

# **SYNCORA HOLDINGS LTD.**

## **Consolidated Financial Statements**

**As of June 30, 2018 (Unaudited) and December 31, 2017 and for the  
Six Months Ended June 30, 2018 and 2017 (Unaudited)**

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**SYNCORA HOLDINGS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2018 (Unaudited) and DECEMBER 31, 2017**  
**(U.S. dollars in thousands, except share and per share amounts)**

<b>ASSETS</b>	<b>2018</b>	<b>2017</b>
Cash and invested assets:		
Debt securities, available-for-sale, at fair value (amortized cost: \$661,701 and \$910,858).....	\$ 664,666	\$ 928,044
Other invested assets, at fair value (cost: \$91,560 and \$94,232).....	113,727	117,110
Cash and cash equivalents.....	110,496	311,951
Total cash and invested assets.....	888,889	1,357,105
Insurance operating assets, retained business:		
Premiums receivable.....	17,187	79,903
Salvage and subrogation recoverable.....	123,530	422,687
Receivables on insurance cash flow certificates, net of deferred gains of \$114,735 and \$116,415.....	137,769	109,869
Deferred acquisition costs, net.....	3,388	34,930
Assets of consolidated variable interest entities, at fair value.....	17,068	118,154
Total insurance operating assets, retained business.....	298,942	765,543
Insurance operating assets, ceded business:		
Premiums receivable.....	53,221	12,921
Prepaid reinsurance.....	127,497	15,565
Reinsurance recoverable on unpaid losses and loss adjustment expenses.....	151,759	-
Credit default and other swap contracts, at fair value.....	203,441	-
Total insurance operating assets, ceded business.....	535,918	28,486
Other assets.....	50,305	38,811
Assets of entity held-for-sale.....	167,372	195,540
Total assets.....	\$ 1,941,426	\$ 2,385,485
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Insurance operating liabilities, retained business:		
Unpaid losses and loss adjustment expenses.....	\$ 459,540	\$ 674,999
Unearned premium revenue.....	34,066	209,320
Credit default and other swap contracts, at fair value.....	8,221	104,094
Liabilities of consolidated variable interest entities, at fair value.....	761	60,708
Total insurance operating liabilities, retained business.....	502,588	1,049,121
Insurance operating liabilities, ceded business:		
Unpaid losses and loss adjustment expenses.....	151,759	-
Unearned premium revenue.....	127,497	15,565
Credit default and other swap contracts, at fair value.....	203,441	-
Reinsurance premiums payable.....	53,221	12,921
Total insurance operating liabilities, ceded business.....	535,918	28,486
Notes payable (par value: \$389,549 and \$677,117).....	257,643	428,887
Accrued interest on notes payable.....	39,364	127,329
Other liabilities.....	17,721	29,244
Liabilities of entity held-for-sale.....	12,375	20,428
Total liabilities.....	1,365,609	1,683,495
Shareholders' equity		
Non-controlling interest in subsidiary- Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc. (2,000 shares authorized and issued; 1,345 shares outstanding, 655 shares held by subsidiary; \$134,526 liquidation preference).....	13,453	13,453
Non-controlling interest in consolidated entity.....	2,200	2,578
Common shares (500,000,000 shares authorized; 90,013,135 and 89,811,623 shares issued; 86,968,547 and 86,767,035 shares outstanding, 3,044,588 shares held as treasury; \$0.01 par value) and additional paid-in capital.....	2,717,440	2,716,798
Accumulated deficit.....	(2,161,875)	(2,061,854)
Accumulated other comprehensive income.....	4,599	31,015
Total Syncora Holdings Ltd. shareholders' equity.....	560,164	685,959
Total shareholders' equity.....	575,817	701,990
Total liabilities and shareholders' equity.....	\$ 1,941,426	\$ 2,385,485

See accompanying Notes to Unaudited Consolidated Financial Statements.

**SYNCORA HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (Unaudited)**  
**SIX MONTHS ENDED JUNE 30, 2018 AND 2017**  
**(U.S. dollars in thousands, except share and per share amounts)**

	<b>2018</b>	<b>2017</b>
<b>Revenues</b>		
Premiums earned, net of reinsurance ceded of \$3,320 and \$731.....	\$ 23,117	\$ 27,386
Net investment income.....	21,394	23,455
Net unrealized and realized gains (losses) on investments, including other-than-temporary impairment losses of \$(11,067) and \$(25,558).....	3,488	(9,750)
Earnings (loss) on insurance cash flow certificates, net of amortization of deferred gains of \$1,679 and \$1,054...	30,084	(16,657)
Fees and other income.....	14,285	3,184
Net (loss) earnings on credit default and other swap contracts: net unrealized gains of \$95,726 and \$1,466 and realized (losses) gains and other settlements of \$(120,407) and \$1,654.....	(24,681)	3,120
Net change in fair value of consolidated variable interest entities.....	2,149	5,600
<b>Total revenues</b> .....	<b>69,836</b>	<b>36,338</b>
<b>Expenses</b>		
Losses and loss adjustment expenses, net of reinsurance ceded of \$(3,670) and zero.....	14,605	41,853
Amortization of deferred acquisition costs.....	3,730	4,025
Interest expense, including accretion of \$25,927 and \$18,960.....	49,376	42,613
Loss on debt prepayment.....	91,416	-
Operating expenses.....	28,524	21,440
<b>Total expenses</b> .....	<b>187,651</b>	<b>109,931</b>
<b>Loss before income tax expense from continuing operations</b> .....	<b>(117,815)</b>	<b>(73,593)</b>
Income tax expense.....	244	1,750
<b>Loss from continuing operations</b> .....	<b>(118,059)</b>	<b>(75,343)</b>
<b>Income from discontinued operations</b> .....	<b>10,760</b>	<b>6,043</b>
<b>Net loss</b> .....	<b>(107,299)</b>	<b>(69,300)</b>
Other comprehensive (loss) income:		
Other comprehensive (loss) income from continuing operations.....	(18,988)	20,997
Other comprehensive income from discontinued operations.....	41	6
<b>Other comprehensive (loss) income</b> .....	<b>(18,947)</b>	<b>21,003</b>
<b>Comprehensive loss</b> .....	<b>\$ (126,246)</b>	<b>\$ (48,297)</b>
<b>Net income and comprehensive income attributable to non-controlling interest</b> .....	<b>\$ 191</b>	<b>\$ 178</b>
<b>Net loss and comprehensive loss attributable to controlling interest:</b>		
Net loss.....	\$ (107,490)	\$ (69,478)
Comprehensive loss.....	\$ (126,437)	\$ (48,475)
<b>Calculation of basic and diluted earnings (loss) per share attributable to Syncora Holdings Ltd. common shareholders:</b>		
Income from discontinued operations.....	\$ 10,760	\$ 6,043
<i>Per share</i> .....	\$ 0.12	\$ 0.07
Loss from continuing operations.....	\$ (118,250)	\$ (75,521)
<i>Per share</i> .....	\$ (1.36)	\$ (0.87)
Net loss.....	\$ (107,490)	\$ (69,478)
<i>Per share</i> .....	\$ (1.24)	\$ (0.80)
Weighted average common shares outstanding.....	86,902,861	86,669,502

See accompanying Notes to Unaudited Consolidated Financial Statements.

**SYNCORA HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)**  
**SIX MONTHS ENDED JUNE 30, 2018 AND 2017**  
(U.S. dollars in thousands, except share amounts)

	<u>2018</u>	<u>2017</u>
<b>Non-controlling interest in subsidiary – Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc.</b>		
Balance—beginning of period.....	\$ 13,453	\$ 13,453
Balance—end of period.....	<u>13,453</u>	<u>13,453</u>
<b>Non-controlling interest in consolidated entity</b>		
Balance—beginning of period.....	2,578	3,066
Net income and comprehensive income attributable to non-controlling interest.....	191	178
Distributions.....	<u>(569)</u>	<u>(591)</u>
Balance—end of period.....	<u>2,200</u>	<u>2,653</u>
<b>Common shares and additional paid-in capital</b>		
Balance—beginning of period.....	2,716,798	2,716,220
Issuance of 201,512 and 198,353 common shares.....	479	434
Share-based compensation.....	<u>163</u>	<u>72</u>
Balance—end of period.....	<u>2,717,440</u>	<u>2,716,726</u>
<b>Accumulated deficit</b>		
Balance—beginning of period.....	(2,061,854)	(2,195,356)
Net loss attributable to controlling interest.....	(107,490)	(69,478)
Cumulative effect of change in accounting principle for equity securities.....	<u>7,469</u>	<u>-</u>
Balance—end of period.....	<u>(2,161,875)</u>	<u>(2,264,834)</u>
<b>Accumulated other comprehensive income</b>		
Balance—beginning of period.....	31,015	3,797
Other comprehensive income attributable to controlling interest.....	(18,947)	21,003
Cumulative effect of change in accounting principle for equity securities.....	<u>(7,469)</u>	<u>-</u>
Balance—end of period.....	<u>4,599</u>	<u>24,800</u>
Total common shareholders' equity—end of period.....	<u>560,164</u>	<u>476,692</u>
Total shareholders' equity—end of period.....	<u>\$ 575,817</u>	<u>\$ 492,798</u>

See accompanying Notes to Unaudited Consolidated Financial Statements.

**SYNCORA HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
**SIX MONTHS ENDED JUNE 30, 2018 AND 2017**  
**(U.S. dollars in thousands)**

	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Premiums collected.....	\$ 6,010	\$ 7,249
Investment income collected.....	22,070	25,686
Fees received on credit default swaps.....	305	1,653
Claims paid to policyholders and loss adjustment expenses paid.....	(76,421)	(13,507)
Cash received from settlement.....	301,406	-
Cash paid to reinsurer.....	(362,262)	-
Operating expenses paid.....	(38,432)	(43,386)
Interest paid on notes payable.....	(341,783)	-
Income taxes paid.....	(223)	(583)
Other cash receipts.....	17,287	7,022
Cash paid for insurance cash flow certificates.....	(77)	(41)
Cash received on insurance cash flow certificates.....	1,246	2,119
Investment income collected by variable interest entities.....	20,866	2,671
Interest and other expenses paid by variable interest entities.....	(3,057)	(1,841)
Net cash used in operating activities from continuing operations.....	(453,065)	(12,958)
Net cash provided by operating activities from discontinued operations.....	4,597	7,524
Net cash used in operating activities.....	(448,468)	(5,434)
<b>Cash flows from investing activities:</b>		
Proceeds from sales of investments.....	240,927	213,665
Proceeds from maturity of investments.....	44,864	74,450
Purchases of investments.....	(34,251)	(124,987)
Payment for loan disbursement.....	-	(1,000)
Net proceeds from consolidated variable interest entities' assets.....	35,083	13,122
Net cash provided by investing activities from continuing operations.....	286,623	175,250
Net cash provided by (used in) investing activities from discontinued operations.....	909	(737)
Net cash provided by investing activities.....	287,532	174,513
<b>Cash flows from financing activities:</b>		
Net paydowns of consolidated variable interest entities' liabilities.....	(9,621)	(5,758)
Paydowns on notes payable.....	(58,217)	-
Distributions to non-controlling interest in consolidated entity.....	(569)	(591)
Net cash used in financing activities from continuing operations.....	(68,407)	(6,349)
Net cash used in financing activities.....	(68,407)	(6,349)
(Decrease) increase in cash and cash equivalents and restricted cash.....	(229,343)	162,730
Cash and cash equivalents and restricted cash and cash equivalents—beginning of period.....	351,434	195,430
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	\$ 122,091	\$ 358,160
<b>Summary of cash and cash equivalents and restricted cash and cash equivalents- end of period:</b>		
Cash and cash equivalents.....	\$ 110,496	\$ 327,395
Restricted cash and cash equivalents.....	181	268
Cash and cash equivalents included in assets of entity held-for-sale.....	11,414	28,320
Restricted cash included in assets of entity held-for-sale.....	-	2,177
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	\$ 122,091	\$ 358,160
<b>Supplemental non-cash transactions:</b>		
Deconsolidation of variable interest entities.....	\$ 57,564	\$ -

See accompanying Notes to Unaudited Consolidated Financial Statements.

**SYNCORA HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
**SIX MONTHS ENDED JUNE 30, 2018 AND 2017**  
**(U.S. dollars in thousands)**

	<u>2018</u>	<u>2017</u>
Reconciliation of loss from continuing operations to net cash used in operating activities from continuing operations:		
Loss from continuing operations.....	\$ (118,059)	\$ (75,343)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities from continuing operations:		
Depreciation and amortization.....	522	522
Net unrealized and realized (gains) losses on investments.....	(3,488)	9,750
Unrealized gains on credit default and other swap contracts.....	(95,726)	(1,466)
Net change in variable interest entities.....	(2,149)	(5,600)
Foreign currency exchange loss (gain).....	751	(2,102)
(Accretion) amortization on insurance cash flow certificates.....	(30,084)	16,657
Other operating activities.....	19,451	10,890
Changes in assets and liabilities:		
Premiums receivable (retained and ceded).....	22,416	21,364
Prepaid reinsurance (ceded).....	(111,932)	-
Deferred acquisition costs, net (retained).....	31,542	4,025
Salvage and subrogation recoverable (retained).....	299,157	4,086
Reinsurance recoverable on unpaid losses and loss adjustment expenses (ceded).....	(151,759)	-
Other assets.....	(14,472)	(1,761)
Unpaid losses and loss adjustment expenses (retained and ceded).....	(63,700)	24,259
Unearned premium revenue (retained and ceded).....	(63,322)	(44,510)
Reinsurance premiums payable (ceded).....	40,300	
Notes payable.....	(113,027)	18,892
Accrued interest on notes payable.....	(87,964)	23,721
Accounts payable, accrued expenses and other liabilities.....	(11,522)	(16,342)
Total adjustments.....	<u>(335,006)</u>	<u>62,385</u>
Net cash used in operating activities from continuing operations.....	\$ <u>(453,065)</u>	\$ <u>(12,958)</u>

See accompanying Notes to Unaudited Consolidated Financial Statements.

**SYNCORA HOLDINGS LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

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## **1. Organization and Business**

Syncora Holdings Ltd. (“Syncora Holdings”) is a Bermuda holding company, which was formed on March 17, 2006 that provides, through its wholly-owned subsidiary, financial guarantee insurance and reinsurance. Syncora Holdings collectively with its consolidated subsidiaries is hereafter referred to as the (“Company”).

Syncora Holdings’ principal business operating subsidiary is Syncora Guarantee Inc. (“SGI” or “Syncora Guarantee”). SGI collects and expects to continue to collect premiums on existing business; however, because of the events discussed herein, SGI ceased writing substantially all new business in January 2008 and is no longer licensed to do so in certain states and other jurisdictions. On December 29, 2017 SGI and its wholly-owned subsidiary, Syncora Capital Assurance Inc. (“SCAI”) entered into a Merger Agreement and other related agreements, which resulted in SCAI merging into SGI, with SGI as the surviving entity. The merger was effective December 31, 2017. As such, the existing reinsurance arrangements and all other intercompany agreements between SGI and SCAI were terminated by operation of law. SGI is an insurance company domiciled in the State of New York, which is regulated by the New York State Department of Financial Services (“NYDFS”) and at one time was licensed to conduct financial guarantee insurance business throughout all 50 of the United States and other jurisdictions.

