credit ratings. During 2007, the Company recorded case basis reserves for the first time in its history. The case basis reserves were predominately due to the unprecedented stress conditions in the mortgage and credit markets, and were recorded for financial guarantees of RMBS, where the underlying collateral is home equity lines of credit (HELOC) and second-lien mortgages (2nd lien). The aggregate amount of case basis reserves recorded for the HELOC and 2nd lien financial guarantees are approximately €2.3 (\$121.0) million, net of salvage and subrogation recoveries of approximately €0.5 (\$30.1) million. The case basis reserves incurred exceeded the active credit reserve as of December 31, 2007, rather than depleting the entire active credit reserve, the Company recorded the case basis reserves incurred as a direct charge of approximately €4.2 (\$138.5) million to the accompanying consolidated statements of operations.

Management believes that the Company's reserves are adequate to cover the ultimate net cost of claims. However, because the reserves are based on management's judgment and estimates, there can be no assurance that the ultimate liability will not exceed such estimates. The internal case basis reserve models are dependant upon assumptions and subjective judgments by management. Small changes in any significant assumptions such as, but not limited to, ratings, default rates, projections of delinquencies, prepayment speeds, and recoveries may materially impact the Company's loss reserve expectations, particularly, since there is significant uncertainty in the credit and mortgage markets, which have led to unprecedented economic conditions. Further deterioration in the RMBS, multisector CDOs, or other obligations the Company guarantees could lead to the establishment of additional case basis reserves in the future.

Losses and loss adjustment expenses reserves as of December 31, 2007 do not reflect estimates of loss mitigation efforts; it is not possible to predict at this time whether these efforts will be successful, nor how much benefit might be derived if these efforts are successful.

Loss and loss adjustment expenses in the accompanying consolidated statements of operations are presented net of ceded amounts of €42 (\$62), €21 (\$31), and €28 (\$41) thousand for the years ended December 31, 2007, 2006, and 2005, respectively.

#### **(4) Net Insurance in Force**

The Company's financial guaranty policies issued by CIFG NA and CIFG Europe guarantee the scheduled payments of principal and interest on municipal and structured obligations. The net exposure retained on any risk is subject to formalized underwriting guidelines.

As of December 31, 2007, guarantees in force had a range of legal maturities of approximately 0.2 – 87.9 years. However, the expected life of these transactions may vary substantially from the legal final maturities and are influenced by actual performance, market conditions, and business objectives of the issuers. The expected maturities of these policies are between 0.1 – 43.8 years, which are diversified among 2,050 outstanding policies.

The weighted average expected life of the guaranteed portfolio based on gross par is 9.1 years.

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The distribution of gross and net par inforce by bond type is presented in the following table:

	2007		2006	
	Gross	Net	Gross	Net
Global public finance and infrastructure:				
State general obligation and appropriation	€ 4,595,051	4,595,051	4,265,353	4,265,353
City and County GO	3,602,606	3,592,922	3,026,376	3,014,969
Sovereign/sub sovereign	2,201,462	1,896,981	1,970,463	1,659,893
Utility systems	1,279,532	1,279,532	1,017,724	1,017,724
Toll roads	1,250,543	1,250,543	889,333	889,333
HealthCare	1,224,854	1,224,854	1,134,546	1,134,546
State tax backed	1,223,524	1,223,524	1,269,409	1,269,409
Airports	1,209,031	1,209,031	1,229,201	1,229,201
Higher education	1,127,621	1,127,621	996,170	996,170
Investor owned utilities	820,591	820,591	804,582	804,582
Project finance	668,138	625,451	704,904	664,578
Special revenue	623,746	623,746	437,906	437,906
Transportation	618,892	618,892	617,429	617,429
Public power	605,470	605,470	562,290	562,290
Municipal housing	508,692	508,692	569,595	569,595
Local tax backed	345,123	345,123	294,918	294,918
Total	<u>21,904,876</u>	<u>21,548,024</u>	<u>19,790,199</u>	<u>19,427,896</u>
Global structured finance:				
CDO leveraged loans	16,086,005	15,806,060	12,549,266	12,269,320
Multi-Sector CDO	7,363,935	6,942,020	7,509,455	7,033,356
CDO investment grade synthetics	6,180,784	6,129,785	6,001,014	6,001,014
CDO – other	5,127,647	5,127,647	3,782,337	3,782,337
Home equity	2,154,160	2,154,160	2,475,466	2,475,466
Student loans	1,676,196	1,610,917	1,295,667	1,295,667
Mortgage backed	1,400,888	1,400,888	1,847,120	1,847,120
Other consumer	950,000	950,000	350,000	350,000
Commercial mortgage backed	923,937	882,777	627,060	585,900
Commercial asset backed	699,784	699,784	613,356	613,356
Leases assets	491,304	464,804	643,318	612,278
Other structured finance	448,722	448,722	244,736	244,736
Transportation	100,000	100,000	100,000	100,000
Credit cards	68,679	68,679	76,844	76,844
Auto loans	36,895	36,895	77,144	77,144
Total	<u>43,708,936</u>	<u>42,823,138</u>	<u>38,192,783</u>	<u>37,364,538</u>
Grand total	<u>€ 65,613,812</u>	<u>64,371,162</u>	<u>57,982,982</u>	<u>56,792,434</u>

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The Company attempts to limit its exposure to losses when writing financial guarantees through a formal underwriting and credit approval process and by monitoring its portfolio of insured transactions. Additionally, the Company attempts to mitigate credit risk by underwriting investment grade transactions. As of December 31, 2007, 98.4% of guaranteed transactions were rated investment grade by at least two rating agencies and 1.6% were rated below investment grade.

Included in the table above is direct net par exposure related to securitization transactions supported by subprime mortgage assets. Subprime exposure is identified by a low credit rating (or FICO score), S&P and Moody's industry types or Bloomberg classifications. No case reserves in this sector have been incurred to date.

In addition, for direct RMBS transactions where the underlying collateral is HELOC and 2nd liens, the net par exposure is approximately €34.7 (\$768.3) million and €47.1 (\$510.4) million, respectively. HELOC and 2nd lien par exposure has approximately 47.3% with underlying ratings at investment grade by at least two rating agencies and 52.7% rated below investment grade. In the fourth quarter of 2007, the Company observed deterioration in the performance of several of its HELOC and 2nd lien transactions and established €80.3 (\$118.1) million in net case basis reserves as of December 31, 2007. Approximately €5.5 (\$8.1) million in gross claims were paid for this sector during 2007 (note 3 – Losses and Loss Adjustment Expenses Reserves).

In addition, the Company has indirect exposure to subprime mortgage assets as a result of guarantees of senior tranches of multisector CDOs that include varying proportions of subprime mortgage assets in their collateral pools. (note 5 – Credit Derivatives).

Gross par written includes €0 and €190 (\$279.4) million of assumed financial guaranty reinsurance for the years ended December 31, 2007 and 2006, respectively.

Gross par outstanding includes €2.3 (\$3.4) and €3.0 (\$4.4) billion of assumed financial guaranty reinsurance business at December 31, 2007 and 2006, respectively.

As of December 31, 2007, gross and net par outstanding includes financial guaranty contracts treated as derivatives under FAS 133, €40.2 (\$59.1) and €39.2 (\$57.6) billion, respectively.

