ACA Financial Guaranty Corporation

Statutory-Basis Financial Statements
as of and for the Years Ended
December 31, 2008 and 2007
Supplemental Schedules as of
December 31, 2008, and
Independent Auditors' Report

ACA FINANCIAL GUARANTY CORPORATION

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
ACA Financial Guaranty Corporation:

We have audited the accompanying statutory-basis statements of admitted assets, liabilities and surplus of ACA Financial Guaranty Corporation (the "Company") as of December 31, 2008 and 2007, and the related statutory-basis statements of income and changes in surplus, and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of ACA Financial Guaranty Corporation as of December 31, 2008 and 2007, or the results of its operations or its cash flows for the years then ended.

However, in our opinion, the accompanying statutory-basis financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of ACA Financial Guaranty Corporation as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

As discussed in Note 1 and Note 16 to the financial statements, the Company has ceased writing new business and has restructured its obligations under various insured credit swap transactions. On August 8, 2008, the Company made a $209 million loss payment and issued newly created surplus notes with a total face amount of $1 billion.

Our 2008 audit was conducted for the purpose of forming an opinion on the basic 2008 statutory-basis financial statements taken as a whole. The supplemental schedule of investment risk interrogatories, the supplemental summary investment schedule, and the supplemental schedule of reinsurance interrogatories as of and for the year ended December 31, 2008 are presented for purposes of additional analysis and are not a required part of the basic 2008 statutory-basis financial statements. These schedules are the responsibility of the Company's management. Such schedules have been subjected to the auditing procedures applied in our audit of the basic 2008 statutory-basis financial statements. The effects on these schedules of the differences between the statutory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material. Accordingly, in our opinion, such schedules do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the information shown therein. However, in our opinion, such schedules are fairly stated in all material respects when considered in relation to the basic 2008 statutory-basis financial statements taken as a whole.

Deloitte & Touche LLP

April 28, 2009

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND SURPLUS
DECEMBER 31, 2008 AND 2007
(Dollars in thousands)

	2008	2007
ADMITTED ASSETS:		
Bonds—at NAIC carrying value	$ 368,799	$ 593,403
Cash and short-term investments	63,859	58,883
Other invested assets	1,090	19,349
Total cash and investments	433,748	671,635
Accrued investment income	3,221	6,098
Premiums receivable	-	15
Receivable from parent, subsidiaries and affiliates	-	9,914
Net deferred tax asset	3,821	388
Tax recoverable	-	7,075
Other assets	211	3,325
TOTAL ADMITTED ASSETS	$ 441,001	$ 698,450
LIABILITIES AND SURPLUS:		
Unearned premiums	$ 219,749	$ 263,013
Losses and loss adjustment expenses	20,973	7,936
Contingency reserve	74,448	185,659
Payable to parent, subsidiaries and affiliates	466	7,421
Payable for securities	20,680	-
Accrued expenses and other liabilities	3,398	6,044
Total liabilities	339,714	470,073
Common stock—1,000,000 shares authorized, issued and outstanding at December 31, 2008 and 2007; par value of $15 per share	15,000	15,000
Surplus note	-	10,000
Gross paid-in and contributed surplus	363,974	353,974
Unassigned deficit	(277,687)	(150,597)
Surplus as regards policyholders	101,287	228,377
TOTAL LIABILITIES AND SURPLUS	$ 441,001	$ 698,450

See notes to statutory-basis financial statements.

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY STATEMENTS OF INCOME AND CHANGES IN SURPLUS
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007
(Dollars in thousands)

	2008	2007
Premium earned	$ 26,098	$ 92,293
Losses and loss adjustment expenses	270,181	38,099
Underwriting expenses incurred	30,589	45,581
Total underwriting expenses	300,770	83,680
Net underwriting (loss) gain	(274,672)	8,613
Net investment income	22,416	30,934
Net realized capital losses, net of tax	(10,802)	(31,062)
Net investment gain (loss)	11,614	(128)
Other income	25,224	148
(Loss) income before federal income tax	(237,834)	8,633
Federal income tax	780	3,807
Net (loss) income	$ (238,614)	$ 4,826
Surplus as regards policyholders—beginning of year	$ 228,377	$ 273,644
Net (loss) income	(238,614)	4,826
Change in net unrealized capital gains (losses)	24,753	(3,950)
Paid in and contributed capital	10,000	-
Change in contingency reserve	111,211	(72,182)
Change in deferred income tax	54,490	22,211
Change in surplus note	(10,000)	-
Dividends to stockholders	-	(3,811)
Change in non-admitted assets	(78,930)	7,639
Change in surplus as regards policyholders	(127,090)	(45,267)
Surplus as regards policyholders—end of year	$ 101,287	$ 228,377

See notes to statutory-basis financial statements.

ACA FINANCIAL GUARANTY CORPORATION

STATUTORY STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007
(Dollars in thousands)

	2008	2007
CASH FLOWS FROM OPERATIONS:		
Premiums collected net of reinsurance	$ (16,930)	$ 111,770
Net investment income	27,143	31,727
Miscellaneous income	25,224	148
Benefits and loss related payments	(238,524)	(24,131)
Commissions, expenses paid and aggregate write-ins for deductions	(51,646)	(53,345)
Federal and foreign income taxes paid	6,296	(5,975)
Security deposit	-	(2,655)
Net cash (used in) provided by operations	(248,437)	57,539
CASH FLOWS FROM INVESTMENTS:		
Proceeds from investments sold or matured	240,886	89,348
Proceeds from other invested assets sold or matured	18,250	8,798
Net gain from short-term investments	-	74
Cost of investments acquired	(9,503)	(215,340)
Net cash provided by (used in) investments	249,633	(117,120)
CASH FLOWS FROM FINANCING AND MISCELLANEOUS SOURCES:		
Dividends to stockholders	-	(3,811)
Other applications	3,780	6,941
Net cash provided by financing and miscellaneous sources	3,780	3,130
Net increase (decrease) in cash and short-term investments	4,976	(56,451)
Cash and short-term investments—beginning of year	58,883	115,334
Cash and short-term investments—end of year	$ 63,859	$ 58,883
SUPPLEMENTAL SCHEDULE OF NON-CASH FINANCING:		
Capitalization of surplus notes into gross paid in and contributed surplus	$ 10,000	$ -

See notes to statutory-basis financial statements.

1. ORGANIZATION AND OWNERSHIP

ACA Financial Guaranty Corporation (the “Company” and “ACA FG”) is organized and domiciled in the State of Maryland and is a licensed, authorized and accredited insurance company in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. The Company is authorized to provide financial guaranty insurance on public finance and other debt obligations, as well as on certain obligations related to asset-backed and corporate financings. Since December 2007, the Company has not issued any new financial guaranty insurance policies and is currently operating as a run-off insurance company. The Company’s common stock is owned 76.6% by ACA Holding, L.L.C. (“ACAH”), a Delaware limited liability company, and 23.4% by KPR Ltd, (“KPR”), a company with limited liability organized under the laws of the Cayman Islands. KPR is a wholly-owned subsidiary of ACAH and ACAH is a wholly-owned subsidiary of Manifold Capital Corp. (“ACACH”), formerly ACA Capital Holdings, Inc.), a Delaware corporation.

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

On November 9, 2006, ACACH priced its initial public offering of 6,875,000 shares of newly issued common stock and 23,541 shares of existing common stock (“IPO”). ACACH realized gross proceeds of $13 per share on the newly issued common stock, or $89.4 million. On November 10, 2006, ACACH’s common stock commenced trading on the New York Stock Exchange and trades under the symbol “ACA”. In 2008, being unable to continue to satisfy the New York Stock Exchange’s listing requirements, ACACH was de-listed from the New York Stock Exchange but continues to trade on the over the counter market under the symbol “ACAH.PK”. In addition, ACACH deregistered its common stock pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended, effective as of April 15, 2008.

On November 9, 2007, Standard & Poor’s Ratings Services (“S&P”) placed its “A” financial strength rating of the Company on “Credit Watch with negative implications.” S&P based its rating action on its opinion that the ($1.7) billion unrealized mark to market loss recorded by ACACH on a GAAP basis for the three months ended September 30, 2007 would likely impair the Company’s ability to generate a satisfactory level of new business. Amongst other things, S&P also cited ACACH’s inability to access its credit facility under its revised terms as a relevant factor in its rating action.