Prior to January 2008, the Company was primarily engaged in the business of providing (i) credit enhancement on fixed and variable rate debt obligations through the issuance of financial guarantee insurance policies and (ii) credit protection on specific referenced credits or on pools of specific referenced credits through the issuance of financial guarantee insurance policies covering the obligations under credit default swap (“CDS”) contracts issued by trusts established to comply with the New York Insurance Law (the “NYIL”). These trusts are consolidated by the Company.

Financial guarantee insurance policies obligate the insurer to provide an unconditional and irrevocable guarantee to the holder of a debt obligation of full and timely payment of certain principal and interest when due. In the event of a default under the debt obligation, the insurer has recourse against the issuer and/or any related collateral (which is more common in the case of insured asset-backed obligations or other non-municipal debt) for amounts paid under the terms of the policy. CDS contracts are derivative contracts that offer credit protection relating to a particular security or pools of specified securities. Under the terms of a CDS contract, the seller of credit protection makes a specified payment to the buyer of credit protection upon the occurrence of one or more specified credit events with respect to a referenced security. Credit derivatives typically provide protection to a buyer rather than credit enhancement of a debt security as in traditional financial guarantee insurance.

Pike Pointe Holdings, LLC (“Pike Pointe”) is a wholly-owned subsidiary of SGI, which was formed as a Delaware limited liability company to hold 100% of the equity ownership of a number of its subsidiaries that ultimately own and operate certain toll road facilities located in the United States and Canada (collectively, “American Roads LLC”).

On July 25, 2013, American Roads LLC and certain of its affiliates filed “pre-packaged” bankruptcy cases under Chapter 11 of the United Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. SGI insured approximately \$830 million of bonds and interest rate swap liabilities issued by American Roads LLC. On September 3, 2013, the approved bankruptcy plan went effective and SGI as an indirect owner of the American Roads LLC interest rate swaps and issuer of related insurance policies received 100% of the equity ownership of the reorganized American Roads LLC.

On August 8, 2017, management, with Board of Directors approval, committed to a formal plan to sell American Roads LLC. On July 16, 2018, the Company closed the sale of American Roads (see Notes 16 and 17 for further discussion).

On August 12, 2016, Syncora Holdings US Inc., a wholly-owned subsidiary of Syncora Holdings, completed, among other things, a surplus note exchange offer and proxy solicitation for the variation of rights to the SHL Preferred Shares, which upon closing, cancelled all of the Syncora Holdings preferred shares outstanding.

The Company has one reportable operating business segment, which is Financial Guarantee Insurance. The Company’s financial guarantee business segment is conducted primarily through its operating subsidiaries, SGI and Syncora Investment Holdings LLC, which invests in private debt and equity securities. Previously, the Company’s other business segment related to the operations of American Roads LLC, which are now presented as discontinued operations. See Note 16 for further discussion.

### *Closing of Reinsurance Agreement with Assured Guaranty Corp.*

On June 1, 2018, SGI closed the previously announced reinsurance transaction with Assured Guaranty Corp. (“Assured”) pursuant to which Assured agreed to provide reinsurance, generally on a 100% quota share basis, to SGI of approximately \$12.1 billion of net par outstanding of SGI-insured financial guaranty insurance policies, representing approximately 92% of SGI’s outstanding insured exposure as of June 30, 2018. As consideration for the transaction, which also involved a commutation of a small



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book of business ceded to SGI by an Assured affiliate which is included in the par outstanding numbers above, SGI paid approximately \$360 million (which amount includes ceded reserves) and assigned over future installment premium for the reinsured policies. In addition, SGI exercised its option to cede certain debt service reserve fund surety and interest rate swap policies for an additional premium payment of \$2.3 million. Subsequent to the execution of this reinsurance agreement, SGI's remaining insured portfolio is approximately \$1.1 billion of net par outstanding as of June 30, 2018. In addition, in connection with the reinsurance, SGI entered into an administrative services agreement with Assured pursuant to which Assured will provide certain administrative services with respect to the reinsured policies, including the obligation to administer and pay claims on behalf of SGI. The Company entered into with Assured a credit agreement and related security agreement, pursuant to which Assured agreed to make loans to the Company to fund its claims payments on remediated RMBS. See Note 14 for collateral requirements.

## **2. Description of Significant Risks and Uncertainties and Description of the Company's On-Going Strategic Plan**

### *Significant Risks and Uncertainties*

Given the significant risks and uncertainties discussed below and that the Company's shareholders' equity and its capitalization includes debt, in the form of surplus notes, the Company cautions investors that an investment in Syncora Holdings common shares is speculative and may result in a loss of substantially all of their investment. Also, the market price of Syncora Holdings common shares have experienced, and may continue to experience, a high degree of volatility in response to numerous factors, including many over which the Company has no control. Additionally, given the risks outlined below, including those with respect to SGI's liquidity and financial position, the Company cautions investors that an investment in SGI's preferred shares or surplus notes should also be considered speculative.

Syncora Holdings is a holding company with no operations or significant assets other than \$5.8 million of debt securities and cash and cash equivalents and its common equity ownership of its subsidiaries as of June 30, 2018. In January 2017, Syncora Holdings collected \$2.5 million of cash from amounts included in other assets. Syncora Holdings' only potential sources of funds are dividends and/or reimbursements for certain expenses related to the general services agreement with its subsidiaries to provide funds for its working capital needs and to pay operating expenses. The remainder of its capital is held at SGI, and any dividends and/or distributions from SGI are subject to contractual and regulatory prohibitions and limitations and to the prior claims of SGI's surplus noteholders and its preferred shareholders. There can be no assurance that Syncora Holdings will be able to maintain adequate capital or have sufficient liquidity in the future to pay its operating expenses. See Note 15 for financial information of Syncora Holdings.

The Company is exposed to significant risks and uncertainties that may materially affect its operations, financial and liquidity position. These relate to, among other things, (i) the performance of Assured under the reinsurance and related agreements, (ii) the potential for future adverse loss and claims development on its insured obligations or salvage and (iii) the amount or timing of anticipated recoveries of Puerto Rico related remediation bonds and salvage on related claims payments. These risks and uncertainties are discussed more fully below and could materially and adversely affect the Company's results of operations, financial condition and liquidity.

### *Description of Significant Risks and Uncertainties and Other Matters*

- As described above, effective June 1, 2018, the Company entered into with Assured (i) a reinsurance agreement, pursuant to which the Company ceded \$12.1 billion of its insured exposure, (ii) an administrative services agreement pursuant to which Assured will provide certain administrative services with respect to the reinsured policies, including reporting and making claims payments, and (iii) a credit agreement and related security agreement, pursuant to which Assured agreed to make loans to the Company to fund its claims payments on remediated RMBS. As a result of the reinsurance transaction, the Company is exposed to reinsurance counterparty credit risk that the reinsurer may default in its financial obligations with respect to the terms of the reinsurance agreement. This credit risk could cause increased losses and loss reserves and a reduction in reinsurance recoverables. In addition, the failure of Assured to perform under the administrative services agreement or the credit agreement could cause a disruption to the Company's insurance operations and could increase operational costs and the Company's liquidity needs.
- As of June 30, 2018, the Company has \$250.0 million of net exposure to Puerto Rico (excluding interest outstanding of \$69.4 million), which includes direct insurance and reinsurance of bond policies and direct investments by the Company as a result of remediation transactions. This exposure relates primarily to bonds issued by the Puerto Rico Electric Power Authority ("PREPA") of \$138.9 million (excluding interest outstanding of \$34.7 million) and general obligation bonds of the Commonwealth of Puerto Rico (the "Commonwealth") of \$85.8 million (excluding interest outstanding of \$25.8 million) and \$25.3 million of net exposure to other obligations of Puerto Rico (excluding interest outstanding of \$8.9 million). In July 2018, SGI paid approximately \$35.7 million in net claims, representing principal and interest due on July 1, 2018 maturities primarily

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related to Commonwealth and PREPA exposures. In July 2017, SCAI (pre-merger) paid approximately \$112.6 million in net claims, representing principal and interest due on July 1, 2017 maturities primarily related to Commonwealth and PREPA exposures. Syncora Guarantee, as a result of the merger with SCAI, now directly owns all rights and interests of the bondholders with respect to these payments. Recoveries relating to these rights and interests could be long-dated, which could have a material adverse effect on the Company's short-term liquidity needs. Given that the Puerto Rico proceedings under PROMESA (as detailed below) may continue for an extended period, the Company may be required to make further material claims payments and therefore further increasing the proportion of its assets that are comprised of salvage and subrogation rights.

- On June 30, 2016, the President enacted the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), which provides Puerto Rico and its instrumentalities with both an in-court (Title III) and out-of-court (Title VI) process to restructure debts and bind holdouts. PROMESA provides for the establishment of an Oversight Board, which the President appointed on August 31, 2016, with the authority to approve adjustments of debt of Puerto Rico and its instrumentalities, including PREPA.

On May 3, 2017, the Oversight Board filed a petition under Title III on behalf of the Commonwealth. On June 27, 2017, the Oversight Board voted to reject the PREPA Restructuring Support Agreement (the "RSA"), which resulted in the termination of the RSA on June 29, 2017. On July 2, 2017, the Oversight Board filed a petition under Title III on behalf of PREPA. The Commonwealth's and PREPA's Title III proceedings increase the risk and uncertainty relating to the ultimate recovery on the Commonwealth's general obligations bonds and of PREPA's power revenue bonds.

On June 14, 2017, the judge overseeing the Title III proceedings entered an order appointing a team of mediators to facilitate confidential settlement negotiations of any issues arising in those proceedings. The Company is participating in the mediation process.

On July 18, 2017, certain creditors of PREPA, including Syncora Guarantee, filed a motion in PREPA's Title III case seeking relief from the automatic stay in order to commence an action to enforce their statutory right to appoint a receiver. On September 14, 2017, this motion was denied by Judge Swain. On September 28, 2017, the Company and the other creditors appealed the decision to the United States Court of Appeals for the First Circuit. On August 8, 2018, the First Circuit issued an opinion vacating Judge Swain's decision and holding that sections 305 and 306 of PROMESA do not preclude the court from granting the requested relief to appoint a receiver. The First Circuit remanded the case back to Judge Swain and allowed the creditors to file a renewed motion to seek relief from the automatic stay.

On September 20, 2017, Hurricane Maria made landfall on Puerto Rico causing extensive and widespread damage to property and infrastructure, including loss of electric power throughout the island. On April 19, 2018, the Oversight Board certified revised fiscal plans for both the Commonwealth and PREPA which reflect the impact of Hurricane Maria and are intended to provide the bases for any plans of adjustment in the Title III cases of the Commonwealth and PREPA. The certified fiscal plans have been further revised.

On June 5, 2018, agents representing the Commonwealth and the Puerto Rico Sales Tax Financing Corp ("COFINA") disclosed an agreement in principle resolving the ownership dispute between the Commonwealth and COFINA over the Commonwealth's sales and use tax. The agreement does not allocate distributions among Commonwealth creditors, including holders of insured general obligation bonds. The agents have not yet entered into definitive documentation to memorialize the agreement, which will be subject to court approval. On August 8, 2018, the Oversight Board, the Governor and the COFINA creditors announced the terms of a consensual Title III plan of adjustment for COFINA, which is premised on the earlier settlement regarding the sales and use tax.

On July 30, 2018, the Oversight Board announced that it entered into a preliminary restructuring support agreement with the ad hoc group of PREPA bondholders, PREPA and the Commonwealth. This agreement contemplates the exchange of outstanding uninsured PREPA bonds for two classes of new securitization bonds and does not address the treatment of insured PREPA bonds.

Due to the pending Title III cases and given the effects of Hurricane Maria on Puerto Rico, the Company may experience further losses on these insured obligations which could have a material adverse effect on the Company's liquidity and financial position.

- As of June 30, 2018, in respect of its Puerto Rico-related exposure, the Company has made substantial claim payments and anticipates that it may be requested to make further gross claim payments in the period 2018 to 2029 of at least approximately \$257.7 million, followed in later years (in some cases significantly later years) by recoveries of salvage made in respect of these claims payments. The amount and timing of the salvage recoveries related to all of these claims payments are subject to greater uncertainty than the amount and timing of such future claims payments themselves. Pursuant to the Company's accounting policy

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and guidance under Generally Accepted Accounting Principles (“GAAP”), the net present value of estimated claims and recoveries (including salvage and subrogation) are reflected in the Company’s loss reserves and salvage and subrogation recoverable (see Note 5). Because of the inherent uncertainty in estimating future claim payments and recoveries, no assurance can be given that the amount or timing of claims payments, related recoveries, or ultimate losses match the Company’s estimates, and such differences could materially and adversely affect the Company’s results of operations, financial condition and liquidity. The Company may also experience significant adverse development on its insured obligations that may place further demands on the Company’s liquidity and financial position. See Note 5 “*Schedule of Insured Financial Obligations with Credit Deterioration*” caption for further discussion.

- Any payment of principal or interest on the short-term and long-term surplus notes issued by SGI is subject to the satisfaction of conditions precedent, including, without limitation, prior regulatory approval by the NYDFS. SGI remains exposed to significant risks and uncertainties that may materially and adversely affect its financial condition, liquidity position and ability to make future payments on its surplus notes. In addition, in June 2018, SGI made an aggregate of \$400 million of payments on its surplus notes following the closing of the reinsurance transaction. The NYDFS has not approved and is not required to approve any future payments on the surplus notes. Accordingly, there can be no assurance as to whether and when the NYDFS will approve any future payments on the short-term or long-term surplus notes.
- The Company and its financial position will continue to be subject to risk of global financial and economic conditions that could materially and adversely affect the amount of potential losses (including the timing and amount of potential claims and subsequent recoveries) incurred on transactions it guarantees, the value of its investment portfolio, and otherwise materially and adversely affect the Company. With respect to the Company’s investment portfolio, a prolonged period of low interest rates, along with declining investment balances, may adversely affect the Company’s ability to generate sufficient investment income to fund its future obligations. Issuers or borrowers whose securities or loans the Company insures or holds as well as the Company’s counterparties under swaps and other derivative contracts may default on their obligations to the Company due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting securities that the Company has guaranteed may deteriorate further, causing these securities to incur losses.
- The Company has direct insurance and reinsurance exposure to certain credits within European countries. Global economic conditions have been negatively affected with concerns about the continued sovereign debt crisis within the European region and the possibility that certain European Union member states will default on their debt obligations or leave the European Union. The continued uncertainty over the outcome of the European Union governments’ efforts to provide financial support for sovereigns and sub-sovereigns and the possibility of further deteriorating conditions in Europe could have a material adverse effect on the Company’s financial and liquidity position. As of June 30, 2018, the Company’s net in-force guaranteed principal exposure to the European Union was approximately \$517.9 million of which \$263.8 million of exposure is to credits in the UK and denominated in British Pound sterling and \$254.0 million was specifically related to certain credits in higher risk countries, such as Portugal and Italy. The United Kingdom held a referendum on June 23, 2016, in which a majority of voters voted to exit the European Union (“Brexit”). Negotiations have commenced to determine the future terms of the United Kingdom’s relationship with the European Union. Brexit has caused currency exchange rate fluctuations that resulted in the weakening of the British Pound, in which a portion of the Company’s insured portfolio is denominated. Until there is greater certainty on the terms and conditions of the United Kingdom’s relationship with the European Union, the Company cannot provide any assurance of its effect on its business, results of operations and liquidity, which could be material and adverse.
- The Company is materially exposed to foreign exchange risk as the Company’s insured debt obligations are denominated in a number of foreign currencies and the U.S. dollar. The principal currencies creating foreign exchange risk are the British Pound sterling, Australian dollar and the European Union euro. At June 30, 2018, approximately 47% of the Company’s in-force guaranteed net par outstanding exposure of \$1.1 billion was denominated in such currencies. The Company translates foreign currencies into U.S. dollars at the current market exchange rates. Changes in the exchange rates between foreign currencies and U.S. dollars may have an adverse effect on the settlement of potential claims or the value of salvage/recoveries and therefore could have a material adverse effect on the Company’s liquidity and surplus position. In addition, the Company is materially exposed to risks associated with its financial guarantees covering foreign denominated inflation indexed-linked bonds in connection with the bonds issued by UK and European utility and project finance issuers.
- The Company is involved in legal proceedings. Management cannot predict the outcomes of these legal proceedings with certainty. A favorable outcome could have a material effect on the Company’s financial and liquidity position. Prosecuting these legal proceedings involves significant expense and diversion of management’s attention and resources from other matters.