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The distribution of gross and net par in force by geographical location is presented in the following table:

	2007			2006		
	Gross	Net	Percentage of net	Gross	Net	Percentage of net
United States:						
New York	€ 2,757,485	2,747,800	4.3%	€ 2,944,826	2,933,419	5.2%
Florida	1,397,994	1,397,994	2.2	1,170,304	1,170,304	2.1
Illinois	1,359,015	1,359,015	2.1	1,365,992	1,365,992	2.4
California	1,118,683	1,118,683	1.7	801,965	801,965	1.4
Pennsylvania	978,737	978,737	1.5	776,456	776,456	1.4
Puerto Rico	969,035	969,035	1.5	1,041,101	1,041,101	1.8
New Jersey	908,506	908,506	1.4	950,588	950,588	1.7
Louisiana	822,580	822,580	1.3	731,521	731,521	1.3
Texas	802,099	802,099	1.2	669,607	669,607	1.2
Colorado	402,984	402,984	0.6	393,491	393,491	0.7
Other states	5,079,952	5,079,952	7.9	4,352,875	4,352,875	7.7
United States diversified*	25,012,307	24,498,615	38.1	22,875,701	22,368,562	39.4
Total United States	41,609,377	41,086,000	63.8	38,074,427	37,555,881	66.3
Non-United States:						
Great Britain	2,562,529	2,562,529	4.0	2,838,610	2,838,610	5.0
Italy	1,935,221	1,630,740	2.5	1,800,364	1,489,793	2.6
France	1,220,144	1,178,985	1.8	959,086	917,926	1.6
Spain	505,376	505,376	0.8	40,693	40,693	0.1
Germany	439,573	439,573	0.7	418,651	418,651	0.7
Australia	366,887	366,887	0.6	250,656	250,656	0.4
Portugal	358,000	358,000	0.6	258,237	258,237	0.5
Canada	310,220	267,533	0.4	314,920	274,595	0.5
Netherlands	300,000	300,000	0.5	—	—	—
Greece	250,000	250,000	0.4	250,000	250,000	0.4
Turkey	203,997	203,997	0.3	228,250	228,250	0.4
Other country specific	567,469	567,469	0.9	573,762	573,762	1.0
Europe diversified**	7,098,901	6,918,928	10.7	4,860,520	4,680,548	8.2
Total non-United States	16,118,317	15,550,017	24.2	12,793,749	12,221,721	21.4
Global	7,886,118	7,735,145	12.0	7,114,806	7,014,832	12.3
Grand total	€ 65,613,812	64,371,162	100.0%	€ 57,982,982	56,792,434	100.0%

\* Includes financial guarantees with obligations in multiple states

\*\* Includes financial guarantees with obligations in multiple countries

#### (5) Credit Derivatives

Certain financial guaranty contracts meet the definition of a derivative under FAS 133 and do not qualify for the scope exception. These contracts are viewed as an extension of the Company's financial guaranty business. All of these direct contracts provide credit protection to investors who have entered into credit derivative transactions with Mogador Trust and New Generation Funding Trusts.

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As of December 31, 2007 and 2006, the distribution of par exposure by form of credit enhancement is set forth in the following table on a gross (direct and assumed) basis and net of reinsurance:

	2007		2006	
	Gross	Net	Gross	Net
Financial guarantees	€ 25,459,050	25,144,204	23,408,929	23,085,944
Credit derivatives	40,154,762	39,226,958	34,574,053	33,706,490
Total	€ 65,613,812	64,371,162	57,982,982	56,792,434

The insured credit derivative portfolio includes senior tranches of CDOs. The table below presents par exposure for CDOs by type as of December 31, 2007 and 2006:

	Net par outstanding	
	2007	2006
Cash Flow CDOs	€ 25,647,321	21,385,312
Synthetic CDOs	8,358,195	6,612,884
Total	€ 34,005,516	27,998,196

Cash flow CDOs are debt instruments secured (collateralized) by a pool of other securities, typically bonds, loans and other assets. Synthetic CDOs are a form of CDO that invests in CDS or other noncash assets and replicate certain payment features of a cash security.

The table below presents par exposure for CDOs by product type as of December 31, 2007 and 2006:

	Net par outstanding	
	2007	2006
By product type:		
Collateralized loan obligations/leveraged loans	€ 15,806,061	12,068,608
Asset backed securities CDO – high grade	1,269,201	1,126,032
Asset backed securities CDO – mezzanine	5,672,819	5,904,671
Subtotal	22,748,081	19,099,311
CDO investment grade synthetics	6,129,785	5,325,776
Commercial real estate CDO	2,981,459	1,795,888
Trust preferred securities/subordinated debt CDO	1,509,553	945,929
Municipal CDO	438,543	490,680
CDO squared	198,095	340,612
Subtotal	11,257,435	8,898,885
Total	€ 34,005,516	27,998,196

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As of December 31, 2007 the Company's estimate of the derivative liability for credit derivatives is approximately €1.3 (\$1.9) billion. The Company estimates as of December 31, 2007 that the derivative liability includes approximately €284.0 (\$418.0) million of credit impairments that are probable of future loss payments, no claims have been paid to date, and loss payments are not anticipated as being required until sometime during 2010.

The table below presents the derivative liability by transaction type as of December 31, 2007:

Type:	<b>Derivative liability</b>	<b>Percentage</b>
Collateralized loan obligations/collateralized bond obligations	€ 47,832	3.7%
Synthetic CDO	27,673	2.1
Wrap of wraps	10,814	0.8
Asset-backed securities CDO	1,021,993	78.8
Commercial mortgage backed securities	7,524	0.6
Commercial real estate CDO	108,475	8.4
Other direct asset-backed securities/RMBS	8,211	0.7
Student loans	24,674	1.9
Direct U.S. subprime RMBS	39,469	3.0
Grand total	€ 1,296,665	100.0%

The fair value methodologies will vary by product type; however, the assumptions used and market-based inputs are similar. The fair value models consider the amount of subordination in the transaction before the Company's attachment point, third-party collateral classifications, credit ratings and credit spread indices, estimates of expected losses, yield curves, dealer quotes, remaining average life of the CDS contract, correlation assumptions, and an assumption of the change in the level of risk premium that would be captured by the Company today as compared to the inception of the contract. To validate the results from the mark-to-model, Management performed stress testing and reviewed external data points.

The fair value methodology used for multisector CDOs predominately utilizes among other things, third-party external credit ratings on each piece of underlying collateral to derive an estimate of fair value for the related insured exposure. Losses for the underlying collateral pool are generated using a Monte Carlo simulation, default probabilities derived from historical rating agency data, and utilizing severity and recovery rate assumptions. For other types of credit derivatives, a premium-based approach is used to estimate changes in fair value. This approach estimates the impact that a change in credit spread may have on the premium underwritten by CIFG from inception of the transaction to the balance sheet date.

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The valuation represents management's best estimate of fair value as of the balance sheet date. However, the valuation results from these models could differ materially from amounts that might actually be realized in the market. There may be volatility in the market-based inputs as a result of the lack of liquidity for CDS transactions, particularly the highly customized transactions the Company guarantees, and also due to the significant stress in the credit and mortgage markets. In addition, the fair value models are dependent upon assumptions and subjective judgments by management. Small changes in any significant assumptions may materially impact the fair value results. If market conditions remain volatile, it is likely to cause future valuations to differ significantly from the fair value estimates recorded in these consolidated financial statements.

#### **(6) Related-Party Transactions**

##### *Capital Contributions*

In September 2007, Natixis contributed \$100.0 (€68.0) million to CIFG Holding.

On December 20, 2007, BFBP and CNCE invested \$1.3 billion in equity capital in CIFG Holding and its subsidiaries, and became the primary shareholders.

CIFG Holding contributed \$1.29 billion (€877.2 million) of the equity capital to CIFG Guaranty, which in turn contributed \$20.0 (€13.6) million to CIFG Services, for ultimate contribution to CIFG NA. The amounts were contributed to CIFG NA outside of the capital maintenance agreements discussed below.

On October 31, 2007, the Bermuda Registrar of Companies approved the conversion of CIFG Guaranty's share capital from euros to U.S. dollars. The share capital was converted at an exchange rate of 1.4222, which was the exchange rate in effect as of September 30, 2007.

The functional currency adopted for Bermuda statutory reporting is the U.S. dollar; as a result, the 2007 CIFG Guaranty statutory financial statements have been reported in that currency. For U.S. GAAP a change in functional currency will be recognized as of January 1, 2008, as the criteria to change the functional currency of CIFG Guaranty was met at the end of 2007 with the infusion of the equity capital in U.S. dollars. Beginning in the first quarter of 2008, the Company will report its consolidated U.S. GAAP financial statements in U.S. dollars. The opening balance sheet as of January 1, 2008, will be converted from euros to U.S. dollars at the end of period rate as of December 31, 2007, and those amounts will become the accounting basis for the balance sheet. The currency translation adjustments, in other comprehensive income, will remain in stockholder's equity, unless the subsidiaries attributable to those adjustments are sold or liquidated. Upon sale or liquidation, the amount attributable the subsidiary would be transferred from other comprehensive income and would be realized as a gain or loss on sale or liquidation.