The substantial unrealized mark-to-market loss was caused by the devaluation of mortgage securities, including sub-prime mortgages and securitizations comprised of sub-prime mortgages, which occurred in the credit markets in 2007. This market stress began in the first half of 2007 and continued to deepen throughout 2007 as many financial institutions recorded significant write-downs in connection with their exposure to mortgage related securities. Mortgage defaults levels in 2007 reached historically high levels. These defaults in 2007 coupled with market predictions of additional defaults negatively impacted mortgage related securitizations, resulting in realized losses in these securities and large declines in unrealized market valuations. The value of the insured credit swaps issued by insured affiliates of ACACH continued to experience declines during 2008, which resulted in additional unrealized valuation losses based on accounting principles generally accepted in the United States of America ("GAAP").

Based on these negative developments, on December 19, 2007, S&P downgraded the financial strength and financial enhancement ratings of the Company to "CCC" (Developing Outlook) from "A" (CreditWatch Negative). Under the terms of the Company's insured credit swap transactions, the Company's downgrade to a level below "A-" resulted in an obligation for the Company's insured affiliates to post collateral based on the fair value of the insured credit swaps. Under the terms of the swaps, a failure to post collateral would have represented an event of default under the insured credit swaps, or if collateral was not posted, a mandatory termination payment in an amount approximately equal to the collateral call. This termination payment would give rise to a claim of the counterparties under the related insurance policy. Based on the fair values of the Company's affiliates' insured credit swap transactions, ACACH did not have the ability to post such collateral or make such termination payments. The Company estimates that the fair value of all of its insured credit swaps amounted to ($1.7) billion, as of September 30, 2007.

In light of the insured affiliates' inability to post collateral or make these termination payments, and in order to avoid a regulatory proceeding, the Company and its affiliates entered into multiple forbearance agreements in which their counterparties agreed not to exercise remedies and ultimately a restructuring transaction (the "Restructuring Transaction") with its structured credit and other similarly situated counterparties. The Restructuring Transaction was consummated following a period of claim forbearance by the swap counterparties that began on December 19, 2007, culminating in a Restructuring Transaction completed on August 8, 2008, is discussed further in Note 16.

In summary, the Restructuring Transaction provided that the Company make an upfront loss settlement payment of $209 million to its swap counterparties and issue surplus notes ("Surplus Notes") with a total face amount of $1 billion for the counterparties' benefit. These actions were in full settlement of any and all claims of the swap counterparties under their insured credit swaps. By the terms of the transaction, all insurance policies on credit swap transactions were terminated. Also, by the terms of the transaction, 95% of the value of the Surplus Notes was issued to the counterparties, with the remaining 5% issued to ACACH. As part of the Restructuring Transaction, a $100 million medium term note obligation due March 2010, guaranteed by the Company, was also restructured and settled. Following the Restructuring Transaction, the Company's insured exposure is substantially comprised of public finance exposures. See Note 16 for further details on the Restructuring Transaction and a description of the Surplus Notes.

As provided for by the Restructuring Transaction, subsequent to the closing, the Company is required to conduct its ongoing operations on a run-off basis. As such, the Company will not write any new insurance policies unless it is approved by its board of directors and the Maryland Insurance Administration (the "MIA").

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

Also, following the completion of the Restructuring Transaction, S&P completed its review of the Company's financial strength rating and concluded that the rating was "B". At the Company's request, S&P has since withdrawn its financial strength rating and no longer rates the Company.

Prior to 2007, the Company did not admit its investment in ACA Service, L.L.C. as an asset for statutory-basis financial statement purposes. However as of December 31, 2007, the Company recorded an other-than-temporary impairment loss of $26 million when it believed the unrealized loss was other than temporary. Because the investment was non-admitted, the other than temporary impairment adjustment did not impact policyholders' surplus.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation—The financial statements for the Company are presented in accordance with National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures manual Statement of Statutory Accounting Principles ("SAP") which has been adopted as a component of prescribed or permitted practices by the MIA effective January 1, 2001. The differences between NAIC SAP and MIA SAP are not material to the Company. These practices differ in certain material respects from GAAP.

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

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

Investments—Investments are valued in accordance with the valuation procedures of the NAIC. Investment grade bonds are generally carried at amortized cost and the amortization of premium or discount is determined by applying the effective interest method. Non-investment grade bonds, as determined by the Securities Valuation Office ("SVO") division of the NAIC, are carried at the lower of cost or market.

Realized capital gains and losses on dispositions are computed by the specific identification method and are determined on the basis of amortized cost at the date of sale for bonds. Declines in fair values, which are determined to be other than temporary, are taken as realized losses. In 2008 and 2007, the Company recognized $12.1 million and $4.9 million in other than temporary impairments for investment in asset-backed securities. Additionally in 2007, the Company recognized a $26.0 million other than temporary impairment for ACA Service, L.L.C. No additional other than temporary recognized declines were recorded in 2008 or 2007.

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

As of December 31, 2007, other invested assets consisted principally of investments in United States Tax and Loss bonds in the amount of $18.3 million. These bonds were required to be purchased in connection with the federal tax benefit received by the Company in relation to its deduction of a portion of the contingency reserve. These bonds were redeemed in full in 2008. See Note 7 below.

An investment in a subsidiary is valued using the statutory equity method. The equity in net income of subsidiary is credited directly to the Company's surplus.

Premium Revenue Recognition—Typically, financial guaranty premium is received either on an upfront or installment basis. In general, premiums from insured public finance obligations are received on an upfront basis, while historically, the vast majority of the Company's installment premium was derived from the Company's insured asset-backed and corporate exposures, which was in the form of insured credit default swap transactions. All such credit default swap transactions were terminated as part of the Restructuring Transaction. Up-front premiums are earned in proportion to the expiration of risk. Unearned premiums represent that portion of premiums which is applicable to coverage of risk to be provided in the future on policies in force. Installment premiums are earned over each installment period, which is generally one year or less. As of December 31, 2008 and 2007, premium receivable of $0 and $0.2 million, respectively, was non-admitted. When an insured issue is retired or defeased prior to the end of the expected period of coverage, the remaining unearned premiums, less any amount credited to a refunding issue insured by the Company, are recognized as earned premium. The amounts earned from refundings were $11.5 million and $12.6 million in 2008 and 2007, respectively.

By the terms of the forbearance agreement described in Note 1 (the "Forbearance Agreement"), the Company did not collect premiums on its insured credit swap insurance contracts in force as of the date of the Forbearance Agreement. In connection with this provision of the Forbearance Agreement, in the fourth quarter of 2007, the Company reversed its accrual for premiums earned but not yet received under these insurance contracts. This reversal resulted in a reduction of premiums earned and policyholders' surplus (net of tax) in the amounts of $13.9 million and $9.0 million, respectively.

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

Losses and Loss Adjustment Expenses—A case-basis reserve for unpaid losses and loss adjustment expenses is recorded at the present value of the estimated loss when a guaranteed obligation defaults in payment. The estimated loss is net of anticipated recoveries under salvage and subrogation rights. Generally, case-basis reserves are present valued using the taxable

equivalent yield on a fully invested basis of the Company's investment portfolio. At December 31, 2008 and 2007, the weighted average discount factor used was 4.87% and 4.60%, respectively.

At December 31, 2008, discounted loss and loss adjustment expense reserves were $20.9 million, net of discount of $12.3 million, compared to $7.9 million, net of a $0.7 million discount, at December 31, 2007.

Management of the Company periodically evaluates its estimates for losses and loss-adjustment expenses and believes that reserves are adequate to cover the ultimate net cost of claims. (the reserves are necessarily based on estimates and there can be no assurance that the ultimate liability will not differ from such estimates). The Company will, on an ongoing basis, monitor these reserves and may periodically adjust such reserves based on the Company's actual loss experience, its future mix of business and anticipated economic conditions. See Note 4 for further description of the Company's loss reserves.