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- The Company's ability to pay dividends on its preferred and common shares is subject to risks and uncertainties, including, without limitation, prior regulatory approval by the NYDFS and compliance with certain contractual restrictions. No assurance can be given as to whether or when SGI may be able to pay any dividends on its preferred and/or common shares. As discussed in Note 13, SGI's ability to pay dividends is subject to regulatory constraints.
- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on the Company's in-force business requires the use and exercise of significant judgment and is based on certain assumptions by management, including estimates regarding the likelihood of occurrence, timing and amount of a loss on a guaranteed obligation. Changes in such assumptions could materially adversely affect such reserve estimates, including the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company, these exposures may result in significant increases in claims beyond those assumed in the Company's reserve estimate (that may or may not result in an increase in such loss reserves) in the near to medium term. A material portion of the Company's case basis reserves reflects certain assumptions that affect reimbursements in the remainder of its insured and reinsured portfolio. Actual experience may, and likely will, differ from those estimates and such difference may be material due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred and, in certain cases, will occur over many years in the future. Examples of these events include changes in the level of interest rates, credit deterioration of guaranteed obligations, recoveries in bankruptcy proceedings, changes in the value of specific assets supporting guaranteed obligations and changes in the level of investment yield. Both qualitative and quantitative factors are used in making such estimates. From time to time the Company reevaluates all such estimates, which may be material. Any estimate of future costs is subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should, therefore, be expected that the actual emergence of losses and claims will vary, perhaps materially, from any estimate. The risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed.
- SGI has sought, and may in the future seek, the NYDFS's approval of permitted accounting practices and other regulatory relief which have, and if granted may have, a material effect on SGI's statutory policyholders' surplus. Once granted, these permitted accounting practices have been subject to an annual approval or confirmation. No assurance can be given that the NYDFS will continue to grant approval of SGI's past or any future permitted accounting practices or requested regulatory relief. Failure to obtain continuing approval of the past or future permitted accounting practices or requested regulatory relief could have a material adverse effect on SGI's statutory policyholders' surplus.
- Should the Company experience an "ownership change" for purposes of Section 382 of the Internal Revenue Code, the Company's ability to utilize its net operating loss carryforwards could be subject to an annual limitation in the future, which would be expected to result in a material increase in the Company's U.S. federal income tax liability, reduce reimbursements from profitable affiliates under its tax sharing agreement and therefore materially adversely affect the Company's equity and liquidity position. While the Syncora Holdings Ltd. bye-laws contain restrictions intended to reduce the likelihood of such an "ownership change," it remains possible that an "ownership change" could nonetheless occur. These limitations may prevent Syncora Holdings Ltd. from taking certain strategic actions or may make it more difficult for Syncora Holdings Ltd. to attract additional capital. In addition, although the Company has not taken any uncertain tax positions, the IRS may nonetheless disagree with the Company's interpretation of this and other tax related matters.
- Notwithstanding the amendments to the 2009 MTA obtained by the Company on August 24, 2015, as discussed in Note 3, and the restructuring transactions completed on August 12, 2016 as discussed in Note 1, the Company remains subject to certain contractual and regulatory restrictions that limit its financial and operating flexibility and may materially and adversely impair its ability to execute on its strategic plan. See below Description of the Company's On-Going Strategic Plan and associated risks.
- The Company relies upon information technology and systems, including those of third parties, to support a variety of its business processes and activities. In addition, the Company has collected and stored confidential information. The Company's data systems and those of third parties on which it relies may be vulnerable to security breaches from external and internal factors. Problems in, or security breaches of, these systems could result in, among other things, reputational harm, the disclosure or misuse of confidential or proprietary information, inaccurate loss projections, legal costs and regulatory penalties. As the Company's business operations rely on the continuous availability of its computer systems, as well as those of certain third parties, a failure to maintain business continuity in the wake of disruptive events could prevent the timely completion of critical processes across its operations, including, for example, claims processing and investment operations. These failures could result in additional costs, fines and litigation.
- Syncora Holdings' business could be negatively affected as a result of actions of activist stockholders, and such activism could affect the trading value of its securities. Responding to actions by activist stockholders can be costly and time-consuming, disrupting operations and diverting the attention of management and employees. Such activities could interfere with

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management's ability to execute its strategic plan. In addition, a proxy contest for the election of directors at the Company's annual meeting would require Syncora Holdings to incur significant legal fees and proxy solicitation expenses and require significant time and attention by management and board of directors. The perceived uncertainties as to Syncora Holdings' future direction also could affect the market price and volatility of its securities.

- The Company's success substantially depends upon its ability to retain qualified employees and upon the ability of its senior management and other key employees to implement its strategic plan. The Company relies substantially upon the services of its executive team and other key employees. The loss of the services of any of these individuals or other key members of the Company's management team or the inability to hire talented personnel could adversely affect the implementation of its strategic plan or ability to operate the business.
- The Company may be unable to execute any or all of the elements of its On-Going Strategic Plan on a timely basis or at all, as described below.

*Description of the Company's On-Going Strategic Plan*

The Company, together with its subsidiaries, has completed a comprehensive strategic plan review and is now pursuing certain key strategic initiatives in order to continue to deliver enhanced value to stakeholders.

These initiatives include (i) continuing to make payments on the surplus notes issued by the SGI, (ii) continuing to focus on remediating insured exposures (through their purchase on the open market or otherwise, commutation, defeasance or other restructuring) to minimize potential claim payments, maximize recoveries and mitigate potential losses, (iii) seeking to realize the maximum value of its assets, and various legal proceedings and from any other rights and remedies the Company may have, whether through litigation, settlement, sale or other monetization, (iv) transitioning services to Assured in respect of the reinsurance agreement and the administrative services agreement, (v) seeking to novate or purchase with a view towards novating to Assured, the policies reinsured to Assured, (vi) further reducing operating expenses and improving operational efficiencies, and (vii) to consider to acquire or tender for SGI's preferred securities at a substantial discount. In addition, management is continuing to evaluate when and how to utilize net operating losses ("NOLs") that were reallocated to Syncora Holdings US Inc. as part of the restructuring transaction completed on August 12, 2016.

Any or all of these actions may be outside the ordinary course of the Company's operations or its control and may require consents, approvals or cooperation of third parties, including the NYDFS, and there can be no assurance that any such consents, approvals or cooperation will be obtained on a timely basis or at all.

### **3. Description of the Transactions Comprising the 2009 MTA and Related Transactions**

To remediate its previously reported policyholders' deficit and reestablish compliance with its regulatory minimum policyholders' surplus, on July 15, 2009, SGI consummated a Master Transaction Agreement with certain of its financial counterparties (the "Counterparties") to CDS contracts insured by its financial guarantee insurance policies and certain related transactions (referred to collectively as the "2009 MTA").

The 2009 MTA consisted of the following primary components:

- the restructure, effective defeasance or, in-substance, commutation (in whole or in part) of substantially all of SGI's exposure to such CDS contracts, in exchange for which SGI paid the Counterparties consideration comprised of approximately \$1.2 billion in cash, issuance of \$625.0 million surplus notes of SGI and the transfer of common shares of Syncora Holdings;
- the reinsurance or novation of certain business to a newly formed, wholly-owned insurance subsidiary of SGI, SCAI (prior to merger), in which SGI also issued back-up guarantees on such novated guarantees. See Note 1 for merger discussion.
- the effective defeasance or, in-substance, commutation, of certain of SGI's exposure to insured RMBS securities. See Note 5 for further discussion; and
- certain other transactions to remediate loss exposure, which primarily consisted of certain commutations of its other guarantees and assumed reinsurance, and terminated its office lease agreement.

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The 2009 MTA also contains a number of significant restrictive covenants applicable to SGI and Syncora Holdings (collectively, the “Syncora MTA Parties”), which remain in effect until SGI’s surplus notes have been paid in full and, with respect to certain covenants, until certain policies issued by and CDS contracts insured by SGI are no longer in effect. These include prohibitions on:

- the Syncora MTA Parties entering into a new or amending the existing tax sharing agreement or entering into specified related party transactions (subject to specified exceptions);
- SGI writing new business; incurring indebtedness and other material voluntary obligations (subject in each case to specified exceptions and limitations); merging, consolidating or selling, assigning, transferring or disposing of (including by way of reinsurance, recapture or otherwise) all or any material portion of their respective assets (subject to specified exceptions); and
- SGI making any payments with respect to its short-term or long-term surplus notes except with respect to all such notes on a pro rata basis and on the same terms; paying dividends on or repurchasing, redeeming, exchanging or converting its equity securities (or of any of its direct or indirect parent’s equity securities) or making investments (subject to specified exceptions).

On August 24, 2015, SGI and SCAI (prior to merger) executed certain amendments to the 2009 MTA to, among other things, eliminate or modify certain contractual constraints, including, among other things, restrictions on SGI’s ability to issue equity securities and restrictions on selling the SCAI Surplus Notes (prior to merger), reduce the requisite consenting percentages for future amendments to 50% by value from 75% by vote and value; and bifurcate voting between SGI-only matters and SCAI (prior to merger) -only matters all of which provide SGI with increased financial and operating flexibility. After giving effect to this amendment, SGI remains subject to certain prohibitions, future changes to which would require, in most cases, company-only vote at a 50% voting threshold by value.

#### **4. Significant Accounting Policies**

Specific accounting policies pertaining to insurance operations, investments, debt and discontinued operations are disclosed within the applicable notes to the consolidated financial statements.

##### ***Basis of Presentation***

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring accruals and the use of estimates) considered necessary for a fair presentation pursuant to these requirements have been included. Actual results could differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results for a full year.

##### ***Consolidation***

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and all other entities in which the Company has a controlling financial interest, including VIEs for which the Company is deemed to be the primary beneficiary. All intercompany accounts and transactions have been eliminated.

##### ***Reclassifications***

Certain reclassifications were made to prior period consolidated financial statement amounts to conform to the current period presentation. There were no effects on net income or shareholders’ equity as a result of these reclassifications.

##### ***Fees and Other Income***

Fees and other income include waiver, consent, termination and other fees in connection with certain of the Company’s insured transactions, in addition to other miscellaneous sources of income. Depending upon the type of fee received, the fee is either earned when services are rendered and the fee is due, or deferred and earned over a stipulated period or the life of the related transaction.

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***Operating Expenses***

Operating expenses primarily include compensation and employee benefits, professional and legal fees, computer related costs, rent and occupancy costs, depreciation and amortization expense, administrative services agreement fees, foreign currency exchange losses and other general and administrative expenses.

***Foreign Currency Translation***

Assets and liabilities denominated in foreign currencies are translated into U.S. dollar equivalents at exchange rates prevailing as of the date of the consolidated balance sheet. Revenues and expenses are translated at average exchange rates prevailing during the period. Gains and losses resulting from foreign currency transactions to U.S. dollar equivalents are recorded in current income and reflected in the operating expenses caption in the consolidated statements of operations.

***Earnings Per Share***

Basic earnings per share amounts are calculated by dividing earnings attributable to common shareholders by the weighted average number of common shares outstanding during the period, excluding the effect of dilutive securities. Diluted earnings per share amounts are calculated by dividing earnings attributable to common shareholders by the sum of the weighted average number of common shares outstanding during the period plus additional shares potentially issued from all dilutive securities. There were no dilutive securities outstanding at June 30, 2018 and 2017, respectively.

***Recent Accounting Pronouncements***

Recently Adopted Accounting Pronouncements

In November 2016, the FASB issued “Statement of Cash Flows – Restricted Cash”. This standard clarifies how entities should present changes in restricted cash and restricted cash equivalents in the statement of cash flows. The guidance requires entities to include restricted cash and restricted cash equivalents with the total cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown in the statement of cash flows. This standard was effective for fiscal years beginning after December 15, 2017, including interim periods within those years, with early adoption permitted. The Company early adopted this standard as of December 31, 2017 which resulted in a change in presentation of restricted cash and cash equivalents on the consolidated statements of cash flows.

In January 2016, the FASB issued “Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities”. This standard amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This guidance includes requirements for certain equity investments with readily determinable fair values to be measured at fair value with changes recognized in net income and for financial liabilities where the fair value option has been elected, requiring the portion of the fair value change related to instrument-specific credit risk (which includes a Company's own credit risk) to be separately reported in other comprehensive income. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company adopted this standard as of January 1, 2018. The Company's credit risk included in the variable interest entities' (“VIE”) liabilities for which the fair value option was elected was immaterial. As of January 1, 2018, the Company reclassified the accumulated net unrealized gains relating to equity securities in its investment portfolio at December 31, 2017 (approximately \$7.5 million) from accumulated other comprehensive income to accumulated deficit as a cumulative-effect adjustment, net of tax.

In August 2016, the FASB issued “Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments”. This standard addresses eight specific cash flow issues, with the objective of reducing the existing diversity in practice in how these transactions are classified in the statement of cash flows. This standard was effective for fiscal years beginning after December 15, 2017, including interim periods within those years, with early adoption permitted provided that all of the amendments are adopted in the same period. The standard requires application using a retrospective transition method to each period presented. The Company adopted this standard as of January 1, 2018 and the adoption of this standard did not have a material effect on the Company's consolidated financial statements.

Accounting Pronouncements Pending Adoption

In June of 2016, the FASB issued “Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments.” This standard introduces a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. This standard applies to financial assets measured at amortized cost, debt securities and other financial assets measured at fair value through other comprehensive income, loans, receivables and certain other financial instruments. This standard requires that financial assets measured at amortized cost be presented at the net amount expected to be collected by recording

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a valuation allowance, with changes in the allowance reflected in the income statement each period. For available for sale debt securities, credit losses should also be recorded through a valuation allowance, limited to the difference between the fair value and amortized cost of the security. This standard is effective for fiscal years beginning after December 15, 2019 for public business enterprises that are Securities and Exchange Commission (“SEC”) filers and after December 15, 2020 for public business enterprises that are non-SEC filers. The Company is evaluating the effect of adopting this standard.

In March 2017, the FASB issued “Receivables-Nonrefundable Fees and Other Costs - Premium Amortization on Purchased Callable Debt Securities”. This standard shortens the amortization period for the premium on callable debt securities to the earliest call date. Currently under GAAP, a reporting entity generally amortizes the premium as yield adjustment over the contractual or maturity life of the debt security and if such debt security is called, the entity would record a loss equal to the unamortized premium. This standard does not change the accounting for callable debt securities held at a discount, which will continue to be amortized to maturity. This standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. This standard is to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is evaluating the effect of adopting this standard.