##### *Capital Maintenance Agreements*

CIFG Guaranty has entered into separate capital maintenance agreements with CIFG NA and CIFG Europe. These separate agreements require CIFG Guaranty to contribute capital to CIFG NA and CIFG Europe if, at any time, the separate company capital of CIFG NA and CIFG Europe falls below \$80.0 and €20.0 million, respectively. As of December 31, 2007, the capital maintenance agreement between CIFG

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NA and CIFG Guaranty was triggered, because CIFG NA's statutory surplus was \$66.0 (€44.9) million, approximately \$14.0 (€9.5) million below the \$80.0 million threshold. In March 2008, CIFG Guaranty contributed \$50.0 (€34.0) million to CIFG Services, which in turn contributed those funds to CIFG NA to cover the \$14.0 (€20.5) million short-fall as of the end of 2007.

CIFG EU did not incur any insurance-related losses that would have activated this agreement as the losses of CIFG EU are limited to €20 million under the excess of loss reinsurance agreement between CIFG EU and CIFG Guaranty (see description of this agreement within this related-party note). Additional capital contributions to CIFG Services made after December 31, 2007 under the capital maintenance agreement are discussed in note 19. CIFG NA and CIFG EU may require further capital contributions under the capital maintenance agreements in 2008.

#### ***Long-term Debt***

In December 2007, the Company received \$100 (€68.0) million from its parent and sole shareholder, CIFG Holding and in exchange, the Company issued a subordinated note ("surplus note") to CIFG Holding. Under the terms of the surplus note, which matures on December 10, 2024, the Company is required to remit interest payments to CIFG Holding at six month intervals until such time as the loan has been paid in full either at the time of maturity or before. A fixed interest rate phase during the term of the loan exists for a period of 2 years, December 10, 2007 to December 10, 2009 during which an interest charge of 8% is charged on the outstanding loan balance. At the end of the fixed interest rate phase, a floating interest rate of LIBOR plus 4% per annum will be applied to the outstanding loan balance. The agreement also defines the terms under which singular or multiple early repayments may be made. The terms permit early repayment under the following conditions: (i) prior approval received by the BMA as well as confirmation that any early repayment would not have a material adverse affect on its rating; (ii) irrevocable written notice provided ten days in advance; (iii) date of repayment to coincide with interest payment or other mutually agreed upon date; and (iv) the repayment is for a minimum of \$5.0 (€3.4) million. The agreement further defines the condition under which the Company may defer interest payments. At any interest payment date, should the payment of the interest results or could result in a regulatory or rating agency action, all or a portion of the interest payments may be deferred for one or several interest periods over a maximum of seven years. A deferral must be justified by probative means such as a letter from a regulator, rating agency or reputable law firm advising that the payment is not permitted or would have an adverse affect on the Company. This deferral is applicable for the period for which an adverse affect would incur or no longer prohibited. Deferred interest payments are due in part or in full on the next interest payment date.

The Company has received the approval of the Bermuda Monetary Authority ("BMA") for the treatment of the surplus note as part of its capitalization. The approval has been granted for the period that the subordinated notes is in force and effect.

#### ***Service Agreement***

CIFG Services has entered into an agreement with Natixis Capital Markets (NCM) whereby NCM provides certain advisory, consulting, and infrastructure services to the Company. Expenses incurred under this agreement were €490 (\$720), €548 (\$806), and €37 (\$937) thousand for the years ended 2007, 2006,

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and 2005, respectively. As of December 31, 2007 and 2006 amounts due to NCM under this agreement were €122 (\$179) and €137 (\$201) thousand, respectively.

#### ***Facultative Reinsurance Agreements***

CIFG Guaranty has entered into a Master Facultative Reinsurance Agreement (Agreement) with CIFG NA. Under the terms of this Agreement, CIFG Guaranty has the option to reinsure up to 90% of CIFG NA's insured risks. CIFG Guaranty pays a ceding commission on premiums ceded under the terms of this Agreement. Premiums ceded by CIFG NA and assumed by CIFG Guaranty under this facultative reinsurance agreement were €49.9 (\$73.4), €64.0 (\$95.6), and €70.9 (\$104.3) million for 2007, 2006, and 2005, respectively. These balances are eliminated in consolidation.

As of December 31, 2007 and 2006, CIFG Guaranty pledged to CIFG NA U.S. dollar denominated investments with a fair value of \$754.7 (€13.1) and \$273.0 (€85.6) million, respectively, to support its reinsurance obligations to CIFG NA in accordance with the facultative reinsurance agreement and New York state insurance regulatory requirements. The assets pledged are maintained in a secured trust on behalf of CIFG NA, for its sole use and benefit in accordance with New York State insurance regulation 11NYCRR 126.

CIFG Guaranty has entered into a facultative reinsurance agreement with CIFG Europe. Under the terms of this Agreement, CIFG Guaranty has the option to reinsure up to 100% of CIFG Europe's insured risks. CIFG Guaranty pays a ceding commission on premiums ceded under the terms of this Agreement. CIFG Guaranty retains the right to reject any risk offered by CIFG Europe. Premiums ceded by CIFG Europe and assumed by CIFG Guaranty under this facultative reinsurance agreement were €3.5 (\$5.1), €3.0 (\$4.4), and €2.7 (\$4.0) million for 2007, 2006, and 2005, respectively. These balances are eliminated in consolidation.

#### ***Excess of Loss Reinsurance Agreement***

CIFG Guaranty entered into an excess of loss reinsurance agreement with CIFG Europe. This agreement covers losses of CIFG Europe in excess of €20.0 million. Premiums ceded by CIFG Europe and assumed by CIFG Guaranty during 2007, 2006, and 2005 were €3.3 (\$5.0), €3.5 (\$5.1), and €1.7 (\$2.5) million, respectively. These balances are eliminated in consolidation.

#### ***Financial Guarantees***

In the normal course of business, CIFG Europe and CIFG NA enter into certain financial guaranty contracts with affiliates on terms that management believes are on an arms-length basis. The affiliates involved are CNCE, IXIS Corporate & Investment Bank (IXIS CIB), Credit Foncier (Foncier), and Natixis. Gross premiums written on policies closed with CNCE during 2007 and 2006 were €320 (\$471) and €245 (\$360) thousand, respectively. Gross premiums written on policies closed with IXIS CIB during 2007, 2006, and 2005 were approximately €8.8 (\$12.9), €9.0 (\$13.2), and €1.9 (\$2.8) million, respectively. Gross premiums written on policies closed with Foncier during 2007, 2006, and 2005 were approximately €1.7 (\$2.5), €9.6 (\$14.1), and €9.8 (\$14.4) million, respectively. Gross premiums written with Natixis in 2007 were approximately €1.1 (\$1.6) million.

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**(7) Deferred Acquisition Costs**

Acquisition costs and ceding commissions that vary with and directly related to the production of business are deferred and amortized in proportion to the related premium revenue to be recognized in future periods. Deferred acquisition costs net of ceding commissions and related amortization are as follows:

	<b>December 31</b>	
	<b>2007</b>	<b>2006</b>
Net DAC balance, beginning of period	€ 47,313	41,235
Current year costs:		
Net deferred acquisition costs	14,254	19,046
Amortization during the period	(9,292)	(9,641)
Foreign exchange	(3,807)	(3,327)
Net DAC balance, end of period	€ <u>48,468</u>	<u>47,313</u>

During 2007 and 2006, the Company conducted its annual DAC study, which encompassed both a review of deferrable costs and the amortization pattern of DAC and deferred ceding commissions. In addition, the Company also enhanced its policy systems in 2006, allowing it to update its exposure database with more current information received from external sources. These modifications resulted in a change in accounting estimate for DAC in 2006. This change of approximately €3.2 (\$4.7) million is included in the “amortization of deferred acquisition costs” as a charge to the accompanying consolidated statements of operations.