Surplus Notes—As part of the Restructuring Transaction, surplus notes of $1 billion were issued to former structured credit counterparties, and the existing shareholders. These notes have been recorded in the surplus notes section of the balance sheet with an offsetting $1 billion contra account since earnings are not attributable to the surplus notes until approved by the MIA. Upon the MIA's approval of payment, such payment will reduce the Company's unassigned surplus and contra account. The Company requested and received approval from the MIA to treat its recording of the surplus notes as a permitted accounting practice because such treatment deviates from the statutory accounting treatment of notes issued at a discount. Under SAP, the accretion of the discount is recorded in the Company's statement of income. The recording of the approval and payment represents the only deviation from the NAIC prescribed accounting practices and does not have a net impact on the Company's financial statements.

Contingency Reserve—A contingency reserve is established by a direct charge to surplus for the protection of all policyholders equal to the greater of 50% of financial guaranty premiums written for each category of insured obligation or designated percent of principal guaranteed for that category. These amounts are provided each quarter as either 1/60th or 1/80th of the total required for each category, less permitted reductions. The Company does not discount its contingency reserves.

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

Variances from GAAP—Accounting practices prescribed or permitted by insurance regulatory authorities differ in certain material respects from GAAP in that under GAAP:

- Up-front premiums on municipal business are recognized as earned in proportion to the amount of risk outstanding over the expected period of coverage rather than in proportion to the expiration of risk;
- Acquisition costs are charged to operations as the related premiums are earned rather than as incurred;
- A non-specific loss reserve, which is included in the determination of net income, is calculated representing an estimate of the potential losses in the Company's insured portfolio rather than establishing a contingency reserve;

- Financial guaranty losses are recognized at the time the company determines that payment default is probable and the amount of loss is reasonably estimated. Under SAP, financial guaranty losses are recognized as of the date of payment default;
- Certain assets designated under SAP as "non-admitted" (such as furniture and equipment, leasehold improvements, deferred income taxes in excess of certain limitations, prepaid expenses and any other assets deemed non-admittable) are restored to surplus and are generally reflected as assets. For statutory-basis purposes non-admitted assets are excluded from the balance sheet by direct charges to surplus;
- Investments in bonds are classified at the time of purchase as "held to maturity" and reported at amortized cost, "trading" and reported at fair value with unrealized gains and losses included in earnings, or "available for sale" and reported at fair value with unrealized gains and losses reported in a separate component of surplus. For statutory-basis purposes, bonds are generally carried at amortized cost. Bonds that do not qualify to be carried at amortized cost are carried at a value required by the NAIC with the difference between these values recorded directly to surplus without adjustment for federal income taxes;
- Subsidiaries are either consolidated or the equity in earnings of subsidiaries is credited to the income statement. Under SAP, investments in subsidiaries are included as common stock and valued using the SAP statutory equity method;
- Certain financial guarantees do not qualify for the financial guarantee scope exception under Financial Accounting Standard Board's Statement of Financial Accounting Standards ("SFAS") 133, *Accounting for Derivatives and Hedging Activities,* and are recorded at fair value rather than accrual accounting under SAP;
- The reserves for unpaid losses and unearned premiums are presented gross of reinsurance and corresponding assets for reinsurance recoverable on unpaid losses and prepaid reinsurance premiums, respectively, are recorded;
- Surplus notes are presented as liabilities. Under SAP, surplus notes are included in capital and surplus; and
- Investments in United States Tax and Loss bonds are treated as payments of federal income tax. Under SAP, they are treated as admitted assets.

Although the net effect of the adjustments required to convert the accompanying statutory-basis financial statements to be in accordance with GAAP is not reasonably determinable, it is presumed that such adjustments would have a material impact on net income and surplus as regards policyholders for the years ended December 31, 2008 and 2007, respectively.

New Accounting Pronouncements

In November 2008, the NAIC issued SSAP No. 98, "Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, an amendment of SSAP No. 43 – Loan Backed and Structured Securities. This statement establishes statutory accounting principles for impairment analysis and subsequent valuation of loan-backed and structured securities. This statement is effective for quarterly and annual reporting periods beginning on or after September 30, 2009. The Company is currently evaluating the impact of this pronouncement.

In December 2007, the NAIC issued SSAP No. 97, Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88. The Company adopted the Statement as of December 31, 2007. In accordance with this Statement, which does not differ significantly in the accounting treatment from the previously issued SSAP 88 as it relates to the Company, the

Company is required to non-admit the carrying value of the non-insurance subsidiaries that do not receive a GAAP audit opinion.

In December 2007, the NAIC issued SSAP No. 96, Settlement Requirements for Intercompany Transactions, an Amendment to SSAP No. 25 – Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties. The Company adopted the Statement as of December 31, 2007. In accordance with this Statement, amounts owed to us from affiliated or other related parties over ninety days from the due date shall be non-admitted. All such balances were settled within ninety days and the Company has no non-admitted balances resulting from this requirement.

3. INVESTMENTS

Bonds, with an amortized cost of $4.8 million and $4.8 million were on deposit with various state regulatory authorities as required by insurance regulations at December 31, 2008 and 2007, respectively. Net investment income consisted of the following (dollars in thousands) for the years ended December 31, 2008 and 2007:

	2008	2007
Income from fixed-maturity securities	$ 21,866	$ 25,873
Income from cash equivalents and short-term investments	1,915	6,483
Investment expenses	(1,365)	(1,422)
Investment income	$ 22,416	$ 30,934

The amortized cost and estimated fair value of long-term bonds as of December 31, 2008 and 2007 was as follows (dollars in thousands):

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S.—Treasury securities	$ 5,930	$ 623	$ -	$ 6,553
Federal-agency securities	53,093	4,644	-	57,737
Obligations of states and political subdivisions	20,541	314	(563)	20,292
Corporate securities	100,285	1,368	(7,522)	94,131
Asset-backed securities	29,709	2,599	(11,542)	20,766
Mortgaged-backed securities	159,241	2,094	(13,667)	147,668
	$ 368,799	$ 11,642	$ (33,294)	$ 347,147

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S.—Treasury securities	$ 41,362	$ 1,479	$ (14)	$ 42,827
Federal-agency securities	64,630	1,581	(4)	66,207
Obligations of states and political subdivisions	189,204	2,286	(319)	191,171
Corporate securities	101,260	912	(2,640)	99,532
Asset-backed securities	43,397	110	(17,371)	26,136
Mortgaged-backed securities	153,550	839	(1,941)	152,448
	$ 593,403	$ 7,207	$ (22,289)	$ 578,321

The amortized costs and estimated fair value of long-term bonds at December 31, 2008, by contractual maturity, are shown below (dollars in thousands). Actual maturities could differ from contractual maturities because borrowers have the right to call or prepay certain obligations which may or may not include call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 10,980	$ 11,078
Due after one year through five years	100,860	101,957
Due after five years through ten years	39,772	39,794
Due after ten years	217,187	194,318
	$ 368,799	$ 347,147

Proceeds from sales of long-term bonds during 2008 and 2007 were $216.5 million and $89.3 million, respectively. Gross gains of $4.4 million and $74 thousand and gross losses of $15.2 million and $5.1 million were realized on those sales in 2008 and 2007, respectively.

The following table summarizes, for all securities in an unrealized loss position at December 31, 2008, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position (dollars in thousands):

	Less than 12 months		12 months or more		Total	Total
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S.—Treasury securities	$ -	$ -	$ -	$ -	$ -	$ -
Federal agency securities	-	-	-	-	-	-
Obligations of states and political subdivisions	11,744	(445)	1,953	(118)	13,697	(563)
Corporate securities	40,246	(3,834)	17,154	(3,688)	57,400	(7,522)
Asset-backed securities	9,180	(10,447)	4,241	(1,095)	13,421	(11,542)
Mortgage-backed securities	23,289	(6,031)	35,325	(7,636)	58,614	(13,667)
Total	$ 84,459	$ (20,757)	$ 58,673	$ (12,537)	$ 143,132	$ (33,294)

The Company has a securities monitoring process that on a quarterly basis, identifies securities in an unrealized loss position that are potentially other-than-temporarily impaired. This process involves

monitoring market events that could impact the issuers' credit ratings, business climate, management changes, litigation and government actions and other similar facts. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections in a severe negative economic outlook. The monitoring process has not shown a loss of principal and interest.