## **5. Insurance Operations**

### *Premiums Receivable and Unearned Premium Revenue*

The Company recognizes a liability for unearned premium revenue at the inception of financial guarantee insurance and reinsurance contracts on a contract-by-contract basis. Unearned premium revenue recognized at inception of a contract is measured at the present value of the premium due or expected to be collected. For certain financial guarantee insurance contracts, the Company receives the entire premium due at the inception of the contract, and recognizes unearned premium revenue liability at that time. For other financial guarantee contracts, the Company receives premiums in installments over the term of the contract at stipulated due dates. Unearned premium revenue and a receivable for future premiums are recognized at the inception of an installment contract, and measured at the present value of premiums expected to be collected over the contract period or expected period using a risk-free discount rate that considers the expected maturity of each contract. The expected period is used in the present value determination of unearned premium revenue and receivable for future premiums for contracts where (a) the insured obligation is contractually prepayable, (b) prepayments are probable, (c) the amount and timing of prepayments are reasonably estimable, and (d) a homogenous pool of assets is the underlying collateral for the insured obligation. The Company has determined that substantially all of its installment contracts are required to be measured based on the contract period. The receivable for future premiums is reduced as installment premiums are collected. The Company reports the accretion of the discount on installment premiums receivable as premium revenue. The Company assesses the receivable for future premiums for collectability each reporting period, adjusts the receivable for uncollectible amounts and recognizes any write-off as an operating expense.

### *Premium Revenue Recognition*

Financial guarantee insurance and reinsurance enterprises recognize the premium from a financial guarantee insurance contract as revenue over the period of the contract in proportion to the amount of insurance protection provided. As premium revenue is recognized, a corresponding decrease in the unearned premium revenue occurs. The amount of insurance protection provided is a function of the insured exposure outstanding. Therefore, the proportionate share of premium revenue to be recognized in a given reporting period is a constant rate calculated based on the relationship between the insured exposure outstanding in a given reporting period compared with the sum of each of the insured exposure amounts outstanding for all periods.

The Company’s accounting policies for the recognition of ceded premiums, ceding commissions and ceded losses and loss adjustment expenses under its ceded reinsurance contracts mirror the policies described herein for premium revenue recognition, deferred ceding commissions, and reserves for losses and loss adjustment expenses.

When an insured issue is retired early, is called by the issuer or is in substance paid in advance through a refunding accomplished by placing U.S. Government securities in escrow, any remaining unearned premium revenue is earned at that time, since there is no longer risk to the Company. Also, premiums earned may be accelerated as a result of the Company’s remediation transactions, which result in the Company no longer being at risk (hereafter collectively with refunding referred to as “Premium Accelerations”).



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*Reinsurance*

Reinsurance premiums ceded are earned over the period the reinsurance coverage is provided. Prepaid reinsurance premiums represent the portion of premiums ceded which is applicable to the unexpired term of reinsured policies in-force. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Provision is made for any estimated uncollectible reinsurance.

*Insurance Premiums*

As of June 30, 2018, the Company reported gross and retained premium receivable of \$70.4 million and \$17.2 million, respectively, primarily related to installment policies for which premiums will be collected over the term of the contracts. The weighted average risk-free rate used to discount future installment premiums was 2.8% and the weighted average collection term of the premium receivable was 11.5 years. For the six months ended June 30, 2018, the accretion of the premium receivable was \$1.1 million and is reported in "Premiums earned" on the accompanying consolidated statement of operations. As of June 30, 2018, the Company reported a reinsurance premium payable of \$53.2 million, which represents the portion of the Company's premium receivable that is due to reinsurers. The reinsurance premium payable will be accreted and paid, as premiums due to the Company are accreted and collected.

The following tables present a roll forward of the Company's premium receivable and unearned premium net liability for the six months ended June 30, 2018 and 2017:

(U.S. dollars in thousands)

	Retained business		Ceded Business		Total	
	2018	2017	2018	2017	2018	2017
Premium receivable, beginning of period	\$ 79,903	\$ 104,996	\$ 12,921	\$ 12,732	\$ 92,824	\$ 117,728
Premium payments received	(4,397)	(6,689)	(1,613)	(560)	(6,010)	(7,249)
Adjustments:						
Effects of reinsurance	(41,768)	(664)	41,768	664	-	-
Changes in expected term of policies	(17,537)	(15,603)	-	-	(17,537)	(15,603)
Accretion of premium receivable discount	986	1,308	145	180	1,131	1,488
Premium receivable, end of period	\$ 17,187	\$ 83,348	\$ 53,221	\$ 13,016	\$ 70,408	\$ 96,364

(U.S. dollars in thousands)

	Retained business		Ceded Business		Total	
	2018	2017	2018	2017	2018	2017
Recognition of retained unearned premiums revenue, including premium accelerations of \$13,808 and \$13,861	\$ 63,794	\$ 44,510	\$ -	\$ -	\$ 63,794	\$ 44,510
Recognition of ceded unearned premiums revenue	111,932	124	(111,932)	(124)	-	-
Reduction in previously written retained premiums	(37,357)	(16,393)	-	-	(37,357)	(16,393)
Reduction in ceded premiums written	(115,252)	(855)	115,252	855	-	-
Premiums earned	23,117	27,386	3,320	731	26,437	28,117
Change in net liability due to premiums recognized (retained and ceded)	(175,726)	(44,634)	111,932	124	(63,794)	(44,510)
Change in net liability due to derecognition of variable interest entities	472	1	-	-	472	1
Unearned net liability, beginning of period	209,320	277,092	15,565	15,723	224,885	292,815
Unearned net liability, end of period	34,066	232,459	127,497	15,847	161,563	248,306

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The following table presents the Company's installment premiums on business expected to be collected in the future and the periods in which such collections are expected to occur, the expected unearned premium revenue balance and the expected future premium earnings of the Company's in-force business as of and for the periods presented. In addition to that presented in the table below, the Company had installment premiums receivable of \$2.1 million (on a present value basis) and unearned premium revenue of \$4.8 million relating to assumed reinsurance business at June 30, 2018:

(U.S. dollars in thousands)	Expected Collection of Premiums	Unearned Premium Revenue	Expected Premium Earnings			
			Upfront	Installments	Accretion	Total
<b>Retained business</b>						
Three months ended:						
September 30, 2018	\$ 419	\$ 27,766	\$ 431	\$ 328	\$ 113	\$ 872
December 31, 2018	<u>205</u>	<u>27,070</u>	<u>377</u>	<u>320</u>	<u>110</u>	<u>807</u>
Twelve months ended:						
December 31, 2019	1,205	24,384	1,453	1,231	419	3,103
December 31, 2020	1,158	21,836	1,389	1,160	385	2,934
December 31, 2021	1,117	19,430	1,307	1,099	352	2,758
December 31, 2022	1,038	17,201	1,222	1,008	322	2,552
December 31, 2023	<u>962</u>	<u>15,155</u>	<u>1,121</u>	<u>924</u>	<u>294</u>	<u>2,339</u>
Five years ended:						
December 31, 2028	3,836	8,139	3,436	3,580	1,117	8,133
December 31, 2033	3,486	3,596	1,611	2,932	612	5,155
December 31, 2038	2,354	575	1,206	1,815	163	3,184
December 31, 2043	275	-	339	236	7	582
December 31, 2048	-	-	-	-	-	-
December 31, 2053	-	-	-	-	-	-
December 31, 2058	-	-	-	-	-	-
December 31, 2059	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 16,055</u>		<u>\$ 13,892</u>	<u>\$ 14,633</u>	<u>\$ 3,894</u>	<u>\$ 32,419</u>
<b>Ceded business</b>						
Three months ended:						
September 30, 2018	\$ 609	\$ 126,061	\$ 2,069	\$ 1,176	\$ 425	\$ 3,670
December 31, 2018	<u>773</u>	<u>123,191</u>	<u>1,702</u>	<u>1,168</u>	<u>418</u>	<u>3,288</u>
Twelve months ended:						
December 31, 2019	4,623	112,315	6,339	4,536	1,572	12,447
December 31, 2020	4,533	102,151	5,917	4,249	1,413	11,579
December 31, 2021	3,935	92,778	5,476	3,896	1,265	10,637
December 31, 2022	3,707	84,339	5,039	3,401	1,140	9,580
December 31, 2023	<u>3,678</u>	<u>76,476</u>	<u>4,586</u>	<u>3,277</u>	<u>1,021</u>	<u>8,884</u>
Five years ended:						
December 31, 2028	14,450	46,576	17,655	12,245	3,525	33,425
December 31, 2033	9,620	27,055	12,445	7,075	1,666	21,186
December 31, 2038	5,148	14,496	9,382	3,178	457	13,017
December 31, 2043	504	9,164	4,864	467	70	5,401
December 31, 2048	270	5,160	3,811	193	19	4,023
December 31, 2053	26	1,265	3,876	19	-	3,895
December 31, 2058	-	8	1,257	-	-	1,257
December 31, 2059	<u>-</u>	<u>-</u>	<u>8</u>	<u>-</u>	<u>-</u>	<u>8</u>
Total	<u>\$ 51,876</u>		<u>\$ 84,426</u>	<u>\$ 44,880</u>	<u>\$ 12,991</u>	<u>\$ 142,297</u>

**SYNCORA HOLDINGS LTD.**  
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(U.S. dollars in thousands)	Expected Collection of Premiums	Unearned Premium Revenue	Expected Premium Earnings			
			Upfront	Installments	Accretion	Total
<b>Total</b>						
Three months ended:						
September 30, 2018	\$ 1,028	\$ 153,827	\$ 2,500	\$ 1,504	\$ 538	\$ 4,542
December 31, 2018	<u>978</u>	150,261	<u>2,079</u>	<u>1,488</u>	<u>528</u>	<u>4,095</u>
Twelve months ended:						
December 31, 2019	5,828	136,699	7,792	5,767	1,991	15,550
December 31, 2020	5,691	123,987	7,306	5,409	1,798	14,513
December 31, 2021	5,052	112,208	6,783	4,995	1,617	13,395
December 31, 2022	4,745	101,540	6,261	4,409	1,462	12,132
December 31, 2023	<u>4,640</u>	91,631	<u>5,707</u>	<u>4,201</u>	<u>1,315</u>	<u>11,223</u>
Five years ended:						
December 31, 2028	18,286	54,715	21,091	15,825	4,642	41,558
December 31, 2033	13,106	30,651	14,056	10,007	2,278	26,341
December 31, 2038	7,502	15,071	10,588	4,993	620	16,201
December 31, 2043	779	9,164	5,203	703	77	5,983
December 31, 2048	270	5,160	3,811	193	19	4,023
December 31, 2053	26	1,265	3,876	19	-	3,895
December 31, 2058	-	8	1,257	-	-	1,257
December 31, 2059	<u>-</u>	-	<u>8</u>	<u>-</u>	<u>-</u>	<u>8</u>
Total	<u>\$ 67,931</u>		<u>\$ 98,318</u>	<u>\$ 59,513</u>	<u>\$ 16,885</u>	<u>\$ 174,716</u>

*Deferred Acquisition Costs and Deferred Ceding Commission*

Policy acquisition costs include those expenses that primarily relate to, and vary with, the production of new business. These costs include direct and indirect expenses related to underwriting, marketing and policy issuance, rating agency fees and premium taxes, and are reduced by ceding commission income on premiums ceded to reinsurers. Policy acquisition costs are deferred and amortized over the period in which the related premiums are earned.

For policies reinsured with third parties, the Company receives ceding commissions to compensate for acquisition costs incurred. The Company nets ceding commissions received against deferred acquisition costs and earns these ceding commissions over the period in which the related premiums are earned.

In the event of a Premium Acceleration, the remaining net amount of deferred acquisition costs with respect to refunded insured issue is recognized at such time.

Deferred acquisition costs, net of deferred ceding commission revenue, as well as related amortization, as of and for the six months ended June 30, 2018 and 2017 are as follows:

(U.S. dollars in thousands)	<u>2018</u>	<u>2017</u>
Deferred acquisition costs, net, beginning of period	\$ 34,930	\$ 42,614
Deferred acquisition costs and adjustments on statement of operations:		
Acquisition costs amortized	(3,746)	(4,042)
Ceding commission revenue amortized	<u>16</u>	<u>17</u>
Amortization and adjustments on statement of operations	<u>(3,730)</u>	<u>(4,025)</u>
Deferred acquisition cost adjustments for commutation and reinsurance on balance sheet:		
Deferred acquisition costs on reinsurance	<u>(27,812)</u>	<u>-</u>
Deferred acquisition cost adjustments for commutation and reinsurance on balance sheet	<u>(27,812)</u>	<u>-</u>
Deferred acquisition costs, net, end of period	<u>\$ 3,388</u>	<u>\$ 38,589</u>

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*Unpaid Loss and Loss Adjustment Expenses*

A claim liability (loss reserve) is recognized at the measurement date on a contract-by-contract basis based on the weighted average probability of net cash outflows to be paid under the contract, on a present value basis, to the extent that the claim liability so determined exceeds the unearned premium revenue attributable to such contract at the measurement date.

Establishment of reserves for unpaid losses and loss adjustment expenses requires the use and exercise of significant judgment by management, including estimates regarding the occurrence and amount of a loss on an insured obligation. Actual experience may differ from estimates and such difference may be material, due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred. Examples of these events include changes in the level of interest rates, credit deterioration of insured obligations, and changes in the value of specific assets supporting insured obligations. Both qualitative and quantitative factors are used in establishing such reserves. In determining the reserves, management considers all factors in the aggregate, and does not attribute the reserve provisions or any portion thereof to any specific factor. Any estimate of future costs is subject to the inherent limitation on the Company's ability to predict the aggregate course of future events. It should, therefore, be expected that the actual emergence of losses and loss adjustment expenses will vary, perhaps materially, from any estimate.

The present value of net cash outflows is determined based on a risk free rate of interest commensurate with the expected duration of the related contract. For this purpose, the Company uses the rate on U.S. Treasury obligations with a duration consistent with the duration of the underlying insured obligation for U.S. dollar denominated insured obligations or the comparable risk free rate on foreign government obligations relating to insured obligations denominated in foreign currencies. The weighted average risk free rate at June 30, 2018 and December 31, 2017 was 2.8% and 2.3%, respectively. A claim liability is subsequently remeasured each reporting period for increases or decreases due to changes in the magnitude and likelihood of default and potential recoveries, as well as changes in the risk free rate of interest. Subsequent changes to the measurement of claim liability are recognized as loss expense in the period of change. Measurement and recognition of loss liability is reported gross of any reinsurance. The Company estimates the likelihood of possible claims payments and possible recoveries using probability-weighted expected cash flows based on available information, including market information. Accretion of the discount on a claim liability, as well as any changes in the risk free rate of interest, are included in loss expense.

Loss reserves represent the Company's: (i) probability-weighted average estimate of the net present value of claims to be paid subsequent to the balance sheet date, less (ii) its probability-weighted average estimate of the net present value of recoveries subsequent to the balance sheet date and (iii) any unearned premium revenue relating to such guarantees at the end of the reporting period.

Loss reserves are generally determined using cash flow models to estimate the net present value of the anticipated shortfall between (i) scheduled payments on the insured obligation plus anticipated loss adjustment expenses and (ii) anticipated cash flow from the collateral supporting the obligation and other anticipated recoveries. A number of quantitative and qualitative factors are considered when determining or assessing the need for a case basis reserve. These factors may include the creditworthiness of the underlying issuer of the insured obligation, whether the obligation is secured or unsecured, the projected cash flow or market value of any assets that collateralize or secure the insured obligation, and the historical and projected loss rates on such assets. Other factors that may affect the actual ultimate loss include the state of the economy, changes in interest rates, rates of inflation and the salvage values of specific collateral. Such factors and the Company's assessment thereof will be subject to the specific facts and circumstances associated with the specific insured transaction being considered for loss reserve establishment.