**(8) Investments**

The Company’s investment objective is to optimize after-tax returns while emphasizing the preservation of capital through the maintenance of high-quality investments with adequate liquidity. The weighted average credit quality of the fixed income portfolio by S&P rating, which excludes short-term investments, comprised AAA (85.9%), AA (13.2%), A (0.6%), BBB (0.1%), and below investment grade (0.2%). There are no bonds owned that have been guaranteed by CIFG entities.

Short-term investments consist of United States government obligations (97.1%) and money market instruments (2.9%). Approximately 53.0% of these money market instruments are invested in Société d’Investissement à Capital (SICAV), money market funds registered in France. These funds invest principally in French Treasury bonds, other negotiable debt securities, short-term bonds, and commercial paper. These funds hold investments that have an average life of three months or less.

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The following tables set forth the amortized cost and fair value of the fixed income securities and short-term investments included in the consolidated investment portfolio of the Company:

	<b>December 31, 2007</b>			
	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Non-U.S.*	€ 311,782	698	(13,550)	298,930
United States government obligations	285,198	1,346	(17,520)	269,024
State and municipal obligations	15,868	50	(1,227)	14,691
Corporate obligations	73,554	77	(7,774)	65,857
Short-term investments	1,002,757	77	(19,639)	983,195
Total	€ 1,689,159	2,248	(59,710)	1,631,697

\* Principally euro-denominated debt securities issued by European governments and European municipalities.

	<b>December 31, 2006</b>			
	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Fair value</b>
Non-U.S.*	€ 321,313	98	(13,024)	308,387
United States government obligations	259,897	243	(8,055)	252,085
State and municipal obligations	18,302	—	(1,021)	17,281
Corporate obligations	34,681	46	(1,041)	33,686
Short-term investments	83,007	—	—	83,007
Total	€ 717,200	387	(23,141)	694,446

\* Principally euro-denominated debt securities issued by European governments and European municipalities.

Fixed income investments carried at fair value of approximately €6.6 (\$9.7) and €6.9 (\$10.2) million as of December 31, 2007 and 2006, respectively, were on deposit with various regulatory authorities to comply with insurance laws.

The Company maintains a substantial portion of its cash and investments in two financial institutions that the Company considers high quality; one of the financial institutions is an affiliate.

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The following table sets forth the distribution by contractual maturity of the fixed income and short-term investments at amortized cost and fair value at December 31, 2007 and 2006. Actual maturity may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

	December 31, 2007		December 31, 2006	
	Amortized cost	Fair value	Amortized cost	Fair value
Due in one year or less	€ 1,040,015	1,017,214	118,748	118,082
Due after one year through five years	402,182	382,562	376,313	363,778
Due after five years through 10 years	184,839	177,039	183,719	175,261
After 10 years	62,123	54,882	38,420	37,325
<b>Total</b>	<b>€ 1,689,159</b>	<b>1,631,697</b>	<b>717,200</b>	<b>694,446</b>

The following table presents the consolidated investment portfolio's gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2007 and 2006:

	December 31, 2007					
	Less than 12 months		Greater than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Non-U.S. Obligations*	€ 695,185	(15,824)	291,125	(13,453)	986,310	(29,277)
United States government obligations	80,825	(6,005)	82,619	(11,561)	163,444	(17,566)
Corporate obligations	46,940	(4,695)	16,992	(3,092)	63,932	(7,787)
State and municipal obligations	170,364	(3,861)	8,471	(1,219)	178,835	(5,080)
<b>Total</b>	<b>€ 993,314</b>	<b>(30,385)</b>	<b>399,207</b>	<b>(29,325)</b>	<b>1,392,521</b>	<b>(59,710)</b>

	December 31, 2006					
	Less than 12 months		Greater than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Non-U.S. obligations*	€ 33,290	(1,268)	274,831	(11,756)	308,121	(13,024)
United States government obligations	140,256	(4,128)	108,915	(3,927)	249,171	(8,055)
Corporate obligations	30,100	(1,041)	—	—	30,100	(1,041)
State and municipal obligations	1,023	(8)	20,130	(1,013)	21,153	(1,021)
<b>Total</b>	<b>€ 204,669</b>	<b>(6,445)</b>	<b>403,876</b>	<b>(16,696)</b>	<b>608,545</b>	<b>(23,141)</b>

\* Principally euro-denominated debt securities issued by European governments and European municipalities.

As of December 31, 2007 and 2006, there were 56 and 57 securities, respectively, that were in an unrealized loss position for a continuous 12-month period or longer. The unrealized losses in the

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Company's investment portfolio were caused by increases in interest rates and changes in foreign currency rates. The Company evaluated the credit rating of these securities and noted no significant deterioration.

The Company has evaluated whether the unrealized losses in its investment portfolio were other than temporary considering the circumstances that gave rise to the unrealized losses, along with the Company's ability and intent to hold their securities to maturity or until such time as to recover an amount equal to the amortized cost. Based on its evaluation, the Company realized an other-than-temporary impairment of €8.8 (\$12.9) million related to two structured finance securities. The Company determined that the unrealized losses on the remaining securities were temporary in nature because the impairment analysis did not indicate that the amortized cost of the impaired assets would not be recovered. Additionally, the Company has both the intent and the ability to hold these securities until their fair value recovers to an amount at least equal to the amortized cost or maturity. On a quarterly basis, the Company will reevaluate the unrealized losses in its investment portfolio and determine whether an impairment loss should be realized in current net income.

Net investment income comprised the following:

	<b>December 31</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Fixed income securities	€ 25,094	20,126	13,701
Short-term investments	2,314	4,135	1,297
Investment income	27,408	24,261	14,998
Investment expenses	(267)	(211)	(175)
Net investment income	€ 27,141	24,050	14,823

Net realized (losses) gains comprised the following:

	<b>December 31</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Gross gains:			
Fixed income securities	€ 5	—	—
Short-term investments	587	261	2,494
	592	261	2,494
Gross losses:			
Fixed income securities	(8,848)	(4)	(3)
Short-term investments	—	—	—
	(8,848)	(4)	(3)
Net realized (losses) gains	€ (8,256)	257	2,491

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Net realized (losses) gains from fixed income security sales are primarily generated as a result of the Company's ongoing monitoring of the investment portfolio and are predominantly related to the €8.8 (\$12.9) million impairment loss recognized on two structured finance securities. The remaining realized losses of approximately €4 (\$138.2) thousand are attributable to two non-U.S. obligations and one U.S. agency security. Gross gains recognized on short-term investments resulted from periodic sales of the SICAV investments.

Proceeds from the sale of long-term fixed income securities were €37.1 (\$54.4) million, €42 (\$62) thousand, and €6.9 (\$10.1) million during the years ended December 31, 2007, 2006, and 2005, respectively.

**(9) Reinsurance**

CIFG Guaranty utilizes reinsurance to effectively deploy its capital and to manage its risk profile. It remains liable to its ceding company subsidiaries to the extent that any reinsurance company fails to meet its obligations. As of December 31, 2007, the reinsurers that CIFG Guaranty cedes business to were rated at least A by S&P or Moody's. CIFG Guaranty regularly monitors the financial condition of its reinsurers and believes there is no unrecoverable ceded reinsurance.

As of December 31, 2007, the credit rating for the ceding companies that CIFG NA assumes business from are rated at least A by S&P or Moody's.

The effect of reinsurance on premiums written and earned is as follows:

	<b>December 31</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Direct premium written	€ 81,953	116,890	85,122
Assumed premium written	1,833	2,276	7,916
Ceded premium written	(823)	(1,452)	(1,385)
Net premiums written	<u>82,963</u>	<u>117,714</u>	<u>91,653</u>
Change in direct deferred premium revenue	(12,755)	(64,528)	(53,125)
Change in assumed deferred premium revenue	2,314	2,668	(1,756)
Change in ceded deferred premium revenue	(213)	620	1,059
Change in deferred premium revenue, net	<u>(10,654)</u>	<u>(61,240)</u>	<u>(53,822)</u>
Net premiums earned	<u>€ 72,309</u>	<u>56,474</u>	<u>37,831</u>

In 2007, 2006, and 2005 there were no refunded earned amounts.