The decline in fair value, which mainly resulted from declines in Commercial Mortgage Backed ("CMBS"), Corporate, and Asset Backed ("ABS") Securities is principally the result of credit spread widening primarily due to continued deterioration in the U.S. housing market, tightened lending conditions, increased risk aversion, and a U.S. recession and a declining global economy. For additional information, please refer to Note 2 — Significant Accounting Policies for Investments, which discloses the Company's process for reviewing invested assets for other-than-temporary impairments. Due to the issuers' continued satisfaction of the securities' obligations in accordance with their contractual terms and an expectation that they will continue to do so, management's intent and ability to hold these securities for a period of time sufficient to allow for anticipated recovery in market value, and the evaluation of the fundamentals of the issuers' financial condition, the Company believes that the prices of the securities in the sectors identified in the tables above were temporarily depressed as of December 31, 2008.

FAS 157 and Fair Value Measurements – Included in the Company's investment portfolio are certain financial instruments carried at fair value. Other financial instruments are periodically measured at fair value, such as when impaired, or, for certain bonds with ratings below investment grade, which are carried at the lower of cost or market. The below investment grade bonds carried at market value include one bond with a market value adjustment of $56,373 at December 31, 2007 and six bonds with a market value adjustment of $1,189,306 at December 31, 2008. In addition, the Company impaired three bonds in the aggregate amount of $12.1 million during 2008.

The fair value of as asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

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

The hierarchy defined by SFAS No. 157, Fair Value Measurements gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or a liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

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

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

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

	Level 1	Level 2	Level 3	Total
Assets at fair value on a nonrecurring basis:				
Bonds	-	5,867,388	-	5,867,388
Total Assets at fair value	$ -	$ 5,867,388	$ -	$ 5,867,388

The Company did not hold any Level 3 investments as of December 31, 2008.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The following table is a reconciliation of the beginning and ending balances of the reserve for losses and loss adjustment expenses as of December 31, 2008 and 2007 (dollars in thousands):

	2008	2007
Balance at January 1	$ 7,936	$ (5,380)
Less reinsurance recoverable	-	-
Net balance at January 1	7,936	(5,380)
Incurred related to:		
Current year	273,619	32,450
Prior years	(3,438)	5,649
Total incurred	270,181	38,099
Paid related to:		
Current year	258,404	23,964
Prior years	(1,260)	819
Total paid	257,144	24,783
Net balance at December 31	20,973	7,936
Plus reinsurance recoverables	-	-
Balance at December 31	$ 20,973	$ 7,936

During 2008, the Company incurred losses and loss adjustment expenses ("LAE") of $270.1 million. Of that amount, $247.8 million was incurred claims and LAE related to the Restructuring Transaction. No further liability exists with respect to these claims. In addition the Company incurred a current year loss on one of its insured student housing transactions. Incurred losses and LAE were $16.1 million of which paid losses and LAE were $1.3 million. As of December 31, 2008, total par outstanding on this bond was $16.8 million and the change in loss and LAE reserves were $14.8 million. The final maturity with respect to this insured obligation is December 1, 2035. The Company also increased its existing reserve on an insured securitization of manufactured housing mortgages by $4.7 million based on its updated review of the credit and released $8.3 million of assumed loss reserves from a reinsurance transaction with Ambac Assurance Corporation that was settled at the Restructuring Transaction. Insured par on this credit amounted to $6.7 million at December 31, 2008 and the total reserve as of that date was $5.5 million. Paid claims in 2008 with respect to this insured credit were $2.0 million. At December 31, 2007, the Company included in its loss reserve anticipated salvage for previously paid claims on another insured securitization of manufactured housing mortgages in the amount of $4.3 million. During 2008, the Company received $3.5 million against this anticipated salvage. At December 31, 2008, the remaining anticipated salvage related to this insured exposure was $0.8 million.

During the fourth quarter of 2008, COPIA: The American Center For Wine, Food and the Arts ("COPIA") filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Company insures bonds secured by payments to be made by COPIA with par outstanding of approximately $77 million and ultimately expects to pay claims on this credit. However, under SSAP 60, a loss reserve is not established until a payment default occurs; thus, the Company has not accrued this loss in its 2008 financial statements. COPIA currently has a debt service reserve funded in the amount of approximately $7 million. This cash reserve has been and is expected to continue to be used to make scheduled payments in respect of the insured bonds. Upon the depletion of the debt service reserve, the Company will begin making claim payments and at that time will establish a loss reserve. As of December 31, 2008, the Company had a reserve for LAE of $825 thousand in connection with COPIA. As the mitigation costs become clearer, it

may be necessary to increase this LAE reserve. Based on the Company's current estimates, the claim reserve may be in the range of $40 to $50 million on a present value basis. However, if the Company takes legal title to the underlying COPIA property, it will recognize the loss at that time.

During 2007, the Company's incurred losses and loss adjustment expenses totaled $38.1 million. Of this amount, $24.8 million is related to the settlement of losses on four insured manufactured housing securitizations. These four bond financings were part of a portfolio of 12 transactions originally insured in 1998. The 12 insured bonds had a collective balance of $213.3 million. During 2007, the Company agreed with the insured party to terminate the insurance on all of insured bonds relating to these transactions except for one (for which there is a separate insured party, having a reserve at December 31, 2007 of $2.8 million). From the Company's perspective, this was desirable because termination of these policies increased the Company's rating agency based capital adequacy, since many of these transactions had been downgraded since the time of the original insurance, and thereby were subject to higher rating agency capital charges. Additionally, the Company was paying claims on two of the policies. The agreement to terminate took place in two stages with the first occurring in the third quarter of 2007 and the second in the fourth quarter of 2007. As part of the first stage, the Company agreed to purchase at par a portion of one of the insured bonds. The difference between the amount paid and the then fair value of the bond was recorded as a paid loss. As part of the second stage, the Company agreed to pay the outstanding reserve on two of the other three remaining bonds. The reserve was based on the discounted value of projected future cash flows. The Company continues to pay claims on the fourth bond as they arise. Paid losses in connection with these terminated transactions amounted to $25.4 million. No further insurance exposure exists with respect to the other 10 bonds.

During 2007, the incurred losses related to prior years includes $5.6 million of adverse development related to anticipated salvage and subrogation recoveries on an asset-backed security deal deemed unrecoverable.

The Company's net reserve balance at December 31, 2008 and 2007 includes $749 thousand and $4.3 million, respectively, of anticipated salvage and subrogation recoveries, related to payments made by the Company on two asset-backed security deals.

In 2007, the Company also assumed losses incurred in the amount of $8.5 million in connection with two reinsurance transactions.

5. CONTINGENCY RESERVE

Following the completion of the Restructuring Transaction, in September 2008, the Company made a formal request to the MIA to allow the Company to release that portion of the then existing contingency reserve related to insurance contracts that had been terminated as part of the Restructuring Transaction. The Company also included certain non-public finance insurance contracts for which the exposure expired prior to the Restructuring Transaction. On October 15, 2008, the MIA granted approval for the release of the contingency reserve in the amount of $155.1 million.