Loss reserves on financial guarantee reinsurance assumed are generally established by the Company upon quarterly current notifications from a ceding company. There historically has been no time lag between the time the Company records an assumed case basis reserve and the time the Company's ceding company records such reserves. For each notification of a ceded loss reserve from the ceding company, the Company conducts an examination of the basis of the ceding company's reserve estimate to ensure that the Company concurs with the ceding company's evaluation and conclusions. In certain instances, the Company may develop its own estimates of losses on assumed business due to refinements in the assumptions used in the Company's cash flow models based on research and information review. In other cases, when the Company has assumed loss reserves, it has concurred with the ceding company's evaluation and conclusions with respect to such reserves and, accordingly, there has been no difference between the amount of loss reserves reported to the Company by its ceding company and the amount it has recorded in its financial statements.

In assessing reserves for unpaid losses, the Company considers all available qualitative and quantitative evidence. Qualitative evidence may take various forms and the nature of such evidence will depend upon the type of insured obligation and the nature and sources of cash flows to fund the insured obligation's debt service. For example, such evidence with respect to an insured special revenue obligation such as an obligation supported by cash flows from a toll road would consider traffic statistics such as highway volume and related demographic information, whereas an insured mortgage-backed securitization would consider the quality of the

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mortgage loans supporting the insured obligation including delinquency, default and foreclosure rates, loan to value statistics, market valuation of the mortgaged properties and other pertinent information. In addition, the Company will make qualitative judgments with respect to the amount by which certain other structural protections built into the transaction are expected to limit the Company's loss exposure. Examples of such structural protections may include: (i) rate covenants, which generally stipulate that issuers (i.e., public finance issuers) set rates for services at certain predetermined levels (i.e., water and sewer rates which support debt obligations supported by such revenues), (ii) springing liens, which generally require the issuer to provide additional collateral upon the breach of a covenant or trigger incorporated into the terms of the transaction, (iii) consultant call-in rights, which provide, under certain circumstances, for a consultant to be engaged to make certain binding recommendations, such as raising rates or reducing expenses, (iv) the ability to transfer servicing of collateral assets to another party, and (v) other legal rights and remedies pursuant to representations and warranties made by the issuer and written into the terms of such transactions. Quantitative information may take the form of cash flow projections of the assets supporting the insured debt obligation (which may include, in addition to collateral assets supporting the obligation, structural protections subordinate to the attachment point of the Company's risk, such as cash reserve accounts and letters of credit), as well as (to the extent applicable) other metrics indicative of the performance of such assets and the trends therein. The Company's ability to make a reasonable estimate of its expected loss depends upon its evaluation of the totality of both the available quantitative and qualitative evidence, and no one quantitative or qualitative factor is dispositive.

As of June 30, 2018 and December 31, 2017, the range of risk free rates used to discount the Company's liability for losses and loss adjustment expenses was 0.0% to 2.91% and 0.0% to 2.69%, respectively.

*Salvage and Subrogation Recoverable*

The Company recognizes a salvage and subrogation recoverable based on net discounted anticipated recoveries in excess of net discounted anticipated paid claims on its financial guaranty insurance contracts up to the amount of previously paid claims or when the Company becomes entitled to the net cash inflows from the underlying collateral of an insured obligation under salvage and subrogation rights as a result of a claim payment or estimated future claim payments. Such recoverable amounts and putbacks are included in salvage and subrogation recoverable on the accompanying consolidated balance sheets.

Activity in the Company's liability for unpaid losses and loss adjustment expenses for the six months ended June 30, 2018 and 2017 are summarized as follows:

(U.S. dollars in thousands)

	Retained business		Ceded business		Total	
	2018	2017	2018	2017	2018	2017
Net losses and loss adjustment expenses:						
Changes in loss timing and other assumptions	\$ 31,306	\$ 25,681	\$ (2,185)	\$ -	\$ 29,122	\$ 25,681
Change in reserve discount rates	(22,059)	8,923	(1,845)	-	(23,904)	8,923
Accretion of reserve discount	5,358	7,249	360	-	5,718	7,249
Net losses and loss adjustment expenses	14,605	41,853	(3,670)	-	10,935	41,853
Net losses and loss adjustment expenses recovered (paid)	69,093	(13,508)	155,429	-	224,522	(13,508)
Change in net liability	83,698	28,345	151,759	-	235,457	28,345
Net liability, beginning of period	252,312	641,029	-	-	252,312	641,029
Net liability, end of period	<u>\$ 336,010</u>	<u>\$ 669,374</u>	<u>\$ 151,759</u>	<u>\$ -</u>	<u>\$ 487,769</u>	<u>\$ 669,374</u>
Composition of net liability:						
Unpaid losses and loss adjustment expenses	459,540	766,495	151,759	-	611,299	766,495
Salvage and subrogation recoverable	123,530	97,121	-	-	123,530	97,121
Net liability	<u>\$ 336,010</u>	<u>\$ 669,374</u>	<u>\$ 151,759</u>	<u>\$ -</u>	<u>\$ 487,769</u>	<u>\$ 669,374</u>

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*Case Basis Reserves for Losses and Loss Adjustment Expenses*

A summary of case basis reserves for losses and loss adjustment expenses as of June 30, 2018 and December 31, 2017 are as follows:

(U.S. dollars in millions)	Retained business		Ceded business		Total	
	2018	2017	2018	2017	2018	2017
HELOC, CES and Alt-A mortgage loan collateral...	\$ 300	\$ 495	\$ 151	\$ -	\$ 451	\$ 495
Public finance.....	148	173	1	-	149	173
Structured single risk.....	10	6	-	-	10	6
CDOs.....	1	1	-	-	1	1
Total.....	\$ 459	\$ 675	\$ 152	\$ -	\$ 611	\$ 675

*RMBS*

Reserves for unpaid losses and loss adjustment expenses on the Company's guarantees of obligations supported by HELOC, CES and Alt-A mortgage loan collateral represent the Company's probability weighted average estimate of: (i) the net present value of claims to be paid subsequent to the balance sheet date, less (ii) the net present value of recoveries subsequent to the balance sheet date, and (iii) any unearned premium revenue relating to such guarantees at the balance sheet date. The Company's probability weighted average estimate of losses on the aforementioned guarantees is based on assumptions and estimates extending over many years into the future. Such assumptions and estimates are subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should, therefore, be expected that the actual emergence of losses and loss adjustment expenses will vary, perhaps materially, from any estimate. Among other things, the assumptions could be affected by an increase in unemployment, further decreases in house prices, increase in consumer costs, lower advance rates by lenders or other parties, lower than expected revenues or other events or trends. The Company's estimates are determined based on an analysis of results of a cash flow model.

The cash flow model projects probability weighted average expected cash flows from the underlying mortgage notes. The model output is dependent on, and sensitive to, key input assumptions, including assumptions regarding default rates, draw rates, recoveries and prepayment rates. The cash flow from the mortgages is then run through the "waterfall" as set forth in the indenture for each transaction. Claims in respect of principal generally result when the outstanding principal balance of the mortgages is less than the outstanding principal balance of the insured notes. Recoveries result when cash flow from the mortgages is available for repayment, typically after the insured notes are paid off in full.

The Company bases its default assumptions for the second lien transactions (HELOCs and CESs) in large part on recent observed default rates and the current pipeline of delinquent loans. The losses for the second lien transactions (HELOCs and CESs) are estimated based on a model using a constant default rate curve.

The Company generally observed peak defaults for the second lien transactions in 2009 and 2010. Default rates at June 30, 2018 are mostly forecasted with steady state default rates. Exceptions to this may include transactions for which there is an excessive build-up of severely delinquent loans for which defaults are anticipated or transactions whose collateral includes loans whose interest-only periods will end, at which point temporary increases to default rates are expected.

The Company assumes a steady state constant default rate at a rate well above historical norms. Net losses will be greater if default rates exceed the Company's current assumptions. The constant default rate is a function of several factors, one of which is the state of the economy and unemployment.

The Company's default assumptions for the first lien transactions at June 30, 2018 and December 31, 2017 were based on current delinquent loans and analysis of historical defaults for loans with similar characteristics. A loss severity was applied to the first lien defaults ranging from 26% to 59% at June 30, 2018 and from 28% to 61% at December 31, 2017 based upon actual loss severity observances and collateral characteristics to determine the expected loss on the collateral in those transactions.

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*Schedule of Insured Financial Obligations with Credit Deterioration*

The Company's surveillance department is responsible for monitoring the performance of its in-force portfolio. The surveillance department maintains a list of credits that it has determined need to be closely monitored and, for certain of those credits, the department undertakes remediation activities it determines to be appropriate in order to mitigate the likelihood and/or amount of any loss that could be incurred by the company with respect to such credits.

The surveillance department focuses its review on monitoring lower rated bond sectors and potentially troubled sectors, which have included certain subsectors within the RMBS, Public Finance and Structured Single Risk portfolios. For the RMBS portfolio, it tracks performance to determine whether or not covenants have been breached. If a covenant is breached, the Company may have the right to put the transaction into rapid amortization so that all cash flow generated from that transaction is used to pay down principal and stay current with interest or take other remedial action. Typically, the surveillance department reviews periodic servicing and trustee reports to track coverage levels, enhancement levels, delinquency levels, loss frequency, loss severity and total losses and compares such performance metrics with the metrics that were made available at the time the transaction was closed. If losses are above projections, the surveillance department will analyze the reasons for the deviation. In some cases, it may be an indication of servicing problems, where loans are delinquent and are not put into foreclosure in time to maximize recovery. Typically once per year, the surveillance department will audit servicers of loans and other assets supporting the Company's insured obligations to better understand their servicing practices and to identify potential servicing problems, if any.

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

The activities of the Company's surveillance department are integral to the identification of specific credits that have experienced deterioration in credit quality and the assessment of whether losses on such credits are probable, as well as any estimation of the amount of loss expected to be incurred with respect to such credits. Closely monitored credits are divided into four categories: (i) Loss List—credits where a loss is probable and reasonably estimable; (ii) Red Flag List—credits where a loss is possible but not probable or reasonably estimable, including credits where claims may have been paid or may be paid but full recovery is in doubt; (iii) Yellow Flag List—credits that the Company determines to be non-investment grade but a loss is unlikely, including credits where claims may have been paid or may be paid but reimbursement is likely; and (iv) Special Monitoring List—low investment grade credits where a material covenant or trigger may be breached and closer monitoring is warranted. Credits that are not closely monitored credits are considered to be fundamentally sound, normal risk.

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The following tables set forth certain information in regard to the Company's closely monitored credits as of June 30, 2018 and December 31, 2017, respectively. The number of policies, remaining weighted-average contract period, and insured contractual payments outstanding in the table below excludes exposures that were effectively defeased or, in-substance, commuted through the acquisition of Insurance Cash Flow Certificates and related alternative structures, but includes those ceded to Assured.

(U.S. dollars in millions)	<b>Loss List</b>		<b>Red Flag List</b>		<b>Yellow Flag List</b>		<b>Special Monitoring List</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Retained business</b>								
Insured contractual payments outstanding:								
Principal	\$ 228	\$ 529	\$ 15	\$ 22	\$ 264	\$ 617	\$ 138	\$ 430
Interest	70	170	10	12	108	390	64	90
Total	<u>\$ 298</u>	<u>\$ 699</u>	<u>\$ 25</u>	<u>\$ 34</u>	<u>\$ 372</u>	<u>\$ 1,007</u>	<u>\$ 202</u>	<u>\$ 520</u>
Number of policies	76	88	1	3	1	14	1	7
Remaining weighted-average contract period (in years)	<u>6.1</u>	<u>10.0</u>	<u>13.8</u>	<u>11.1</u>	<u>15.3</u>	<u>15.6</u>	<u>17.4</u>	<u>9.6</u>
Unpaid loss and loss adjustment expenses:								
Gross amount before reductions	\$ 912	\$ 1,503	\$ 13	\$ 10	\$ 7	\$ 24	\$ -	\$ -
Gross estimated recoveries	(288)	(593)	-	-	(2)	(9)	-	-
Unearned premium revenue <sup>(1)</sup>	(9)	(14)	-	-	-	(2)	-	-
Present value discount	(173)	(243)	-	-	-	(1)	-	-
Total	<u>\$ 442</u>	<u>\$ 653</u>	<u>\$ 13</u>	<u>\$ 10</u>	<u>\$ 5</u>	<u>\$ 12</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Ceded business</b>								
Insured contractual payments outstanding:								
Principal	\$ 283	\$ -	\$ 6	\$ -	\$ 188	\$ -	\$ 280	\$ -
Interest	91	-	1	-	148	-	21	-
Total	<u>\$ 374</u>	<u>\$ -</u>	<u>\$ 7</u>	<u>\$ -</u>	<u>\$ 336</u>	<u>\$ -</u>	<u>\$ 301</u>	<u>\$ -</u>
Number of policies	11	-	1	-	8	-	6	-
Remaining weighted-average contract period (in years)	<u>12.9</u>	<u>-</u>	<u>3.8</u>	<u>-</u>	<u>15.4</u>	<u>-</u>	<u>5.2</u>	<u>-</u>
Unpaid loss and loss adjustment expenses:								
Gross amount before reductions	\$ 242	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Gross estimated recoveries	-	-	-	-	-	-	-	-
Unearned premium revenue <sup>(1)</sup>	(3)	-	-	-	-	-	-	-
Present value discount	(87)	-	-	-	-	-	-	-
Total	<u>\$ 152</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

<sup>(1)</sup> The claim liability is determined on a contract by contract basis. As such, instances may arise where the unearned premium revenue on a contract may exceed the present value of the expected net cash outflows. The unearned premium in the table above represents the aggregate of unearned premium revenue on each contract but not in excess of the associated present value of the expected net cash outflows on such contract.



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*Credit Default Swap Contracts*

Credit default swap contracts are derivative financial instruments and are recorded at fair value. Changes in fair value are recorded in "net (loss) earnings on credit default and other swap contracts" on the consolidated statements of operations. Realized gains (losses) and other settlements on credit default swap contracts include credit default swap derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, contractual claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions expense or income and realized gains or losses related to their early termination. Net unrealized gains (losses) on credit default swaps contracts represent the adjustments for changes in fair value in excess of realized gains and other settlements that are recorded in each reporting period. Fair value of credit default swap contracts is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 11 for a discussion on the fair value methodology for credit default swap contracts.

*Credit Default and Other Swap Contract Liabilities*

CDS contracts are derivative contracts which offer credit protection relating to a particular security or pools of securities, which are specifically referenced in the CDS contract. Under the terms of a CDS contract, the seller of credit protection (the issuer of the CDS contract) makes a specified payment to the buyer of such protection (the CDS contract counterparty) upon the occurrence of one or more credit events specified in the CDS contract with respect to a referenced security or securities. The terms of the CDS contracts issued by the Company generally only require the Company to make a payment upon the occurrence of one or more specified credit events after exhaustion of various levels of subordination or first-loss protection. In addition, pursuant to the terms of the Company's CDS contracts, the Company is precluded from transferring such contracts to other market participants without the consent of the counterparty.

Securities or assets referenced in the Company's in-force CDS contracts primarily include structured pools of obligations, such as collateralized loan obligations, corporate CDOs and CMBS CDOs. Such pools were rated investment-grade or better at the issuance of the CDS contract.