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#### (10) Income Taxes

On October 1, 2007, CIFG Guaranty changed its place of domicile from France to Bermuda. Prior to October 1, 2007 CIFG Guaranty was subject to taxation in France. In November 2007, CIFG Guaranty filed its final tax return in France for the period beginning January 1, 2007 through September 30, 2007. The final tax payment made in France for CIFG Guaranty was €631 (\$928) thousand. As of December 31, 2007, CIFG Guaranty recorded €5.2 (\$7.6) million for taxes recoverable on the overpayment of taxes during the year, which was collected in June 2008. CIFG EU continues to be a taxpayer in France.

Effective 2006, CIFG Guaranty and CIFG Europe were no longer part of the CNCE French tax consolidation. These companies calculated their income taxes on a "stand-alone" basis and filed separate company tax returns in France. Prior to 2006, a tax sharing agreement with CNCE stipulated that tax losses of any individual CIFG subsidiary that are utilized by CNCE and the tax benefits derived therefrom are not reimbursed to the subsidiary. The agreement also provided that, in the event that a CIFG Group company leaves the CNCE tax consolidation group, it may be reimbursed for the benefit of any tax losses previously utilized by the CNCE Group.

CIFG Services and CIFG NA file a consolidated U.S. federal income tax return.

The consolidated current provision for income taxes was approximately €2.3 (\$3.4) million, €15.8 (\$23.2) million, and €(409) (\$601) thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the consolidated financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year that the differences are expected to reverse. The effect on tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

As of September 30, 2007, net deferred tax liabilities attributable to CIFG Guaranty were released because the Company was no longer subject to taxation in France and is not subject to taxation in Bermuda. Accordingly, as of December 31, 2007, deferred taxes are calculated for only CIFG EU, CIFG Services and CIFG NA. The Company has established valuation allowances of €54.0 (\$79.4) and €8.1 (\$12.0) million for 2007 and 2006, respectively. The valuation allowances relate to deferred tax assets arising from NOLs generated during prior years, net derivative liabilities, loss reserves and other deferred tax assets generated by certain subsidiaries that have not established enough of an earnings history to recognize such assets. In accordance with U.S. GAAP, a valuation allowance has been recorded to reduce the recognition of net deferred tax assets of these subsidiaries. A net deferred tax liability of €2.7 (\$3.9) million has been recorded in the accompanying consolidated balance sheets.

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The tax effects of temporary differences that give rise to deferred tax assets and liabilities as of December 31, 2007 and 2006 are presented below:

	<b>2007</b>	<b>2006</b>
Deferred tax assets:		
Net operating loss carryforward	€ 13,265	1,859
Loss reserve	2,378	2,757
Compensation	5,807	2,801
Deferred ceding commission revenue, net	5,491	4,771
Derivative liability	39,780	—
Unrealized losses on fixed income investments	370	6,350
Other	336	503
Less valuation allowance	(53,991)	(8,050)
Total deferred tax assets	13,436	10,991
Deferred tax liabilities:		
Loss reserves	6,502	—
Accretion of discount	304	129
Deferred acquisition costs	7,094	23,453
Deferred premium revenue	1,219	586
Other	969	1,163
Total deferred tax liabilities	16,088	25,331
Net deferred tax liabilities	€ 2,652	14,340

In 2006, the CIFG Services U.S. consolidated tax group used approximately €6.5 (\$9.6) million in net operating loss carryforwards generated in prior years to offset taxable income in the current year. In 2007, these entities were in a net operating loss position. As of December 31, 2007 the Company's U.S. subsidiaries had NOL carryforwards available to offset future taxable income of €37.9 (\$55.7) million, of which €2.6 (\$3.8) million will expire in 2023, €2.4 (\$3.5) million will expire in 2024, and €33.0 (\$48.5) million will expire in 2025.

The Company's total tax provision differs from the amount that would be obtained by applying the tax rate to pretax book income, mainly due to the impact of disallowed expenses, the establishment of the valuation allowance for certain deferred tax assets, and the effect of NOLs not being reimbursed by CNCE under the tax sharing agreement.

**(11) Dividend Restrictions**

In September 2007, CIFG Guaranty paid a stock dividend to CIFG Holding of approximately €48.5 (\$71.3) million. At the same time CIFG Holding made a capital contribution to CIFG Guaranty of €48.5 (\$71.3) million for additional shares of common stock. As of December 31, 2006 and 2005, CIFG Guaranty did not declare or pay any dividends.

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Effective May 8, 2008, CIFG Guaranty executed an undertaking with the BMA whereby CIFG Guaranty agreed to consult with the BMA before (i) declaring and/or paying any dividend, (ii) distributing any statutory capital (other than the payment of expenses incurred in the ordinary course and interest payments on the Surplus Note), (iii) entering into any intercompany loans or guarantees, (iv) entering into any contracts of insurance or reinsurance, and (v) entering into any restructuring or other related transactions to which CIFG Guaranty is a party.

Under New York State insurance law, CIFG NA may pay a dividend only from earned surplus subject to the maintenance of a minimum capital requirement. Any dividends declared or paid may not exceed, together with all other dividends declared or distributed by CIFG NA during the preceding twelve months, the lesser of (i) 10% of its policyholders' surplus shown on its last filed statement, or (ii) one hundred percent of adjusted net investment income (as defined under New York insurance law), for such 12-month period without prior approval of the Superintendent of the NYSID.

CIFG NA has not declared or paid any dividends since its inception, given that it has no earned surplus and is therefore ineligible to pay a dividend.

#### **(12) Insurance Regulatory Restrictions**

The Company is subject to insurance regulatory requirements of the jurisdictions in which it is domiciled or licensed to conduct business. CIFG Europe is subject to compliance with the French insurance regulations (*Code des Assurances*). Prior to September 30, 2007, CIFG Guaranty, as a French reinsurance company, was subject to compliance with various aspects of the French insurance regulations. As of October 1, 2007, CIFG Guaranty is subject to regulation by the BMA under the Act. CIFG NA is subject to the insurance regulatory requirements of the state of New York and the other jurisdictions in which it is licensed to conduct business.

The French insurance regulators, BMA and the NYSID and certain other U.S. insurance regulatory authorities have various requirements relating to the maintenance of certain minimum statutory capital and surplus.

CIFG Guaranty prepares statutory financial statements in accordance with the Act and is required to maintain a total of \$258 (€75.4) million in statutory capital and surplus. Statutory capital and surplus of CIFG Guaranty was \$260 (€77.1) million at December 31, 2007. Statutory net loss for CIFG Guaranty was \$(1.9) (€1.3) billion for 2007. In addition, CIFG Guaranty is required to meet certain minimum solvency and liquidity ratios amounts calculated as of December 31, 2007 were \$258.0 (€75.4) million and \$1.4 billion (€94.8) million, respectively. CIFG Guaranty met the minimum solvency and liquidity thresholds as of December 31, 2007.

CIFG NA prepares statutory financial statements in conformity with accounting practices prescribed or permitted by the NYSID. Prescribed statutory accounting principles include state laws, regulations, and general administrative rules, as well as a variety of the National Association of Insurance Commissioners (NAIC) requirements. The NAIC Statements of Statutory Accounting Principles (SSAP's) have been adopted as a component of prescribed or permitted practices by the NYSID. Additionally, the NYSID has

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adopted certain prescribed practices that vary from those found in SSAP's. These differences have no impact on the net income and the determination of statutory surplus of CIFG NA.

CIFG NA is required to maintain a total of \$65.0 (€44.2) million in statutory capital and surplus. Statutory capital and surplus of CIFG NA was \$66.0 (€44.9) and \$103.8 (€70.6) million at December 31, 2007 and 2006, respectively. Statutory net loss for CIFG NA was \$(51.6) (€35.1) million, \$(2.1) (€1.4) million, and \$(2.5) (€1.7) million for 2007, 2006, and 2005, respectively. Statutory capital and surplus differs from stockholder's equity determined under U.S. GAAP principally due to statutory accounting rules that treat loss reserves, premiums earned, policy acquisition costs, ceding commissions, investments, and deferred income taxes differently.