6. REINSURANCE

As of and for the years ended December 31, 2008 and 2007, amounts reinsured were as follows (dollars in thousands):

	2008	2007
Income and expenses:		
Written premiums ceded	$ 32	$ 1,532
Written premiums assumed	87	8,307
Earned premiums ceded	74	1,842
Earned premiums assumed	1,811	289
Loss and loss-adjustment-expense payments ceded	-	-
Loss and loss-adjustment-expense payments assumed	98	14
Assets and liabilities:		
Unearned-premium reserve ceded	508	550
Unearned-premium reserve assumed	7,067	8,791
Loss and loss-adjustment-expense reserves ceded	-	-
Loss and loss-adjustment-expense reserves assumed	-	8,486
Off balance sheet balances:		
Principal outstanding ceded	21,276	36,959
Principal outstanding assumed	939,523	1,140,898

During 2008 and 2007, the Company reinsured a portion of its risk with other insurance companies under pro-rata, excess-of-loss, first loss and facultative reinsurance agreements. Effective October 1, 2005, ACA FG entered into an excess of loss reinsurance agreement with HCC Reinsurance Company Limited ("HCC Reinsurance") whereby ACA FG cedes its first $50 million in excess of $490 million on non-derivative, non-investment grade municipal paid losses. This reinsurance agreement was amended effective February 1, 2006 to increase the Company's retention to $525 million. The agreement was cancelled effective January 1, 2007 and replaced with a new agreement with HCC Reinsurance whereby the Company had the ability to cede losses, if any, on its insured, non-investment grade municipal portfolio in excess of contractually defined limits. During the first quarter of 2008, this contract was cancelled with HCC Reinsurance. Under the terms of the contract, the Company was required to pay an additional minimum premium of $3 million. The Company settled its obligation to pay an additional premium under this contract for $150 thousand as part of the Restructuring Transaction.

The Company ceded a portion of its business to other non-affiliated insurance and reinsurance companies and reduced its estimated liabilities for unpaid losses and loss adjustment expenses and unearned premiums accordingly. A contingent liability exists relating to such reinsurance in the event that the reinsurer becomes unable to meet its obligations under the terms of the reinsurance agreement; in which event the Company would be liable for such defaulted amounts. There were no unpaid losses and loss adjustment expenses ceded to non-affiliated insurance and reinsurance companies at December 31, 2008 and 2007, while unearned premiums ceded were $0.5 million and $0.6 million at December 31, 2008 and 2007, respectively.

In 2007, the Company assumed, under a facultative insurance arrangement, approximately $1.1 billion of public finance exposure. This exposure consists of several transactions with average credit quality ratings of "AA". Under the terms of the original reinsurance agreement, the ceding company had the ability to cancel the reinsurance once the Company's financial strength rating fell

below “A”. In light of the Restructuring Transaction, the ceding company has amended the reinsurance agreement and waived its termination rights under the original agreement.

7. INCOME TAXES

The actual tax expense on income from operations differs from tax expense calculated at the U.S. statutory tax rate. A reconciliation of the Company’s income tax expense together with the significant book to tax adjustments for the years ended December 31, 2008 and 2007 is set forth below (dollars in thousands):

	2008	2007
Income before income taxes	$ (237,834)	$ 8,633
Expected tax expense at 35%	$ (83,242)	$ 3,022
Change in contingency reserve	38,923	(25,263)
Dividends from subsidiaries	(8,818)	-
Tax exempt interest, net of proration	(1,242)	(1,884)
Prior year tax adjustment and other	669	5,721
Total statutory tax expense	$ (53,710)	$ (18,404)
Federal income tax expense	$ 780	$ 3,807
Change in net deferred income taxes	(54,490)	(22,211)
Total statutory tax expense	$ (53,710)	$ (18,404)

The Company generated a combined net operating loss of approximately $165 million during 2008, which is available to offset future net income subject to federal income tax. The net operating loss was reduced by $58 million, which was the tax benefit related to the cancellation of indebtedness income excluded by its disregarded subsidiary, ACA Service, L.L.C. The amount of federal income taxes incurred and available for recoupment with respect to the 2008 net operating loss is as follows (dollars in thousands):

Second preceding year (1/1/07 -11/21/07)	$ 16,026
First preceding year (11/22/07 – 12/31/07)	None

The Company filed two stub period tax returns during 2007: from January 1, 2007 to November 21, 2007 and from November 22, 2007 to December 31, 2007. Thus, the Company’s 2008 net operating loss will only be utilized against the second preceding tax year in 2007 (January 1, 2007 to November 21, 2007) because the Company generated a net loss in the first preceding year (November 22, 2007 to December 31, 2007). The federal income taxes incurred above includes income and expenses of its disregarded subsidiaries.

The federal income tax rate applicable to ordinary income was 35%.

The Company will be included in its parent’s, ACACH’s, consolidated income tax return prior to August 11, 2008 with the following members:

- Manifold Capital Corp. (formerly ACA Capital Holdings, Inc.)
- ACA Holding, L.L.C.
- ACA Financial Products, Inc.
- ACA Assurance, Ltd.

A written tax sharing agreement was executed at the close of the Restructuring Transaction. The agreement sets forth the manner in which total consolidated tax for all entities is allocated to each entity in the consolidation. Generally, the allocation is based upon separate return calculations. The agreement is also subject to approval by the MIA.

In accordance with Maryland law, the Company is required to establish a statutory contingency reserve in quarterly amounts equal to the greater of 50% of financial guaranty premiums earned or a percentage of the principal guaranteed which can vary from .55% to 2.50% depending on the type of obligation guaranteed. These amounts may not be withdrawn for a period of 15 or 20 years depending on the type of the obligation, except as permitted by the state for payment of certain losses. Section 832(e) of the Internal Revenue Code provides that the amount set aside in statutory contingency reserves may be deducted currently for income tax purposes provided non-interest bearing U.S. Mortgage Guaranty Tax and Loss Bonds issued by the Treasury Department are purchased in an amount commensurate with the tax benefit derived from deducting any portion of the Company's statutory contingency reserve. The statutory contingency reserve is shown as a liability on page 3 of the annual statement and the total Tax and Loss Bonds recorded in other invested assets on page 1 of the annual statement. The Company had an investment in Tax and Loss Bonds as of December 31, 2008 and December 31, 2007 in the amount of $0 and $18.3 million, respectively. In anticipation of the Company's restructuring transaction, the Tax and Loss Bonds were redeemed in July 2008.

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

	December 31,	
Description	2008	2007
Gross deferred tax assets	$ 129,260	$ 89,814
Gross deferred tax liabilities	(9)	(15,053)
Net deferred tax asset	129,251	74,761
Non-admitted deferred tax asset	(125,430)	(74,373)
Net admitted deferred tax asset	3,821	388
Increase in non-admitted deferred tax assets	$ (51,057)	$ (22,314)

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

	December 31,	
Description	2008	2007
Current year expense	$ -	$ -
Prior year under accrual	780	3,807
Current income tax expense	780	3,807
Less: benefit on capital loss	-	-
Current ordinary income tax expense	$ 780	$ 3,807

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

Deferred tax assets:	December 31, 2008	December 31, 2007	Change
Net operating loss carryforward	$ 77,975	$ -	$ 77,975
Contingency reserve	26,057	64,980	(38,923)
Unearned premiums reserve	7,693	9,194	(1,501)
Loss reserve discounting	23	70	(47)
Unearned ceding commisions	-	1,100	(1,100)
Unamortized licenses	473	599	(126)
Capital loss carryforward	14,864	11,432	3,432
General expense accrual	-	126	(126)
Change in accounting method	-	447	(447)
Fixed assets	1,642	1,715	(73)
Other temporary differences	533	151	382
Gross deferred tax asset	129,260	89,814	39,446
Nonadmitted deferred tax asset	(125,430)	(74,373)	(51,057)
Gross admitted deferred tax asset	3,830	15,441	(11,611)
Gross deferred tax liabilities - Investments	(9)	(15,053)	15,044
Net admitted deferred tax asset	$ 3,821	$ 388	$ 3,433

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

	December 31, 2008	December 31, 2007
Total deferred tax assets, January 1	$ 89,814	$ 52,673
Total deferred tax liabilities, January 1	15,053	123
Net deferred tax asset, January 1	74,761	52,550
Net deferred tax asset, December 31	129,251	74,761
Change in net deferred asset	54,490	22,211
Tax effect of unrealized losses	-	-
Change in net deferred income tax	$ 54,490	$ 22,211

There were no reserves for tax contingencies as required under SSAP 5, "*Liabilities, Contingencies and Impairments of Assets*", as of December 31, 2008 and 2007.