Typical market CDS contracts are standardized, liquid instruments that reference tradable securities such as corporate bonds. These market standard CDS contracts also involve collateral posting, and upon a default of the referenced obligation, can be settled in cash. In contrast, the Company's CDS contracts do not contain the typical CDS market standard features as described above but have been customized to replicate the Company's financial guarantee insurance. The Company's CDS contracts provide protection on specified obligations, such as those described above and, generally, contain some form of subordination prior to the attachment of the Company's liability. The Company is not required to post collateral and, upon an underlying default, the Company generally makes payments on a "pay-as-you-go" basis after the subordination in a transaction is exhausted.

The Company's payment obligations after a default vary by deal type. There are three primary types of policy payment requirements: timely interest and ultimate principal; ultimate principal only at final maturity; and payments upon settlement of individual collateral losses as they occur upon erosion of subordination.

The Company's CDS contracts are generally governed by a single transaction International Swaps and Dealers Association Master Agreement relating only to that particular transaction/contract. Under most monoline financial guarantee standard termination provisions, there is no requirement for mark-to-market termination payments upon the early termination of a guaranteed CDS contract. However, substantially all of the Company's CDS contracts provided for mark-to-market termination payments following the occurrence of events that are outside the Company's control, such as SGI being placed into receivership or rehabilitation or a regulator taking control of SGI or, in some instances, SGI's insolvency. Pursuant to the 2009 MTA, substantially all of the Company's guarantees of CDS contracts that were not commuted were novated to SCAI (pre-merger) and amended to remove any events triggering mark-to-market termination payments except for SCAI (pre-merger) failing to make payment under the applicable contract or being placed into receivership or rehabilitation or a regulator taking control of SCAI (pre-merger). Under current market conditions, if the Company were required to pay such termination payments, it may result in a liability to the Company which may be in excess of that currently recorded by the Company. An additional difference between the Company's CDS contracts and the typical market standard CDS contracts is that, except in the circumstances noted above, there is no acceleration of the payment to be made under the Company's CDS contracts unless the Company, at its option, elects to accelerate. Furthermore, by law, the Company's guarantees are unconditional and irrevocable, and cannot be transferred to most other capital market participants as they are not licensed to write such business. However, through the purchase of back-to-back credit protection, the risk of loss (but not counterparty risk) on these contracts can be transferred to other financial guarantee insurance and reinsurance companies.

*Credit Default and Other Swap Contract Assets*

In connection with the Company's reinsurance agreement with Assured, substantially all of the CDS contracts insured by the Company have been reinsured by Assured. These CDS contracts are recorded at fair value and do not qualify for reinsurance accounting treatment. As a result, the Company recorded credit default and other swap contracts assets, which represent the fair value

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of the reinsurance of these CDS contracts, which will offset the Company's credit default swap and other swap contract liabilities recorded on the consolidated balance sheets. Since the fair value of these CDS assets and CDS liabilities will be equal, any subsequent changes to the fair value of these reinsured CDS contracts will result in the equal offset to the CDS liabilities and corresponding CDS assets on the consolidated balance sheets.

Set forth below is certain information regarding the Company's in-force CDS and other swap contracts as of June 30, 2018 and December 31, 2017, including the aggregate notional amount outstanding, the weighted average life of such contracts, and the ratings of obligations referenced in such contracts.

**CDS and other swap contracts**  
(U.S. dollars in millions)

	Retained Business		Ceded Business	
	2018	2017	2018	2017
Notional Amount Outstanding .....	\$ 147	\$ 3,214	\$ 3,034	\$ 16
Weighted Average Life (years) .....	20.7	22.6	22.3	19.8
Percentage of referenced assets by rating <sup>(1)</sup>				
AAA .....	- %	7.5 %	7.7 %	- %
At or above investment grade but below AAA .....	100.0	92.5	92.3	100.0
Below investment grade .....	-	-	-	-
Total .....	100.0 %	100.0 %	100.0 %	100.0 %

<sup>(1)</sup> Based on S&P rating as reflected in Syncora's records, if available, and internal Syncora's rating if no S&P rating is available.

The following table provides the components of net earnings (loss) on credit default and other swap contracts for the six months ended June 30, 2018 and 2017:

(U.S. dollars in thousands)	2018	2017
Change in fair value of credit default and other swap contracts:		
Realized gains (losses) and other settlements:		
Net CDS contract premiums received and receivable	\$ 452	\$ 1,654
Net CDS contract losses paid and payable	(120,859)	-
Total realized gains and losses and other settlements	(120,407)	1,654
Unrealized gains (losses):		
Change in fair value of CDS and other swap contracts	95,726	1,466
Net earnings (loss) on credit default and other swap contracts <sup>(1)</sup>	\$ (24,681)	\$ 3,120

<sup>(1)</sup> The change in net realized/unrealized gains (losses) relating to the CDS and other swap contracts still held as of June 30, 2018 and 2017 was \$(24.7) million and \$3.1 million, respectively.

*Consolidation of VIEs*

The Company has exposure to VIEs primarily through the issuance of financial guaranty insurance contracts that typically insure the timely payment of principal and interest with respect to debt obligations of the VIEs. As part of the terms of its insurance contracts, at the outset of a contract, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. In addition, the Company has exposure to VIEs through the ownership of Uninsured Cash Flow Certificates ("UCFs") and other interests from its remediation transactions.

The Company is not primarily liable for the debt obligations issued by the VIEs; however, where the Company has issued an insurance contract, the Company would only be required to make payments on the debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. The Company or the Company's creditors do not have any rights with regard to the assets of the VIEs.

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The table below shows the fair value of the consolidated VIE assets and liabilities of the retained business in the Company's consolidated balance sheets, segregated by the types of assets held by VIEs that collateralize their respective debt obligations as of June 30, 2018 and December 31, 2017. As of June 30, 2018 and December 31, 2017, the Company's qualitative and quantitative analyses have indicated that it does not have a controlling financial interest in any other VIEs.

(U.S. dollars in thousands)	2018		2017	
	Assets	Liabilities	Assets	Liabilities
Subprime (1st lien)	\$ -	\$ -	\$ 57,564	\$ 57,564
Prime (HELOC)	14,600	355	51,229	935
Alt-A (2nd lien)	1,759	378	8,161	2,162
Alt-A (1st lien)	709	28	1,200	47
	<u>\$ 17,068</u>	<u>\$ 761</u>	<u>\$ 118,154</u>	<u>\$ 60,708</u>

The following table presents the revenues and expenses of consolidated VIEs included in the Company's consolidated statements of operations for the six months ended June 30, 2018 and 2017:

(U.S. dollars in thousands)	2018	2017
Interest income	\$ 20,771	\$ 2,602
Interest expense	(2,943)	(1,665)
Other expenses	(17)	(107)
Net realized and unrealized losses	(15,662)	4,770
Net change in variable interest entities	<u>\$ 2,149</u>	<u>\$ 5,600</u>

The Company's maximum exposure to loss provided through its financial guarantees of principal and interest with respect to debt obligations of unconsolidated variable interest entities was \$0.9 billion and \$6.1 billion at June 30, 2018 and December 31, 2017, respectively.

*Exposures Under Guarantees*

While the Company establishes reserves for losses and loss adjustment expenses on obligations it has guaranteed or reinsured, the risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed. Set forth below are tables which reflect certain information regarding the Company's in-force principal and interest exposure at June 30, 2018 and December 31, 2017.

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The following table sets forth the Company's in-force guaranteed principal by bond sector as of June 30, 2018 and December 31, 2017, respectively:

**Bond Exposure**  
(U.S. dollars in millions)

	<b>Retained business</b>		<b>Ceded business</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Public Finance				
Special Revenue	\$ 238	\$ 3,315	\$ 3,013	\$ 42
General Obligation	119	1,320	1,043	-
Utility	110	938	642	-
Non Ad Valorem	7	691	681	-
Other	3	4	-	-
Appropriation	-	335	310	-
Total Public Finance	<u>477</u>	<u>6,603</u>	<u>5,689</u>	<u>42</u>
Asset-Backed Securities				
RMBS	<u>2</u>	<u>367</u>	<u>340</u>	<u>-</u>
Total Asset-Backed Securities	<u>2</u>	<u>367</u>	<u>340</u>	<u>-</u>
Collateralized Debt Obligations				
Cashflow CDO	<u>2</u>	<u>27</u>	<u>20</u>	<u>-</u>
Total Collateralized Debt Obligations	<u>2</u>	<u>27</u>	<u>20</u>	<u>-</u>
Structured Single Risk				
Global Infrastructure	380	2,512	1,977	550
Specialized Risk	138	263	74	-
Power & Utilities	<u>100</u>	<u>5,067</u>	<u>3,998</u>	<u>-</u>
Total Structured Single Risk	<u>618</u>	<u>7,842</u>	<u>6,049</u>	<u>550</u>
Total Outstanding	<u>\$ 1,099</u>	<u>\$ 14,839</u>	<u>\$ 12,098</u>	<u>\$ 592</u>

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The following table sets forth the number of years to maturity of the Company's in-force guaranteed principal and interest exposure at June 30, 2018:

**Years to Maturity - Debt Service Amortization**  
(U.S. dollars in millions)

	<u>Retained business</u>		<u>Ceded business</u>	
	<u>Scheduled Net Debt Amortization</u>	<u>Principal and Interest Outstanding</u>	<u>Scheduled Net Debt Amortization</u>	<u>Principal and Interest Outstanding</u>
2018 Q2	\$ -	\$ 1,671	\$ -	\$ 19,370
2018 Q3	62	1,609	251	19,119
2018 Q4	27	1,582	137	18,982
Total 2018	<u>89</u>		<u>388</u>	
2019	81	1,501	775	18,207
2020	78	1,423	885	17,322
2021	83	1,340	1,149	16,173
2022	93	1,247	842	15,331
Total 2019-2022	<u>335</u>		<u>3,651</u>	
2023-2027	539	708	3,765	11,566
2028-2032	223	485	2,638	8,928
2033-2037	190	295	2,221	6,707
2038 and thereafter	295	-	6,707	-
Total 2023-thereafter	<u>1,247</u>		<u>15,331</u>	
Total	<u>\$ 1,671</u>		<u>\$ 19,370</u>	

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The following table sets forth the Company's in-force guaranteed principal exposure by geographic concentration at June 30, 2018 and December 31, 2017, respectively:

**Geographic Distribution - Par Exposure**  
(U.S. dollars in millions)

	Retained business				Ceded business			
	Amount		%		Amount		%	
	2018	2017	2018	2017	2018	2017	2018	2017
United States								
California	\$ 15	\$ 2,197	1.3 %	14.9 %	\$ 2,166	\$ 41	18.1 %	7.0 %
New York	92	1,158	8.3	7.8	1,043	-	8.6	-
Virginia	-	609	-	4.1	597	-	4.9	-
District Of Columbia	-	432	-	2.9	424	-	3.5	-
Texas	-	296	-	2.0	290	-	2.4	-
Georgia	-	247	-	1.7	244	-	2.0	-
Florida	-	255	-	1.7	223	-	1.8	-
Puerto Rico	221	220	20.1	1.5	-	-	-	-
Washington	-	214	-	1.4	206	-	1.7	-
Massachusetts	-	208	-	1.4	176	-	1.5	-
Missouri	-	178	-	1.2	172	-	1.4	-
New Jersey	-	210	-	1.4	169	-	1.4	-
Tennessee	-	168	-	1.1	133	-	1.1	-
Other <sup>(1)</sup>	149	1,412	13.7	9.5	926	-	7.6	-
Non-PF Multi <sup>(2)(3)</sup>	4	375	0.4	2.5	342	-	2.8	-
Total United States	\$ 481	\$ 8,179	43.8 %	55.1 %	\$ 7,111	\$ 41	58.8 %	7.0 %
International								
United Kingdom	\$ 264	\$ 5,034	24.0 %	34.0 %	\$ 3,910	\$ 551	32.3 %	93.0 %
Chile	-	370	-	2.5	334	-	2.8	-
New Zealand	-	323	-	2.2	308	-	2.5	-
Australia	-	258	-	1.7	244	-	2.0	-
Italy	138	137	12.5	0.9	-	-	-	-
Other <sup>(1)</sup>	216	538	19.7	3.6	191	-	1.6	-
Non-PF Multi <sup>(2)(4)</sup>	-	-	-	-	-	-	-	-
Total International	\$ 618	\$ 6,660	56.2 %	44.9 %	\$ 4,987	\$ 551	41.2 %	93.0 %
Total Par Outstanding	\$ 1,099	\$ 14,839	100.0 %	100.0 %	\$ 12,098	\$ 592	100.0 %	100.0 %

<sup>(1)</sup> Single state/country with par outstanding < 1% of the total exposure in the current period plus any multi-state/country Public Finance exposures.

<sup>(2)</sup> Non-Public Finance deals with underlying securities in multiple states/countries.

<sup>(3)</sup> Consists of \$2 million and \$27 million of CDO net par in 2018 and 2017, respectively, and \$2 million and \$348 million of ABS net par in 2018 and 2017, respectively.

*Effective Commutation or Defeasance of Syncora Guarantee's Exposure to Insured RMBS Securities (the "RMBS Offer")*

In connection with the 2009 MTA, the Company invested in a fund (the "RMBS Fund") that executed certain transactions designed to effectively defease or, in-substance, commute the Company's exposure on certain of its financial guarantee insurance policies written on RMBS. The RMBS Fund purchased certain of such RMBS in return for a trust certificate of an owner trust representing the uninsured cash flows of such RMBS UCFs plus a cash payment. In general, the RMBS Fund contributed any such purchased RMBS (and certain of the Company's reimbursement rights) to separate owner trusts in return for certificates representing the cash flows consisting of insurance payments made on the policies insuring such RMBS ("Insurance Cash Flow Certificates"). In return for such investments, the Insurance Cash Flow Certificates were distributed to the Company. The Company will, should the cash flows from the underlying RMBS transaction be sufficient, receive certain reimbursement payments in respect of insurance payments previously made by the Company on such RMBS. The Company also entered into several alternative transactions effectively replicating the economics of the RMBS Offer.

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

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In connection with the reinsurance transaction as discussed above, the Company has substantially ceded all of its RMBS exposure to Assured.