CIFG Europe has a minimum capital requirement of €800 thousand (\$1.2) million and had statutory net equity of €7.6 (\$40.6) and €8.5 (\$56.6) million at December 31, 2007 and 2006, respectively. Statutory net income for CIFG Europe was €10.8 (\$15.9), €3.4 (\$5.0), and €2.9 (\$4.3) million at December 31, 2007, 2006, and 2005, respectively. CIFG Europe is also subject to compliance with the French insurance regulation's solvency requirement. French insurance regulation mandates insurance companies maintain a minimum net equity (net of nonadmissible assets) at or above the solvency requirement calculated annually. Net equity, net of nonadmissible assets, was €20.3 (\$30.0), and €31.5 (\$46.3) million; the solvency requirement calculated for CIFG Europe was €5.5 (\$8.1) and €6.8 (\$10.0) million at December 31, 2007 and 2006, respectively.

#### (13) Fair Value of Financial Instruments

The following fair value amounts were determined by using independent market information when available, and appropriate valuation methodologies when market quotes were not available. In cases where specific market quotes were unavailable, interpreting market data and estimating market values required considerable judgment by management. Accordingly, the estimates presented are not necessarily 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.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

**Fixed Income Securities** – The fair values of fixed income securities are based primarily on quoted market prices.

**Short-Term Investments and Cash** – The carrying amount of these items approximate fair value.

**Investment Income Due and Accrued** – The fair value of investment income due and accrued is assumed to approximate carrying value due to the length of time to maturity.

**Deferred Premium Revenue** – The fair value of the deferred premium revenue is based upon the estimated cost to reinsure those exposures at market rates, which amount consists of deferred premium revenue, less an estimated ceding commission thereon.

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***Losses and Loss Adjustment Expenses Reserve*** – The carrying amount of losses and loss adjustment expenses reserves approximates fair value as the case basis loss reserves are established for an amount that is sufficient to cover the present value of the anticipated defaulted debt service payments over the expected period of default and estimated expenses associated with settling the claims, less estimated recoveries under salvage or subrogation rights. Losses and loss adjustment expenses reserves are discounted at a rate that is commensurate with the performance of the Company's investment portfolio, which as of December 31, 2007 was 2.996%. The active credit reserve and loss adjustment expenses reserves are not discounted.

***Installment Premiums*** – Certain other financial guaranty contracts have been written on an installment premium basis, where the future premiums to be received by the Company are determined based on the outstanding exposure at the time the premiums are due. The fair value of the Company's future premium revenue under its installment contracts is measured using the present value of estimated future installment premiums, less an estimated ceding commission thereon, discounted at a rate that is consistent with the Company's investment portfolio. The estimate of the amounts and timing of the future installment premiums is based on contractual premium rates, debt service schedules, and expected run-off scenarios. This measure is used as an estimate of the cost to reinsure the CIFG Group's exposures under these policies.

***Long-term debt*** – The fair value of the surplus note has been estimated using external data sources based on the terms and conditions of the note.

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The carrying amount and estimated fair value of financial instruments are presented below:

	<u>December 31, 2007</u>		<u>December 31, 2006</u>	
	<u>Carrying amount</u>	<u>Estimated fair value</u>	<u>Carrying amount</u>	<u>Estimated fair value</u>
	(In euros)			
Financial assets:				
Fixed income securities	€ 648,502	648,502	611,439	611,439
Short-term investments	983,195	983,195	83,007	83,007
Cash	11,789	11,789	8,279	8,279
Investment income due and accrued	12,810	12,810	12,316	12,316
Derivative assets	17	17	749	749
Financial liabilities:				
Deferred premium revenue:				
Gross	€ 190,641	133,449	198,384	138,439
Net of reinsurance	187,716	131,401	195,235	136,665
Losses and loss adjustment expenses reserves	125,822	125,822	5,938	5,938
Derivative liabilities	1,296,665	1,296,665	469	469
Long-term debt	68,000	68,000	—	—
Off-balance-sheet instruments:				
Installment premium receivable:				
Gross	€ —	201,231	—	167,210
Net of reinsurance	—	197,894	—	164,434

**(14) Variable Interest Entities**

The Company's consolidated financial statements include the consolidation of Mogador Limited and New Generation Funding Trusts (VIEs). For each of the years ended December 31, 2007, 2006, and 2005, gross direct premium written by these VIEs were €45.7 (\$67.2), €40.9 (\$60.1), and €30.2 (\$44.4) million, respectively, and at December 31, 2007 and 2006 gross par outstanding includes €39.4 (\$57.9) and €39.0 (\$57.4) billion respectively, underwritten through these VIEs.

**(15) Retirement Plan**

CIFG Europe and its employees in France contribute to compulsory pension systems: Régime Général de la Sécurité Sociale and UCREPPSA. CIFG Europe has no additional liability due to pension commitments towards its employees, except for the retirement indemnity, payable at retirement date. The estimated liability for this retirement indemnity was €126 (\$185) and €101 (\$149) thousand at December 31, 2007 and 2006, respectively, and is accrued on the accompanying consolidated balance sheets as of those dates.

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Employees of CIFG Services participate in a defined contribution savings plan under Section 401(k) of the Internal Revenue Code. This plan covers substantially all employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis up to \$15.5 (€10.5) thousand for those employees who are under 50. Employees who are 50 and older are allowed to make a “catch up” contribution of an additional \$5.0 (€3.0) thousand for 2007 under the current Internal Revenue Service (IRS) code. CIFG Services may make discretionary contributions to the plan on behalf of employees. CIFG Services contributed approximately \$498 (€339), (\$538) €66, and (\$315) €14 thousand to the plan on behalf of employees for the years ended December 31, 2007, 2006, and 2005, respectively.

#### **(16) Long-Term Incentive Plans**

As of December 31, 2007, CIFG Holding had five incentive stock option plans, consisting of CIFG Holding’s calendar 2003 Stock Option Plan (the 2003 Plan), the calendar 2003 Stock Option Program (the 2003 Program), the calendar 2004 Stock Option Plan, the calendar 2005 Stock Option Plan, and the calendar 2006 Stock Option Plan. Each year, the Compensation Committee of the CIFG Holding Board approves and adopts Stock Option Plans for the related year. Collectively, these stock option plans (the Stock Option Plans) enable employees of the Company’s subsidiaries to acquire nonvoting Class P shares of common stock to be issued by CIFG Holding, allowing them to benefit from appreciation in the value of the capital stock of CIFG Holding. The Class P shares carry all of the rights of a regular share of CIFG Holding’s stock, except that Class P shares are nonvoting. In the event of a public listing of CIFG Holding’s shares, the investment certificates will be recombined with the voting rights and the preferred shares (P shares) will be converted to ordinary shares and thus will have the same rights as ordinary shares.

Options granted under these plans have vesting schedules that provide for pro rata annual vesting over periods ranging between zero and five years from the date of grant. The Stock Option Plans contain provisions for accelerated vesting under certain circumstances including a change of control as defined in the plan documents. In 2006, a change in control was deemed to have occurred under the calendar 2003 Stock Option Plan and calendar 2003 Stock Option Program as a result of the Natixis transaction. The effect of this change in control resulted in the accelerated vesting of 2.8 million stock options under the affected Stock Option Plans. CIFG Holding is reviewing whether the investment by CNCE and BFBP and the sale of shares by Natixis to CNCE and BFBP constitute a change in control under the Stock Option Plans and whether the options granted under the Stock Option Plans would thereby accelerate. Should it be determined that the shares should be accelerated under the Stock Option Plan, the effect of this change in control may result in the accelerated vesting of 640 thousand stock options from the 2004, 2005, and 2006 plans. The Company estimates that the financial impact may be at the maximum €35 (\$51.5) thousand, if a legal determination is made that a change in control occurred under the stock option plan documents.