8. OUTSTANDING EXPOSURE AND COLLATERAL

The vast majority of the Company's policies insure the scheduled payments of principal of and interest on public finance obligations. The outstanding principal amount of insured obligations in the insured portfolio, net of amounts ceded (see Note 6) at December 31, 2008 and 2007, respectively, included the following types of issues (dollars in millions):

	December 31, 2008		December 31, 2007	
	Net Par Outstanding	% of Net Par Outstanding	Net Par Outstanding	% of Net Par Outstanding
Public Finance:				
Healthcare	$ 795	11.6 %	$ 846	1.1 %
Tax backed	933	13.6	996	1.3
Education	1,344	19.6	1,419	1.9
Long-term care	507	7.4	686	0.9
General obligations	1,089	15.9	1,157	1.5
Utilities	217	3.2	225	0.3
Transportation	446	6.5	646	0.8
Not for profit	488	7.1	529	0.7
Housing	317	4.6	327	0.4
Other	400	5.8	421	0.6
Total public finance obligations	6,535	95.4	7,252	9.5
Non-Municipal:				
Insured credit swaps	-	0.0	68,541	89.9
Structured finance	-	0.0	8	0.0
Other	312	4.6	448	0.6
Total non-municipal obligations	312	4.6	68,997	90.5
Total	$ 6,847	100.0 %	$ 76,249	100.0 %

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

	December 31, 2008		December 31, 2007	
	Net Par Outstanding	% of Net Par Outstanding	Net Par Outstanding	% of Net Par Outstanding
California	$ 1,097	16.8 %	$ 1,285	17.7 %
New York	898	13.7	1,177	16.2
Texas	452	6.9	463	6.4
Florida	355	5.4	362	5.0
Washington	355	5.4	359	5.0
Other states	3,379	51.7	3,606	49.7
Total municipal obligations	$ 6,535	100.0 %	$ 7,252	100.0 %

The principal amount of insured obligations as of December 31, 2008, in the insured portfolio, net of amounts ceded, and the terms to maturity were as follows (dollars in millions). Actual maturities

could differ from final maturities because borrowers have the right to refund or prepay certain obligations.

Terms to Maturity	
0 to 5 years	$ 1,086
5 to 10 years	1,230
10 to 15 years	1,312
15 to 20 years	1,368
20 and above	1,852
Total	$ 6,847

Debt service on insured obligations for 2009 is approximately $459 million.

By the terms of the Restructuring Transaction, all insurance policies on insured credit swaps were settled and cancelled. After the Restructuring Transaction, in force par was $6.8 billion and consisted principally of municipal exposures.

9. RELATED PARTY TRANSACTIONS

In 2002, the Company replaced one of its investment managers with Stephens Capital Management (''Stephens'') and incurred investment management fees of $14 thousand in 2007. This investment manager is affiliated with SF Holding Corp. (f/k/a Stephens Group Inc.), which had a representative on the Company's Board of Directors and is an investor in ACACH. In January 2007, the investment management agreement with Stephens was terminated.

The Company and its affiliates shared operating expenses based on estimates of respective usage. Effective January 1, 2005 costs are allocated between the Company and its affiliates pursuant to a cost sharing, staffing and management services agreement and a funding agreement. The MIA approved these agreements on January 25, 2006. This arrangement was terminated and settled effective January 1, 2008.

The Company issued financial guaranty policies guaranteeing to third parties the performance of ACA Assurance, Ltd., a former affiliate, which entered into reinsurance agreements with the third parties. In 2008, ACA Assurance commuted its remaining exposures and the Company no longer retains any related risk.

On December 29, 2004, the Company issued a $10 million, 30-year surplus note to ACACH in exchange for $10 million. The surplus note accrues interest at a rate equal to 3-month LIBOR plus 3.35%. The Company paid $0.8 million in interest on its surplus note with ACACH during the year ended December 31, 2007. This surplus note was cancelled as part of the Restructuring Transaction. As a result, the $10 million was reclassified as paid in capital. This represents the non-cash financing item in the Company's statement of cash flows.

On December 20, 2006, the Company received approval from the MIA to make dividend payments to ACACH due in 2007 in respect of the Company's share of the interest expense on $40 million of trust preferred debt outstanding at ACACH. During 2007, the Company made dividend payments in respect of 2007 in the aggregate amount of $2.8 million. The Company also made dividend payments in respect of 2006 during the first quarter of 2007 in the aggregate amount of $1.0 million. The Company does not expect to make future dividend payments to ACACH, other than payments under the surplus note, if any.

As part of the Restructuring Transaction, the Company entered into an Intercompany Agreement with ACAH, whereby all intercompany balances between the companies, inclusive of each company's subsidiaries, were cancelled. As a result, in addition to the cancellation of the previously existing surplus note due from the Company to ACAH in the amount of $10 million, expense related to intercompany payable balances between the Company and ACACH and subsidiaries of ACACH of approximately $0.3 million were also cancelled. Additionally, a net payable balance due from ACACH and its subsidiaries to the subsidiaries of the Company in the amount of $14.3 million was also cancelled.

Following the Restructuring Transaction, intercompany balances and cash between the Company and its subsidiaries were settled and transferred resulting in a net dividend to the Company of $25.2 million. This amount was reflected in other income in the Company's income statement.

Effective at the closing of the Restructuring Transaction, ACACH disclaimed control over the Company, which was approved by the MIA.

The receivable from parents, subsidiaries and affiliates excluding those balances reported as other invested assets at December 31, 2008 and 2007 are due from the following affiliates (dollars in thousands):

	2008	2007
ACA CDS 2002-2 LLC	$ -	$ 7,443
ACA Capital Holdings Inc.	-	-
ACA Risk Solutions L.L.C.	-	1,200
ACA Financial Products Inc.	-	1,078
Other	-	193
Sub-Total	$ -	$ 9,914
Less: non-admitted	-	-
Total Admitted Intercompany Receivables	$ -	$ 9,914
ACA Capital Singapore Pte Ltd	$ 437	$ -
ACA Service LLC	-	4,282
ACA Capital Holdings, Inc.	-	1,264
ACA Management, L.L.C.	29	1,223
ACA Solutions, Ltd	-	405
ACA Assurance, Ltd	-	235
ACA Financial Assets, L.L.C.	-	12
Total Intercompany Payables	$ 466	$ 7,421

10. BENEFIT PLANS

The Company sponsors a defined contribution plan, which covers all full time employees as of their start date. Eligible participants may contribute a percentage of their salary, subject to IRS limitations. The Company's contributions are based on a fixed percentage of employees' contributions, subject to IRS limitations, and are approved by the Board of Directors. The Company's expense for the plan during 2008 and 2007 was $0.3 million and $0.4 million, respectively. As of December 31, 2008, the fair value of the plan assets was $7.4 million. In 2008, the plan had undergone a partial termination as a result of employee terminations. A partial termination is deemed to occur when an employer-initiated action results in a significant decrease in plan participation.

The Company participated in ACACH's Stock Incentive Plan under which 6,327,972 shares of ACACH's common stock were reserved for issuance to employees, directors and consultants. Unless otherwise specified, each option either vests ratably annually, over 3 years, or every 6 months over 3½ years, beginning at the date of grant. As long as the grantee is still with ACACH, if not vested by its terms, each option fully vests upon the earliest of (i) the grantee's normal retirement date; (ii) the grantee's death or disability; or (iii) the occurrence of a change of control of ACACH. During 2008, the Company effectively terminated the Stock Incentive Plan by increasing the forfeiture rate to 100 percent because ACACH's stock price fell below $0.50 and the likelihood of an exercise was remote.

During 2008 and 2007, the ACACH Board of Directors (separate and distinct from the Company's currently seated Board of Directors) granted 0 and 68,625 shares of restricted common stock, respectively, to certain of the Company's officers who were also ACACH officers. The officers' shares vest in equal installments on each of the four anniversaries of the grant date. For the years ended December 31, 2008 and 2007, the Company was allocated stock based compensation expense of $0 and $2.1 million, respectively.

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Long-Term Bonds—The carrying amount of long-term bonds represents amortized cost. The estimated fair value of long-term bonds as discussed in Note 3 is generally based on independent market quotations. The estimated fair value approximates the SVO market value.

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

	December 31, 2008		December 31, 2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
Assets:				
Long-term bonds	$ 368,799	$ 348,126	$ 593,403	$ 578,321
Short-term investments	63,058	63,058	19,440	19,440
Cash on hand and on deposit	801	801	39,443	39,443

12. RESTRICTED BALANCES

As mentioned in Note 3, the Company has assets on deposit with various regulatory authorities. The Company's landlord also holds cash in the amount of $2.7 million as a security deposit in respect of the Company's operating lease.