***Exposure to RMBS***

The following table presents the net principal outstanding for the Company's insured RMBS portfolio by type of collateral<sup>(1)</sup> as of June 30, 2018 and December 31, 2017, respectively:

**RMBS Exposure**

(U.S. dollars in millions)

	Retained business				Ceded business			
	Amount		%		Amount		%	
	2018	2017	2018	2017	2018	2017	2018	2017
Prime (1st lien)	\$ -	\$ 18	-	5.0 %	\$ 16	\$ -	4.7 %	-
Prime (2nd lien)	-	7	-	2.0	6	-	1.8	-
Prime (HELOC)	2	74	100.0	20.3	60	-	17.6	-
Alt-A (1st lien)	-	22	-	6.1	21	-	6.2	-
Alt-A (2nd lien)	-	2	-	0.7	2	-	0.6	-
Subprime (1st lien)	-	219	-	59.1	212	-	62.3	-
Subprime (2nd lien)	-	7	-	1.8	4	-	1.3	-
Subprime (1st lien) - International	-	18	-	5.0	19	-	5.5	-
Total RMBS Outstanding	<u>\$ 2</u>	<u>\$ 367</u>	<u>100.0 %</u>	<u>100.0 %</u>	<u>\$ 340</u>	<u>\$ -</u>	<u>100.0 %</u>	<u>- %</u>

<sup>(1)</sup> Collateral type is defined as follows: Prime (1<sup>st</sup> lien) mortgage loans are secured by first liens on one-to-four family residential properties. The underwriting standards used to underwrite prime mortgage loans are the standards applied to the most creditworthy borrowers and are generally acceptable to Fannie Mae and Freddie Mac. Prime (2nd lien) mortgage loans are secured by 2nd liens on one-to-four family residential properties. The underwriting standards used to underwrite prime mortgage loans are the standards applied to the most creditworthy borrowers and are generally acceptable to Fannie Mae and Freddie Mac. This category also includes Alt-A (2nd lien) loans. HELOC is an adjustable rate line of credit secured by a second lien on residential properties. An Alt-A loan means a mortgage loan secured by first liens on residential properties, which is ineligible for purchase by Fannie Mae or Freddie Mac. Subprime (1st lien) mortgage loans are secured by first liens on residential properties to non-prime borrowers. The underwriting standards used to underwrite subprime mortgage loans are less stringent than the standards applied to the most creditworthy borrowers and less stringent than the standards generally acceptable to Fannie Mae and Freddie Mac with regard to the borrower's credit standing and repayment ability. Subprime (2nd lien) mortgage loans are secured by second liens on residential properties to non-prime borrowers. See Subprime (1st lien) for a description of the underwriting standards. Subprime (1st lien) – International mortgage loans are secured by first liens on residential properties to non-prime borrowers located outside the United States.

**6. Investments and Cash**

*Investments*

The Company determines the appropriate classification of investments at the time of purchase, which are recorded on the trade date. All of the Company's investments in debt (including UCFs) and equity securities are considered available-for-sale and accordingly are measured at fair value. The fair value of investments is based on quoted market prices received from nationally recognized pricing services or, in the absence of quoted market prices, dealer quotes or determined using the Company's own internal model estimates. Net unrealized gains or losses on debt securities, net of deferred income taxes, are included in accumulated other comprehensive income. Effective January 1, 2018, net unrealized gains or losses on equity investments are included in the consolidated statement of operations and comprehensive loss. Any unrealized loss in value on debt securities considered by management to be other-than-temporary is charged to income in the period that such determination is made.

Bond discounts and premiums are amortized on a level-yield basis over the remaining terms of securities acquired. For pre-refunded bonds, the remaining term is determined based on the contractual refunding date. For mortgage-backed securities, and any other holdings for which prepayment risk may be significant, assumptions regarding prepayments are evaluated periodically and revised as necessary. Any adjustments required due to the resulting change in effective yields are recognized in income in the period such change is made.

*Cash and Cash Equivalents*

The Company's cash and cash equivalents include cash on hand, interest bearing bank deposits, commercial paper and money market funds. The Company defines cash equivalents as short-term, highly liquid securities and interest earning deposits with maturities at time of purchase of 90 days or less.

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*Restricted Cash and Cash Equivalents*

Restricted cash and cash equivalents are restricted as to withdrawal and use by the Company. Restricted cash and cash equivalents primarily include deposits held in escrow accounts and cash deposits or allowable funds held to satisfy regulatory requirements.

The amortized cost and fair value of investments as of June 30, 2018 and December 31, 2017 are as follows:

(U.S. dollars in thousands)	Cost or		Gross Unrealized		Gross Unrealized		Fair Value	
	Amortized Cost		Gains <sup>(3)</sup>		Losses <sup>(3)</sup>			
	2018	2017	2018	2017	2018	2017	2018	2017
<b>Debt securities</b>								
Mortgage-backed securities:								
RMBS <sup>(1)</sup> .....	\$ 71,673	\$ 78,468	\$ 1,971	\$ 2,495	\$ (404)	\$ -	\$ 73,240	\$ 80,963
CMBS.....	25,503	26,618	77	256	(312)	-	25,268	26,874
Asset-backed securities.....	66,806	57,640	190	53	(609)	-	66,387	57,693
U.S. Government and government agencies.....	117,737	154,408	144	248	(473)	(6)	117,408	154,650
Corporate and Other.....	335,778	545,399	1,070	9,902	(2,164)	(18)	334,684	555,283
U.S. states and political subdivisions of the states...	44,204	48,325	3,494	4,256	(19)	-	47,679	52,581
Total debt securities.....	<u>\$ 661,701</u>	<u>\$ 910,858</u>	<u>\$ 6,946</u>	<u>\$ 17,210</u>	<u>\$ (3,981)</u>	<u>\$ (24)</u>	<u>\$ 664,666</u>	<u>\$ 928,044</u>
Total other invested assets <sup>(2)</sup> .....	<u>\$ 91,560</u>	<u>\$ 94,232</u>	<u>\$ 22,427</u>	<u>\$ 23,101</u>	<u>\$ (260)</u>	<u>\$ (223)</u>	<u>\$ 113,727</u>	<u>\$ 117,110</u>

<sup>(1)</sup> At June 30, 2018, residential mortgage-backed securities include \$1.5 million of fair value and \$0.1 million of amortized cost related to UCFs. At December 31, 2017, residential mortgage-backed securities include \$2.2 million of fair value and \$0.9 million of amortized cost related to UCFs.

<sup>(2)</sup> At June 30, 2018 and December 31, 2017, other invested assets include \$14.3 million and \$14.3 million, respectively, of net unrealized gains that were recorded through net income on the consolidated statement of operations on investments in which the Company has elected the fair value option.

<sup>(3)</sup> As of June 30, 2018 and December 31, 2017, gross unrealized gains of zero and \$4.7 million, respectively, related to foreign currency exchange are not included in the table above.

The change in net unrealized (losses) gains consists of changes in the valuation and holdings of debt securities of \$(14.2) million and \$1.6 million for the six months ended June 30, 2018 and 2017, respectively.

Proceeds from sales of debt securities, net of receivables, for the six months ended June 30, 2018 and 2017 were \$238.1 million and \$201.0 million, respectively.

The gross realized gains and gross realized (losses), excluding other-than-temporary impairment losses, for the six months ended June 30, 2018 and 2017 were \$16.5 million and \$16.1 million and \$(1.9) million and \$(0.3) million, respectively. Realized investment gains and losses on the sale of investments are determined on the basis of the first-in first-out method and are included in net income.

The amortized cost and fair value of bonds at June 30, 2018 and December 31, 2017 by contractual maturity are shown below. Actual maturity may differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are generally more likely to be prepaid than other fixed-maturity securities. As the stated maturities of such securities may not be indicative of actual maturities, the totals for mortgage-backed securities are shown separately.

(U.S. dollars in thousands)	2018		2017	
	Amortized	Fair Value	Amortized	Fair Value
	Cost	Fair Value	Cost	Fair Value
Due within one year .....	\$ 59,147	\$ 59,311	\$ 81,851	\$ 82,107
Due after one through five years .....	338,202	336,898	498,812	501,665
Due after five through ten years .....	82,622	84,241	148,878	157,311
Due after ten years .....	17,748	19,321	18,591	21,431
Subtotal .....	<u>497,719</u>	<u>499,771</u>	<u>748,132</u>	<u>762,514</u>
Mortgage- and asset-backed securities .....	163,982	164,895	162,726	165,530
Total .....	<u>\$ 661,701</u>	<u>\$ 664,666</u>	<u>\$ 910,858</u>	<u>\$ 928,044</u>



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Net investment income for the six months ended June 30, 2018 and 2017 is derived from the following sources:

(U.S. dollars in thousands)	<u>2018</u>	<u>2017</u>
Debt securities and cash and cash equivalents .....	\$ 19,356	\$ 21,567
Equity securities .....	2,377	2,266
Other invested assets .....	404	354
Less: Investment expenses .....	(743)	(732)
Net investment income .....	<u>\$ 21,394</u>	<u>\$ 23,455</u>

The Company has a formal review process for all debt securities in the Company's investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include: a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months; a decline in the market value of a security for a continuous period of 12 months; recent credit downgrades of the applicable security or the issuer by rating agencies; the financial condition of the applicable issuer; whether loss of investment principal is anticipated; whether scheduled interest payments are past due; and whether the Company intends to sell the security prior to its recovery in fair value.

The Company's review process, in certain instances, also includes analyses of the ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. If the Company believes a decline in the value of a particular investment is temporary, the Company records the decline as an unrealized loss on the Company's consolidated balance sheets in "accumulated other comprehensive income" in shareholders' equity. The Company recognizes an other-than-temporary impairment loss in the consolidated statements of operations for a debt security in an unrealized loss position when either the Company has the intent to sell the debt security or it is more-likely-than not that the Company will be required to sell the debt security before its anticipated recovery.

Any credit-related impairment on debt securities the Company does not plan to sell and more-likely-than-not will not be required to sell is recognized in the consolidated statement of operations, with the non-credit-related impairment recognized in other comprehensive income. For other impaired debt securities, where the Company has the intent to sell the security or where the Company will more-likely-than not be required to sell or where the entire impairment is deemed by the Company to be credit-related, the entire impairment is recognized in the consolidated statements of operations.

If it is determined that an impairment is other than temporary, then an impairment loss is recognized in the consolidated statements of operations equal to the difference between the investment's cost and its fair value at the balance sheet date for which the assessment is made. The measurement of the impairment shall not include partial recoveries after the balance sheet date. The fair value of the investment becomes the new cost basis of the investment and shall not be adjusted for subsequent recoveries in fair value.

The Company's assessment of a decline in value includes management's current assessment of the factors noted above. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

For the six months ended June 30, 2018 and 2017, the Company recorded other-than-temporary impairment charges of \$11.1 million and \$25.6 million, respectively, on its debt securities. The other-than-temporary impairment charges recorded by the Company during the six months ended June 30, 2018 were primarily due the Company's conclusion that it was more-likely-than not that the Company would be required to sell certain debt securities (including its UCFs) before recovering their cost. The other-than-temporary impairment charges recorded by the Company during the six months ended June 30, 2017 were primarily due to foreign currency exchange losses on certain debt securities and the Company's conclusion, resulting from its near term anticipated cash needs, that it was more-likely-than not that the Company would be required to sell certain debt securities (including its UCFs) before recovering their cost.

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The following tables present the aggregate gross unrealized losses and fair value by investment category at June 30, 2018 and December 31, 2017, respectively.

(U.S. dollars in thousands)

<u>Less than 12 Months</u>	<u>Unrealized loss</u>		<u>Fair value</u>		<u>Number of securities</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Mortgage-backed securities:						
RMBS.....	\$ (404)	\$ -	\$ 62,426	\$ -	56	-
CMBS.....	(312)	-	21,616	-	33	-
Asset-backed securities.....	(609)	-	40,983	-	28	-
US Government and government agency..	\$ (472)	\$ (6)	\$ 96,943	\$ 5,539	37	8
Corporate and other.....	(2,165)	(18)	283,811	10,174	262	8
US states & political subdivisions.....	(19)	-	3,713	-	5	-
Total debt securities.....	<u>\$ (3,981)</u>	<u>\$ (24)</u>	<u>\$ 509,492</u>	<u>\$ 15,713</u>	<u>421</u>	<u>16</u>
 Total other invested assets.....	 <u>\$ (260)</u>	 <u>\$ (223)</u>	 <u>\$ 5,872</u>	 <u>\$ 1,764</u>	 <u>6</u>	 <u>3</u>

## 7. Notes Payable and Interest

As part of the consideration paid in connection with the effective defeasance, or in-substance commutation, of certain of the Company's guarantees of CDS contracts pursuant to the 2009 MTA discussed in Note 3, on July 15, 2009, SGI issued \$150.0 million face amount of short-term and \$475.0 million face amount of long-term surplus notes to the counterparties of such CDS contracts. Subsequent to their issuance, \$142.5 million of paid-in-kind interest has been added to the face amount of the surplus notes. As part of the 2012 settlement of RMBS-related claims and other claims with Bank of America Corp. ("BAC") and affiliates thereof, \$48.4 million face amount of surplus notes (\$21.2 million short-term and \$27.2 million long-term) were received back from the Company which included \$7.7 million of paid-in-kind interest. In addition, in connection with the August 12, 2016 restructuring, the total face amount of the short-term and long-term notes was reduced by \$33.5 million as a result of the discount received and the surplus note payment and \$40.0 million of surplus notes (\$31.5 million and \$8.5 million of long-term and short-term surplus notes, respectively) were reallocated to external parties, which resulted in no change to the par value outstanding. Furthermore, the total notes were reduced by \$296.1 million in connection with subsequent payments made. The total face amount of the surplus notes held by third parties as of June 30, 2018 is \$389.5 million. The short-term surplus notes have a 5.00% interest rate and matured on December 28, 2011, and the long-term surplus notes have a 6.00% interest rate and mature on June 27, 2024. The Company recorded the notes at their estimated fair value of \$141.0 million (\$91.2 million for the short-term notes and \$49.8 million for the long-term notes) at the date of their issuance and accretes the discount from the face amount of the notes over the term of the notes using the interest method. The reallocated surplus notes were recorded at fair value on August 12, 2016 with the discount also accreting over the term of the notes using the interest method. The estimated yield-to-maturity used for both notes was 31.88% at origination; as a result of the August 12, 2016 restructuring, the estimated yield-to-maturity on the long-term surplus notes is 30.11%. The estimated yield-to-maturity on the reallocated surplus notes (long-term surplus notes only) is 12.64%. Interest expense is recognized on the accrual basis using the effective interest rate method. Accretion is recorded as interest expense which is reflected in the accompanying consolidated statements of operations. See table below for the par value, carrying value and accrued interest of these surplus notes as of June 30, 2018 and December 31, 2017, and interest expense for the six months ended June 30, 2018 and 2017:

(U.S. dollars in millions)	<u>Total</u>		<u>Short-term</u>		<u>Long-term</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Par value	\$ 389.5	\$ 677.1	\$ 61.5	\$ 121.7	\$ 328.0	\$ 555.4
Carrying value	257.6	428.9	61.5	121.7	196.1	307.2
Accrued interest	39.4	127.3	28.0	47.0	11.4	80.3
Interest expense	49.4	42.6	4.2	4.3	45.2	38.3

Interest on the short-term and long-term surplus notes was payable semi-annually, on June 27th and December 28th of each year (commencing December 28, 2009). Such interest was payable in cash or in-kind at the election of the Company through June 27, 2011 (June 27, 2013 for the long-term notes). Interest subsequent to June 27, 2011 (June 27, 2013 for the long-term notes) was required to be paid in cash, subject in each case to the prior approval of the NYDFS. Absent satisfaction of the conditions to payment, including the approval of the NYDFS, the Company is not entitled to make payments on its surplus notes. Failure to make any payment as a result of the failure of any such condition (as in the present case) would not constitute a default thereunder.

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Scheduled repayment of the Company's short-term notes on December 28, 2011 did not meet the conditions to payment (including the approval of the NYDFS) and consequently principal and interest payments were not made. On the scheduled payment dates from December 2011 through June 2016, SGI sought approval for payment on its short-term surplus notes, and the NYDFS did not approve any payment during this period. Accordingly, any interest not approved for payment by the NYDFS on or after December 28, 2011 will not be capitalized on the outstanding principal balance reflected above, but will accrue interest at the existing rate. The outstanding principal balance of the short-term surplus notes as of June 27, 2011 also will separately accrue interest at such rate.