The exercise prices of options granted under these Stock Option Plans were established using 100% of the fair market value of CIFG Holding’s capital stock on the date granted. Fair market value was determined by applying a valuation methodology that was approved by the board of directors. The valuation methodology considers the book value of CIFG Holding plus the value of the in-force portfolio of guaranteed risks, including the cost of capital and other relevant components. Using this valuation methodology, the exercise price for the options granted in 2007, 2006, and 2005 was established at €1.18, €1.065, and €1.047, respectively. Absent a change of control, options are exercisable as specified at the

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time of grant, are generally not exercisable prior to the fourth anniversary of the date of grant, and expire 10 years from the date of grant (or shorter if specified or following termination of employment).

Alternatively, in the event of a transaction involving an acquisition by one or more third parties of at least ten percent (10%) of the Class P shares of CIFG Holding, the price of the shares in such transaction shall be deemed to be a reliable indicator of the fair market value of Class P shares and shall be in effect for a period of three (3) months following the effective date of the transaction.

CIFG Holding's Compensation Committee authorized 202,751, 71,365, and 416,138 shares of its capital stock for allocation under the calendar 2006, 2005, and 2004 stock Option Plans, respectively. As required under French law, the Stock Option Plans contain an antidilution feature which protects the interests of the beneficiaries. As a result of the issuance of restricted stock during 2006 and 2005, additional options of 11,903 and 12,597 options were granted and the strike prices for the 2004 and 2003 plans were reset to €10.43 and €9.22, respectively pursuant to the antidilution provisions under these plans.

In 2007, two dilutive events occurred, the Natixis capital contribution of \$100 (€72.3) million to CIFG Holding and the distribution of the stock dividend to Natixis by CIFG Holding. As a result of the capital contribution and the issuance of shares, additional options of 49,710 were granted and the strike prices for the 2005, 2004, and 2003 plans were reset to €10.49, €10.27, and €9.08, respectively. In addition, as required under specific employment contracts, the 2003 Stock Option Program contains an antidilution feature that further protects the interests of the beneficiaries. As a result of the stock dividend in 2007, certain recipients of stock option grants from the 2003 Stock Option Program were granted additional options of 132,255 and the strike price was again reset to €8.58.

As of December 31, 2007, 2006, and 2005, the cumulative number of stock options forfeited was 361,829, 343,094, and 146,022, respectively.

For awards granted prior to December 31, 2005 the option valuation methodology reflects "minimum value," as defined by FAS 123 as it excludes volatility from estimating the option's value. Awards granted in 2006 and 2007 include a volatility assumption as prescribed by FAS 123R. Under the method of accounting adopted by the Company under the provisions of FAS 123 and FAS 123R, employee stock option compensation expense for the years ended December 31, 2007, 2006, and 2005 was €169 (\$249) thousand, €2.0 (\$2.9), and €1.5 (\$2.2) million, respectively. The unrecognized compensation cost related to nonvested stock options, as of December 31, 2007, would range from €199 (\$293) thousand to €0.0 depending on the determination of the change in control. In 2007, all of the stock option awards that are deemed liability awards are out of the money and therefore no additional expense would be recognized. The cost is expected to be recognized over a weighted average period of 2.0 years.

The Stock Option Plans contain a liquidity put option feature, providing beneficiaries with the option to receive cash equal to the difference between the strike price and fair market value of the stock at the time of exercise of the put feature. Prior to a public offering of the shares of CIFG Holding, this liquidity put option feature requires CIFG Holding to repurchase any Class P shares acquired upon exercise of the stock option, which are presented by employees after the requisite services have been completed and any other conditions necessary to earn the right to benefit from these instruments have been met. The price to be paid by CIFG Holding for these Class P shares upon the exercise of the liquidity put option by the employee

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shall be equal to the fair market value in effect at the time CIFG Holding receives notice from the employee. The fair market value will be calculated on a fully diluted basis using the valuation methodology. As of December 31, 2007, 3.0 million stock options were vested and exercisable; if all the stock options plan were accelerated, an additional 3.6 million shares would vest and be exercisable.

In 2007, 28 thousand shares were exercised and “put” to CIFG Holding. The aggregate intrinsic value for stock options exercised in 2007 was €1 (\$90) thousand. In addition to the 28 thousand shares that were exercised and “put” to CIFG Holding, there were also 68 thousand shares exercised and pending as of December 31, 2007. The sum of these shares or 96 thousand shares were recorded as treasury shares by CIFG Holding. Assuming all vested stock options were exercised and the liquidity put option was also exercised, the aggregate intrinsic value as of December 31, 2007, 2006, and 2005 would be €0.0, €6.0 (\$8.8), and €2.4 (\$3.5) million, respectively. The liquidity put option terminates upon a public listing of CIFG Holding.

In the event that beneficiaries elect to exercise their stock options and hold the Class P shares acquired, CIFG Holding has a right to repurchase these Class P shares at the value determined using the same valuation methodology approved by the Compensation Committee to set the exercise price at the time the options were granted.

To compute the compensation expense, the value for these options was estimated at the date of the grant using CIFG Holding’s option valuation methodology (minimum value under FAS 123).

The number of options granted and the assumptions used for valuing such option grants during the year are shown in the following table:

	<b>December 31</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Number of options granted	230,049	59,462	401,980
Exercise price	€ 11.18	10.65	10.47
Dividend yield	—	—	—
Expected Volatility	34.50%	27.91%	N/A
Risk-free interest rate	4.57%	3.81%	3.10%
Expected option term (in years)	6.00	6.00	6.00

Beginning in 2006, the fair value of each option award was estimated on the date of grant using the Black Scholes option pricing model. The dividend yield assumption is zero since CIFG Holding’s shares do not pay dividends. CIFG Holding applies an average industry volatility factor to current stock-based awards to determine the stock option’s value, due to limited historical company data. The risk-free interest rate assumption is based on the current yield available for a risk-free Euro bond with a remaining term equal to the remaining expected life. The expected option term was derived utilizing published industry data in accordance with the SAB No. 107, *Share-Based Payment*.

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A summary of the CIFG Holding's stock option plans as of December 31, 2007, 2006, and 2005, and changes during the year, are set forth in the following table:

	2007		2006		2005	
	Number of shares	Weighted average price per share	Number of shares	Weighted average price per share	Number of shares	Weighted average price per share
Options:						
Outstanding at the beginning of the year	3,250,133	€ 9.38	3,279,548	€ 9.37	3,010,992	€ 9.29
Granted	230,049	11.18	59,462	10.65	401,980	10.47
Antidilution adjustment	181,964	8.67	11,903	9.37	12,597	9.25
Exercised	28,489	9.22	—	—	—	—
Expired or canceled	18,735	10.45	100,780	9.73	146,021	9.27
Outstanding at the end of the year	3,614,922	9.02	3,250,133	9.38	3,279,548	9.40
Exercisable at the end of the year	2,976,790	—	2,830,123	—	—	—
Weighted average value per share of options granted during the year		—		2.17		1.79*

\* Minimum value as defined previously

The following table summarizes information about CIFG Holding's stock option plans as of December 31, 2007.

Range of exercise price	Number outstanding	Weighted average remaining contractual life in years	Weighted average exercise price of outstanding shares	Number exercisable	Shares vested as of last anniversary date of the grants	Weighted average price of exercisable shares
€8.58 – 11.18	3,614,922	6.55	€ 9.02	2,976,789	2,976,789	€ 8.67

**(a) Restricted Stock**

On September 13, 2007, December 20, 2006, and December 30, 2005, the CIFG Holding Compensation Committee authorized the grant of 243,301, 184,445, and 235,938 restricted shares, respectively, of its common stock to certain employees of subsidiaries of CIFG Holding, with a fair value of €1.18, €0.65, and €0.47 per share, respectively. These shares vest two years after the date of grant and must be held for an additional two years before they can be sold.

U.S. employees eligible for restricted stock have the option to either take 100% of their restricted stock award in restricted stock or take 50% in restricted stock and 50% in tax units. The tax units are intended to provide cash to help employees meet their tax obligations arising from the vesting of the restricted stock. These tax units vest two years after the date of grant, similar to the restricted stock,

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and the unit price is equal to the fair value of the restricted stock at the time of grant. The tax units are earned ratably over the vesting period, and liability accounting principles are applied.