13. REGULATORY MATTERS

As disclosed in Note 1, the Company is currently operating under the Order issued by the MIA. As of December 31, 2008, the Company's policyholders' surplus, as determined in accordance with statutory-basis accounting practices, was $101 million. Such amount was in excess of the minimum capital and surplus level required by the MIA.

In addition, to the MIA, the insurance departments of certain other states, have various requirements relating to the maintenance of certain minimum statutory-basis capital and reserves, single risk limits and limits on non-investment grade obligations. As a runoff company, the Company is reviewing its compliance with each of the state's various requirements.

Under Maryland insurance law, the Company may pay a dividend without the prior approval of the Commissioner of the MIA from earned surplus, as defined, subject to the maintenance of a minimum-capital requirement, and the dividend, which, together with all dividends declared or distributed by it during the preceding twelve months, may not exceed the lesser of 10% of policyholders' surplus shown on its last annual statement, or net investment income, as defined, for such twelve-month period. Based upon these restrictions, the maximum amount that was available during 2008 for payment of dividends by ACA FG without prior approval of the MIA is $0, due to its having negative earned surplus.

Consistent with prior years, based upon these restrictions, the Company also required the approval of the MIA to pay any dividends in 2007. On December 20, 2006, the Company received approval from the MIA to make dividend payments to ACACH due in 2007 in respect of the Company's share of the interest expense on $40 million of trust preferred debt outstanding at ACACH. For the year ended December 31, 2007, the Company made dividend payments in respect of 2007 in the aggregate amount of $2.8 million. The Company also made dividend payments in respect of 2006 during the first quarter of 2007 in the aggregate amount of $1.0 million. Additionally, the Company paid $0.8 million in interest on its surplus note with ACACH during the year ended December 31, 2007. As part of the Restructuring Transaction, the surplus note was cancelled at the closing of the restructuring. The Company does not expect to make dividend payments to ACACH in the future.

The portion of unassigned surplus increased (reduced) by each item below at December 31, 2008 and 2007 is as follows:

	2008	2007
a. Unrealized gains (losses) on bonds	$ 1,189	$ 56
b. Unrealized gains on investment in subsidiaries	$ -	$ -
c. Non-admitted asset values	$ (153,815)	$ (74,885)

14. CONTINGENCIES

ACACH is named as defendant in two securities class actions on behalf of persons who invested in ACACH's initial public offering in November 2006 and through November 20, 2007. Both ACACH and its chief executive officer (CEO) are named as defendants in these suits. Both complaints allege that ACACH and its CEO violated sections 11 and 12(a)(2) of the Securities Act of 1933 by failing to disclose that ACA's transactions in collateralized debt obligations were "materially impaired and overvalued." Both complaints also allege the CEO is liable for Securities Act violations as a "controlling person" under section 15 of the Securities Act. One of the suits alleges that the defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by allegedly deceiving the investing public and causing class members to purchase ACACH securities at inflated prices. Plaintiffs in these two actions have moved to consolidate these cases and to appoint lead plaintiff and lead counsel. The Company is not named in these two cases, and is indemnified by ACACH pursuant to the Intercompany Agreement, for any liability arising from any claim or action by one or more of the present or former shareholders of ACACH in their capacity as shareholders. ACA FG is not named in the complaint and management does not expect these claims to have a material effect on the statutory-basis financial statements of the Company.

In July 2008, the Company, along with five other bond insurance companies, was named in substantively identical suits brought by the City of Los Angeles and the City of Stockton, which assert various causes of action based on allegations that the Company (i) conspired with its co-defendants and with bond rating agencies to maintain a credit-rating system that led local governments to buy unnecessary insurance policies on their bonds; and (ii) failed to properly disclose its exposure to the sub-prime market. The Company believes it was named in error because the allegations in both suits are based on the assertion that the bond insurance defendants sold the plaintiffs AAA financial strength ratings, and the Company had never been rated AAA. As a result, management does not expect this suit to have a material impact on the statutory-basis financial statements of the Company.

ACA FG is one of a number of defendants in a lawsuit brought by Retirement Housing Foundation and several affiliates relating to the plaintiffs' issuance of auction-rate securities insured by ACA FG. The plaintiffs allege that the Company's insurance of securities backed by sub-prime mortgages was not financially responsible and was contrary to the Company's

statement about its investment practices, and that when the Company's credit rating was downgraded from "A" to "CCC" after the collapse of the sub-prime market, the plaintiffs were forced to refinance their securities. While this action is in the preliminary stages, the Company believes it has substantial defenses to the claims against it.

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

15. LEASES

On November 17, 2006, the Company assumed all of ACA Service LLC's obligations under its lease of office space at 140 Broadway, New York, New York, which lease was due to expire on August 31, 2009 (the "Existing Premises"). On October 19, 2006, the Company subleased certain additional office space at the above location, which sublease was due to expire on October 31, 2009 (the "Additional Premises", and together with the Existing Premises, the "Premises"). Each of the lease and sublease contain provisions for escalations in real estate taxes and building operating costs, in addition to base rent. Rental expense for the Company for 2008 and 2007 was $2.2 million and $2.0 million, respectively.

On December 7, 2006, the Company entered into a renewal lease for the Premises, that expires on April 30, 2020. This lease provides for scheduled periodic rent increases and escalations in real estate taxes and building operating costs. At December 31, 2008, expected future minimum lease payments under the renewal lease are as follows (dollars in thousands):

Year Ending December 31	Operating Leases
2009	$ 2,382
2010	2,467
2011	2,655
2012	2,655
2013	2,655
Beyond 5 Years	20,812
Total	$ 33,626

The Company is pursuing a sublease of all or a portion of its office space at 140 Broadway in order to reduce its monthly rental costs. However, the commercial rent market in New York City has weakened significantly due to the state of the economy and the recent financial crisis resulting in considerable job losses in the financial industry and related sectors. The loss of jobs has caused many institutions to have more office space than needed and has resulted in a growing inventory of available space which has, in turn, put downward pressure on rental rates. Because of the state of the market, the Company will almost certainly be forced to sublease its office space at a loss. On a present value basis, the Company estimates the loss would be minimally in the $7 million to $10 million range; however, under a sublease arrangement, on a cash basis, this amount would be realized over the remaining original lease period, which expires in April 2020.

16. RESTRUCTURING TRANSACTION

On August 8, 2008, the Company completed its Restructuring Transaction in order to settle potential claims arising out of Company's insured credit swap policies and certain medium term note obligations issued by a subsidiary of the Company and guaranteed by the Company. Certain other

parties to which the Company had obligations were also settled. The Restructuring Transaction included three main components.

The first of the three components of the Restructuring Transaction consisted of a Global Settlement Agreement whereby insured credit swap counterparties' claims were settled by the payment in cash of an aggregate loss amount of approximately $209 million. In addition, the counterparties received an aggregate 95% voting interest in newly created surplus notes (the "Surplus Notes") with a total face amount of $1 billion. The remaining 5% or $50 million is non-voting and was issued to ACACH.

The second component of the Restructuring Transaction involved a Medium Term Note ("MTN") Restructuring Agreement which provided for the settlement of a $100 million medium term note guaranteed by the Company. This obligation was settled by a cash payment of approximately $48 million to the noteholders in 2008 and the relinquishment by the Company of investments in CDO equity with an estimated value of $2.5 million, also for the benefit of Surplus Note holders. Of the total cash settlement, approximately $32 million was paid out of a cash collateral account supporting the issued note held by the subsidiary while the remaining amount of approximately $16 million was funded by cash from the Company and its other subsidiaries.

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

Surplus Notes

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

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

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

17. ADJUSTMENTS TO AMOUNTS REFLECTED IN THE ACCOMPANYING STATUTORY-BASIS FINANCIAL STATEMENTS TO THE FINANCIAL STATEMENTS FILED WITH THE MIA

The 2008 financial statements differ from the 2008 annual statement as filed by the Company as follows:

Financial Statement Line Item:	As Reported In the Annual Statement	Adjustment	As Reported in the Audited Financial Statement
December 31, 2008			
Total Admitted Assets	$ 441,209	$ (208)	$ 441,001
Total Liabilities	339,923	(208)	339,715
Total Surplus	101,286	-	101,286
Net Income	(268,955)	30,341	(238,614)

The change in admitted assets of $208 thousand relates to a balance sheet reclassification. The increase in net income relates to the reversal of an other than temporary impairment loss on an investment in a subsidiary of $26 million that was recognized in the Company's 2007 Audited Financial Statements. In addition, a decrease in net loss by $4.3 million relates to a reversal of an impairment to the Company's investment in a subsidiary, that was previously non-admitted.

The 2007 financial statements differ from the 2007 annual statement as filed by the Company as follows:

Financial Statement Line Item:	As Reported In the Annual Statement	Adjustment	As Reported in the Audited Financial Statement
December 31, 2007			
Total Admitted Assets	$ 691,792	$ 6,658	$ 698,450
Total Liabilities	462,652	7,421	470,073
Total Surplus	229,140	(763)	228,377
Net Income	30,837	(26,011)	4,826

The change in admitted assets relates to the Company's decision to terminate operations in ACA Singapore and account for the interest as a non admitted asset, resulting in a decrease in assets of $0.8 million, and to present intercompany receivables and payables on a gross basis, resulting in an increase in assets and liabilities of $7.4 million. The decrease in net income relates to the recognition of an other-than-temporary impairment loss on an investment in subsidiary that was previously recognized as an unrealized loss. As this investment in subsidiary was previously reflected as an unrealized loss, there was no effect on surplus.

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ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SUMMARY OF INVESTMENT SCHEDULE AS OF DECEMBER 31, 2008

Investment Categories	Gross Investment Holdings Under NAIC		Admitted Assets as Reported in the Annual Statement	
Bonds:				
U.S. treasury securities	$ 5,929,710	1.4 %	$ 5,929,710	1.4 %
U.S. government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. government sponsored agencies	53,093,377	12.2 %	53,093,377	12.2 %
Securities issued by states, territories and possessions and political subdivisions in the U.S.:				
States, territories and possessions general obligations				
Political subdivisions of states, territories and possessions and political subdivisions general obligations	5,065,712	1.2 %	5,065,712	1.2 %
Revenue and assessment obligations	15,475,109	3.6 %	15,475,109	3.6 %
Mortgage-backed securities (includes residential and commercial MBS)				
Pass-through securities:				
Issued or guaranteed by GNMA	28,534,895	6.6 %	28,534,895	6.6 %
Issued or guaranteed by FNMA and FHLMC	43,313,545	10.0 %	43,313,545	10.0 %
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	15,392,200	3.5 %	15,392,200	3.5 %
Issued by non-U.S. government issuers and collateralized by mortgage-backed securities issued or guaranteed by GNMA, FNMA, FHLMC or VA				
All other	72,280,751	16.7 %	72,280,751	16.7 %
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	119,514,629	27.6 %	119,514,629	27.6 %
Unaffiliated foreign securities	10,198,828	2.4 %	10,198,828	2.4 %
Receivable for securities				
Cash, cash equivalents and short-term investments	63,858,810	14.7 %	63,858,810	14.7 %
Other invested assets	1,090,068	0.3 %	1,090,068	0.3 %
Total invested assets	$ 433,747,634	100.0 %	$ 433,747,634	100.0 %

ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SCHEDULE OF INVESTMENT RISK INTERROGATORIES
AS OF DECEMBER 31, 2008

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

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

1. $441,001,385

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

	Issuer	Description of Exposure	Amount	Percentage of Total Admitted Assets
2.01	Bear Stearns Commercial Mortgage	MBS CMO / REMIC / Other Prvt Issued	21,126,481	4.8%
2.02	Ixion	Other Debt / Unaffiliated Domestic	11,048,706	2.5%
2.03	New York State Dormitory Authority	Revenue / Assessment Obligation	9,657,155	2.2%
2.04	Citigroup Inc.	Other Debt / Unaffiliated Domestic	6,325,511	1.4%
2.05	Citigroup Deutsche Bank Commercial Mortgage	MBS CMO / REMIC / Other Prvt Issued	6,266,976	1.4%
2.06	Banc of America Commercial Mortgage	MBS CMO / REMIC / Other Prvt Issued	6,107,924	1.4%
2.07	Commercial Mtg Pass-Through	MBS CMO / REMIC / Other Prvt Issued	6,029,589	1.4%
2.08	GS Mortgage Securities Corp.	MBS CMO / REMIC / Other Prvt Issued	5,944,999	1.3%
2.09	Wachovia Bank Commercial Mortgage	MBS CMO / REMIC / Other Prvt Issued	5,016,478	1.1%
2.10	Bank of America Corp.	Other Debt / Unaffiliated Domestic	4,825,856	1.1%

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

Bonds				Stocks			
3.01	NAIC-1	$ 392,077,833	88.9 %	3.07	P/RP-1	$ -	- %
3.02	NAIC-2	33,911,218	7.7 %	3.08	P/RP-2	-	-
3.03	NAIC-3	1,709,118	0.4 %	3.09	P/RP-3	-	-
3.04	NAIC-4	-		3.10	P/RP-4	-	-
3.05	NAIC-5	1,658,232	0.4 %	3.11	P/RP-5	-	-
3.06	NAIC-6	2,500,039	0.6 %	3.12	P/RP-6	-	-

4. Assets held in foreign investments:

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

4.02 Total admitted assets held in foreign investments: $ 21,247,534 4.8%

4.03 Foreign-currency-denominated investments: $ 0 0%

4.04 Insurance liabilities denominated in that same foreign currency: $0 0%

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

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

Countries rated NAIC-1 $ 21,247,534 4.8 %

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

Country: Ireland $ 11,048,706 2.5 %

Country: Cayman Islands $ 5,997,070 1.4 %

7. Aggregate unhedged foreign currency exposure $ - - %

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

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

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

1 Issuer	2 NAIC Rating	3	4
Ixion	2	11,048,706	2.5%
ACA ABS 2007-3	1	4,745,221	1.1%
Oil Casualty Insurance	2	1,147,057	0.3%
Aspen Insurance	2	1,067,949	0.2%
British Telecom PLC	2	1,051,884	0.2%
Scottish Power PLC	1	934,867	0.2%
Dresdner Fndg Trust I	1	651,125	0.1%
Hutchison Whamp Intl	1	600,724	0.1%

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

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

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

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

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

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

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

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

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

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets? Yes (X) No ( )
If response to 14.01 is yes, responses are not required for remainder of Interrogatory 14.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

		Owned		Written	
20.01	Hedging	$ -	0%	$ -	0%
20.02	Income generation	-	-	-	-
20.03	Other	-	-	-	-

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

		At End of Each Quarter				
		At Year-end		1st Qtr	2nd Qtr	3rd Qtr
21.01	Hedging	$ -	0%	$ -	$ -	$ -
21.02	Income generation	-	-	-	-	-
21.03	Replications	-	-	-	-	-
21.04	Other	-	-	-	-	-

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

		At End of Each Quarter				
		At Year-end		1st Qtr	2nd Qtr	3rd Qtr
22.01	Hedging	$ -	0%	$ -	$ -	$ -
22.02	Income generation	-	-	-	-	-
22.03	Replications	-	-	-	-	-
22.04	Other	-	-	-	-	-

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

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

ACA FINANCIAL GUARANTY CORPORATION

SUPPLEMENTAL SCHEDULE OF REINSURANCE INTERROGATORIES
AS OF DECEMBER 31, 2008

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

9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 3% of prior year-end loss and loss expense reserve ceded greater than 3% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- (a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- (c) Aggregate stop loss reinsurance coverage;
- (d) An unconditional or unilateral right by either party to commute the reinsurance contract except for such provisions which are only triggered by a decline in the credit status of the other party;
- (e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- (f) Payment schedule, accumulating retention from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [ ] No [X]

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:

- (a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- (b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates. Yes [ ] No [X]