As required under the plan provisions, the Restricted Stock Plans contain an antidilution feature that protects the interests of the beneficiaries. In 2007, two dilutive events occurred, Natixis capital contribution of \$100 (€72.3) million to CIFG Holding and the distribution of the stock dividend to Natixis by CIFG Holding. As a result of the capital contribution and the issuance of shares, additional units of 5,439 were granted. In addition, as required under specific employment contracts, the 2004 Restricted Stock Plan contains an antidilution feature that further protects the interests of the beneficiaries. As a result of the stock dividend in 2007, certain employees with grants from the 2004 Restricted Stock Plan were granted additional units of 2,680.

The Restricted Stock Plans include a liquidity put feature similar to that described above for the Stock Option Plan, allowing employees to put their shares to CIFG Holding and receive cash for the fair market value of the shares. There are certain restrictions on the liquidity put option feature.

	<b>December 31</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Restricted stock awarded	205,296	184,445	212,725
Weighted average fair value per share	€ 11.18	10.65	10.47
Gross restricted stock expense year to date	€ 1,850	995	—

Unrecognized compensation cost related to nonvested restricted stock as of December 31, 2007 is approximately €2.8 (\$4.12) million. The cost is expected to be recognized over a weighted average period of 1.3 years. It should be noted, since these plans are governed under French law, acceleration is not permitted even under a change in control.

#### **(b) Performance Unit Plan**

The Compensation Committee approved the CIFG Holding PUP Plan in April, 2004. During 2007, 2006, and 2005, the Company incurred compensation expense (Pup Plan) of (€127) (\$191) thousand, €862 thousand (\$1.3) million, and €60 thousand (\$1.3) million related to this plan, respectively. Awards under the PUP Plan are payable in cash.

#### **(17) Currency Swap**

Effective September 23, 2005 CIFG Guaranty entered into a currency swap with its parent CIFG Holding to economically hedge the impact of the revaluation of CIFG Guaranty's U.S. dollar denominated securities.

For the year ended December 31, 2006, CIFG Guaranty recognized €8.2 (\$12.1) million on the revaluation of the currency swap, which was recorded in earnings and offset by foreign currency revaluation (losses) gains on those U.S. dollar denominated AFS securities which are reflected in OCI.

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Effective January 1, 2007 the currency swap was terminated. As of December 31, 2007, the balance due to CIFG Holding under the currency swap agreement was approximately €566.8 (\$833.5) thousand. In July 2008, CIFG Guaranty paid the outstanding balance due to CIFG Holding.

#### **(18) Commitments**

In the normal course of operating its businesses, the Company may be involved in various legal proceedings.

In December 2007, CIFG NA and New Generation Funding Trust have been named in a lawsuit alleging that CIFG NA had agreed to provide credit protection on a multisector CDO obligation, although no financial guaranty insurance policy had been issued. The Company does not include this obligation among its portfolio of insured exposures. In addition, a second party has raised similar claims alleging that CIFG NA had agreed to provide credit protection on a multisector CDO obligation, although no formal litigation has been filed to date. In both cases, although the related multisector CDO obligations were considered to be in the highest rating category, the collateral in each of the underlying transactions has significantly deteriorated. Although the Company intends to vigorously defend itself, in the event that these disputes are decided adversely against CIFG NA, the Company will be required to take material case basis reserves with respect to the subject transactions, which will have a material adverse effect on the Company's financial condition.

A claim has been raised against CIFG Europe alleging that CIFG Europe had agreed to provide credit protection on an infrastructure obligation guaranteed by one of the Company's competitors. As with the other claims, CIFG Europe has not executed any binding documentation with respect to the subject transaction, nor has it issued a financial guaranty, and the exposure is not carried on the Company's consolidated financial statements. The Company intends to vigorously defend itself but there can be no certainty that the outcome will be favorable to the Company or that an adverse outcome will not be material.

CIFG Holding, its subsidiaries, and certain of its former officers have been named in a number of disputes with former employees. CIFG Holding does not expect the outcome of these disputes to have a material adverse affect on its financial condition, although the outcome is uncertain and no assurance can be given that the Company will not suffer a loss.

From time to time, the Company and its subsidiaries receive formal and informal inquiries from their regulators regarding a variety of subjects. CIFG NA has received a subpoena from the Attorney General of the state of Connecticut regarding the methodologies used by rating agencies for determining the credit rating of municipal debt. The Company is cooperating fully with its regulators and is in the process of satisfying all such requests. The Company may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future.

Subsidiaries of CIFG Guaranty lease office space in London, Paris, New York, California, and Bermuda. The operating leases in London and Paris have lease terminations in 2016 and 2015, respectively. The lease for the New York office space was renewed in December 2005 and expires in 2019. Both California leases were renewed in 2007 and have an expiration date of 2010. The Bermuda office was established in

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2007 and has a one year lease. In addition to base rental costs, the leases for office space provide for rent escalations resulting from increased assessments for real estate taxes, utilities, maintenance, and reductions for lease incentives. The leases in London and Paris also include charges for services provided by the landlord such as cleaning, insurance, telephone charges, etc.

Rent expense is recognized on a straight-line basis over the terms of the respective operating leases, net of lease incentives. Deferred rent obligations carried on the accompanying consolidated balance sheets for lease incentives at years ended December 31, 2007 and 2006 are approximately €59 thousand (\$1.4) million and €13 thousand (\$1.2) million, respectively. For the years ended December 31, 2007, 2006, and 2005 rent expense was €2.5 (\$3.7), €1.9 (\$2.8), and €1.4 (\$2.1) million, respectively.

Future minimum lease payments under the operating leases at December 31, 2007 are as follows

	<u>Future minimum rent payments</u>	<u>Future minimum service charges</u>	<u>Total future minimum lease payments</u>
year ending December 31:			
2008	€ 1,827	353	2,180
2009	1,754	353	2,107
2010	1,696	353	2,049
2011	1,734	353	2,087
2012	1,782	353	2,135
Thereafter	9,607	1,029	10,636

Pursuant to the lease agreement for the space occupied by CIFG Services, a standby letter of credit has been provided for approximately €79 (\$410) thousand. A certificate of deposit for a similar amount is held as collateral by the issuer of the letter of credit.

The Company has contracted an accounting services firm in Bermuda that performs certain general accounting and administrative functions. The monthly cost is \$16 thousand. The contract requires the Company to provide a 90 day notice of termination upon cancellation of service.

#### (19) Subsequent Events

The Company formally evaluates the adequacy of case reserves on a quarterly basis in connection with the quarterly statutory reporting process. As of March 31, 2008, the Company experienced adverse reserve development on the HELOC and 2nd lien case basis reserves carried as of December 31, 2007 due to further credit deterioration after year-end. During the first quarter of 2008, the Company had an increase in losses for the HELOC and 2nd lien of €17.2 (\$25.3) million. Claim payments made from January through June 2008 on these transactions are approximately €46.7 (\$68.7) million before reinsurance.

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The deterioration in the credit markets experienced subsequent to December 31, 2007, particularly in relation to the multisector CDOs, is expected to have a significant adverse impact on the derivative liability. At this point in time the Company has not yet quantified the impact of this deterioration on the fair value derivative liability.

In addition to the \$50.0 (€34.0) million capital contribution to CIFG NA in March 2008 (note 6) due to the additional case basis reserves recorded by CIFG NA as of March 31, 2008, the capital maintenance agreement was again triggered. On May 15, 2008, CIFG Guaranty contributed \$87.6 (€59.6) million to CIFG NA under the capital maintenance agreement.

As of March 31, 2008, CIFG NA was not in compliance with New York Insurance Department single issue risk limit requirements on nine municipal credits due to the decrease in Capital and Surplus during the first quarter from incurred losses.

As of March 31, 2008, CIFG NA met the aggregate risk limit as prescribed by the NYSID.

In 2008, CIFG Services implemented a cash-based long-term incentive plan that provides long-term incentive awards to employees payable over three years or earlier upon the occurrence of certain events.