In addition, SGI was obligated by the terms of its long-term surplus notes to pay interest on the outstanding principal balance of \$475 million together with paid-in-kind interest. Accordingly, any interest not approved for payment by the NYDFS on or after December 28, 2013 will not be capitalized on the outstanding principal balance reflected above, but will accrue interest at the existing rate. The outstanding principal balance of the long-term surplus notes as of June 27, 2013 also will separately accrue interest at such rate. Commencing on December 28, 2018, principal amortizes in twelve equal installments payable semi-annually on June 27th and December 28th through the maturity of the notes. The Company can provide no assurance about whether the NYDFS will approve any future payments on the short-term or long-term notes.

In connection with the August 12, 2016 restructuring transactions, \$30.0 million of long-term and short-term surplus notes were transferred from the Company to SGI, and cancelled by SGI. \$23.6 million and \$6.4 million of long-term and short-term notes, respectively (including principal, paid-in-kind interest and accrued interest) of surplus notes were cancelled. In addition, upon closing of the transaction, SGI made a net cash payment of \$55.0 million on its long-term and short-term externally held surplus notes after receiving approval from the NYDFS for such payment. The Company will continue to request NYDFS approval for cash payments to holders of surplus notes each calendar year (to be paid in two equal semi-annual installments during such year), beginning in June 2017. The Company can provide no assurance about whether the NYDFS will approve any future payments on the short-term or long-term surplus notes.

On June 14, 2017 the NYDFS approved the Company's request for a net payment of \$27.5 million, which consisted of \$21.7 million and \$5.8 million of long-term and short-term notes, respectively, (including principal and accrued interest) and such payments were made on July 24, 2017. The aforementioned payment reduced the face amount of the short-term note by \$4.3 million.

On November 21, 2017 the NYDFS approved the Company's request for a net payment of \$27.5 million, which consisted of \$21.7 million and \$5.8 million of long-term and short-term notes, respectively, (including principal and accrued interest) and such payments were made on December 28, 2017. The aforementioned payment reduced the face amount of the short-term note by \$4.2 million.

On May 14, 2018 the NYDFS approved the Company's request for a net payment of \$400.0 million, which consisted of \$316.5 million and \$83.5 million of long-term and short-term notes, respectively, (including principal and accrued interest) and such payments were made on June 27, 2018. The aforementioned payment reduced the face amount of the short-term note by \$60.2 million and the long-term note by \$227.3 million. The Company incurred a loss on debt prepayment of \$91.4 million in connection with this payment which was recorded on the consolidated statement of operations for the six months ended June 30, 2018.

Each payment of interest on or principal of the notes is subject to restrictions under the terms of the notes themselves and the NYIL, including that such payments may only be made with the prior approval of the NYDFS, and then only to the extent the Company has sufficient free and divisible surplus to make such payment. Absent the satisfaction of these conditions, the Company may not make any payments on its notes.

Each of the notes noted in the table above ranks *pari passu*. In the event the Company is subject to liquidation or other such proceeding, policyholder claims would be afforded greater priority than that of noteholders, and the noteholders' claims would be afforded greater priority than claims of the Company's stockholders.

## **8. Preferred and Common Shares**

### *Non-Controlling Interest in Subsidiary – Series B Perpetual Non-Cumulative Preferred Shares of SGI*

On February 11, 2008, Syncora Guarantee Re Ltd., a former affiliate of SGI issued 2,000 shares of non-cumulative perpetual Series B preferred shares (the “Series B Preferred Shares”) for consideration aggregating \$200 million pursuant to the exercise of a put option under its capital facility. The put option fair value was \$180.0 million at date of exercise. Upon the exercise of the put option, the Company reduced the amount of the Series B Preferred Shares by such amount. Accordingly, the original carrying value of the Series B Preferred Shares of \$20.0 million represented the net proceeds received upon the issuance less the reversal of the fair value of the put option on the date of exercise. After the merger of Syncora Guarantee Re Ltd. with and into SGI, the Series B Preferred Shares became preferred shares of SGI. The Series B Preferred Shares have a par value of \$120 per share and a liquidation preference of \$100,000 per share. Holders of outstanding Series B Preferred Shares are entitled to receive, in preference to the holders of SGI’s common shares non-cumulative cash dividends, when, as and if declared by the board of directors, at a percentage rate per Series B Preferred Share for any dividend period ending on or prior to December 9, 2009, one-month LIBOR plus 1.00% per annum, calculated on an actual/360 day basis; and for any subsequent dividend period, one-month LIBOR plus 2.00% per annum, calculated on an actual/360 day basis.

Upon any voluntary or involuntary liquidation, dissolution or winding-up of SGI, each holder of Series B Preferred Shares is entitled to payment of any amount equal to the liquidation preference per share, plus accrued and unpaid dividends thereon (to the extent declared), if any, to the date of distribution in preference to holders of SGI’s common shares. Neither the merger or consolidation of SGI (as successor to Syncora Guarantee Re Ltd.) into or with any other company, the merger of any other company into SGI, nor the sale, lease or conveyance of all or substantially all of the property or business of SGI shall alone be deemed to be a dissolution, liquidation or winding up of SGI.

The holders of the Series B Preferred Shares are not entitled to any voting rights as shareholders of SGI and their consent is not required for taking any corporate action. Subject to certain requirements, the Series B Preferred Shares may be redeemed, in whole or in part, at the option of SGI at any time or from time to time after December 9, 2009 for cash at a redemption price equal to the liquidation preference per share plus any accrued and unpaid dividends thereon to the date of redemption without interest on such unpaid dividends. SGI has not declared or paid dividends on the Series B Preferred Shares during the six months ended June 30, 2018 and 2017. As a result of the BAC settlement, SGI holds 655 shares of its non-cumulative perpetual Series B preferred shares, which were transferred by BAC.

### *Common Shares*

In connection with the Company’s previously reported 2012 settlement of RMBS-related claims and other claims with BAC and affiliates thereof, the Company reported that as part of such settlement, subsidiaries of BAC transferred or agreed to transfer to SGI or its designee certain of SGI’s and the Company’s preferred shares, surplus notes and other securities. The transfer of the Company’s common shares and preferred shares had remained subject to the Company’s board approval and with respect to the preferred shares, regulatory approval. During the fourth quarter of 2014, 3,044,588 of Syncora Holdings’ common shares were transferred from BAC to SGI and such shares are accounted for and held as treasury shares by the Company, but remain legally outstanding for voting and other purposes. See Note 13 for further discussion on dividend restrictions.

On August 12, 2016, in connection with the restructuring transaction, in the aggregate, the Company issued 30.3 million of additional common shares, which were recorded at a fair value of \$37.9 million.

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**9. Accumulated Other Comprehensive Income**

Changes in accumulated other comprehensive income for the six months ended June 30, 2018 and 2017 by component are as follows:

(U.S. dollars in thousands)	Total		Available-for-sale securities		Unrecognized pension and post-retirement costs	
	2018	2017	2018	2017	2018	2017
Other comprehensive income before reclassifications	\$ (6,007)	\$ 12,245	\$ (6,027)	\$ 12,245	\$ 20	\$ -
Amounts reclassified from accumulated other comprehensive income:						
Realized gains on sale of securities.....	(10,384)	(6,729)	(10,384)	(6,729)	-	-
Cumulative effect of change in accounting principle for equity securities.....	(7,469)	-	(7,469)	-	-	-
Foreign currency impairment losses.....	-	14,304	-	14,304	-	-
Other-than-temporary impairments.....	(2,556)	1,183	(2,556)	1,183	-	-
Current period other comprehensive income, net.....	(26,416)	21,003	(26,436)	21,003	20	-
Balance, Beginning.....	31,015	3,797	30,663	3,951	352	(154)
Balance, Ending.....	\$ 4,599	\$ 24,800	\$ 4,227	\$ 24,954	\$ 372	\$ (154)

**10. Income Taxes**

Syncora Holdings is not subject to any taxes in Bermuda on either income or capital gains under current Bermuda law. In the event that there is a change such that these taxes are imposed, Syncora Holdings would be exempted from any such tax until March 2035 pursuant to Bermuda law.

As the Company is a Bermuda corporation and, except for gross basis withholding taxes on U.S. source investment income, neither it nor its non-U.S. subsidiaries have paid U.S. Federal corporate income taxes, on the basis that they are not engaged in a trade or business or otherwise subject to taxation in the United States. However, because definitive identification of activities which constitute being engaged in a trade or business in the United States is not provided by the Internal Revenue Code of 1986, as amended, regulations or court decisions, there can be no assurance that the Internal Revenue Service would not contend that the Company or its non-U.S. subsidiaries are engaged in a trade or business or otherwise subject to taxation in the United States.

In addition to the foregoing, there is a risk that the Internal Revenue Service could disagree with a number of tax positions taken by the Company with respect to certain transactions, including but not limited to, certain transactions undertaken in connection with the 2009 MTA. If any of the positions taken by the Company were successfully challenged by the Internal Revenue Service, there could be a material adverse effect on the amount of U.S. NOLs available to the Company to offset future taxable income.

SGI files a consolidated U.S. federal tax return with Syncora Holdings U.S. Inc. (the U.S. common parent of the Syncora Holdings' group) and its subsidiaries (which consists of SGI and Syncora Holdings U.S. Inc.'s other U.S. based subsidiaries). Syncora Holdings U.S. Inc. maintains a tax sharing agreement with its subsidiaries, whereby each subsidiary determines its payment due to/from Syncora Holdings U.S., Inc. on a separate company return basis. Further, if the subsidiary's separate return computation results in a taxable loss for the period, Syncora Holdings U.S., Inc. is obligated to reimburse the subsidiary to the extent that such loss reduces the Company's consolidated income tax liability. The tax sharing agreement calls for the reimbursement to take place within thirty days of Syncora Holdings filing its federal consolidated tax return.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Reform Act" or "H.R.1"), was signed into law. Among other things, the Tax Reform Act reduces the corporate federal tax rate from 35% to 21% effective January 1, 2018. As a result, the Company is required to re-measure, through income tax expense, its deferred tax assets and liabilities using the enacted rate at which management expects them to be recovered or settled. The primary effect to the Company was the re-measurement of federal deferred tax assets and liabilities from 35% to 21%. The re-measurement of the net deferred tax asset resulted in additional income tax expense of \$411.3 million for the year ended December 31, 2017, which was fully offset by a change in valuation allowance.

The Company's income tax provision for the six months ended June 30, 2018 and 2017 was approximately \$0.2 million and \$1.8 million, respectively. In accordance with U.S. GAAP, for the six months ended June 30, 2018 and 2017, the Company recorded income tax based on the estimated effective tax rate for the full year 2018 and 2017. The primary reason that this effective tax rate differs from the U.S. statutory tax rate of 21% in 2018 and 35% in 2017 is the full valuation allowance that Management expects to maintain against its net U.S. deferred tax assets.

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As of June 30, 2018 and December 31, 2017, respectively, the Company had no unrecognized tax benefits and no adjustments to liabilities or operations were required.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense, which were zero for the six months ended June 30, 2018 and 2017. Tax years 2014 through 2018 are subject to examination by U.S. federal authorities. There are currently no state or local tax audits underway for the Company as of June 30, 2018. However, there is a U.S. federal tax audit underway for tax year 2016.

At June 30, 2018, the Company had net operating loss carryforwards expiring from 2027 through 2038 of \$2.8 billion.

At June 30, 2018, the Company had capital loss carryforwards of \$184.4 million expiring from 2018 through 2023.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No.118 guidance to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of H.R. 1 commonly referred to as the Tax Cuts and Jobs Act. Given the longstanding practice of private companies electing to apply SABs, the FASB did not object to private companies applying the provisions of this guidance. Due to a lack of information, specifically as it relates to IRS provided discounting factors as modified for the corporate bond yield, the company is unable to provide a reasonable estimate for the additional tax basis discounting that may be required as a result of enactment of H.R. 1. Accordingly, the Company has elected to apply the provisions of this guidance in their financial statements and forgo estimating any additional effect to current and deferred taxes. The effects of H.R. 1, specifically as it relates to provisional tax basis loss reserve discounting will be adjusted in the first reporting period in which a reasonable estimate can be determined, which will coincide with the IRS's release of the applicable discounting components. Any change in estimate would be offset by a corresponding change in the valuation allowance.

The most significant items giving rise to deferred tax assets as of June 30, 2018 are Syncora Holdings' and Syncora Guarantee's net operating loss and capital loss carryforwards which are offset by a full valuation allowance.

Management has concluded that results from operations forecasted to be generated in the future are more likely than not insufficient to permit realization of the Company's U.S. deferred tax assets, thus a valuation allowance has been established against the entire U.S. deferred tax assets of the Company at June 30, 2018 and December 31, 2017. The valuation allowance was calculated in accordance with the provisions of the accounting pronouncements for income taxes, which place primary importance on operating results in recent periods when assessing the need for a valuation allowance. The Company intends to maintain a full valuation allowance for its net U.S. deferred tax assets until sufficient positive evidence exists to support reversal of all or a portion of the valuation allowance.

As of June 30, 2018 and December 31, 2017, the Company recorded net deferred tax liabilities of \$0.1 million and \$0.1 million, respectively, and are included in "Other liabilities" on the Company's consolidated balance sheet.

At June 30, 2018, the Company's cumulative NOLs, which may be carried forward to offset future taxable income, are \$2.8 billion. The Company's ability to utilize its NOLs at June 30, 2018 expires from 2027 through 2038. Approximately \$161.3 million of the Company's NOLs are subject to limitation under Section 382 of the Internal Revenue Code ("Section 382") as a result of an ownership change, as defined under that code section that occurred on August 5, 2008. An ownership change, as defined under Section 382 generally occurs if the percentage stock ownership of shareholders owning (or deemed under Section 382 to own) 5% or more of Syncora Holdings' common shares increases by more than 50 percentage points over the lowest percentage of Syncora Holdings' common shares owned by such shareholders during a defined period of time. To avoid an ownership change in the future and further limitation on the use of the Company's NOLs, on October 21, 2008, Syncora Holdings' Board of Directors approved changes to Syncora Holdings' Bye-laws which were subsequently approved by the shareholders on February 9, 2009 to limit the transfer of shares prior to the expiration of certain time periods specified in such bye-laws.

In connection with the Restructuring Transactions completed on August 12, 2016, pursuant to an amended and restated tax sharing agreement, SGI reallocated \$1.75 billion of excess net operating losses to Syncora Holdings US Inc. for its sole use and benefit, where these net operating losses may be used more broadly. In addition, Syncora Holdings US Inc. provided contractual protections relating to the preservation and utilization of SGI's retained net operating losses. The amendments to the tax sharing agreement did not have any effect on the Company's consolidated financial results.

The Company's significant NOLs are expected to reduce future U.S. tax liability that otherwise would be payable by the Company. The ability to utilize these NOLs would be limited in certain events, including if an "ownership change" under Section 382 were to occur. Section 382 limits the ability of a corporation that experiences an ownership change to utilize its NOLs and certain built-in losses after the ownership change. An ownership change is generally any change in ownership of more than 50 percentage points of a corporation's stock over a rolling 3-year period. These rules generally operate by focusing on ownership changes among shareholders owning directly or indirectly 5% or more of the stock of a corporation (including for this purpose certain groupings of

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shareholders each of whom owns less than the 5% threshold) or any change in ownership arising from a new issuance or a redemption of stock by the corporation. Generally under Section 382, in the event of an ownership change, the amount of taxable income that a corporation can offset by its “pre-change losses” (which include its NOLs) is restricted to an annual amount equal to the equity value of the corporation immediately prior to the ownership change multiplied by the long-term tax-exempt rate. These limitations generally prohibit transactions that result in the creation of a new 5% shareholder or increases the ownership interest of an existing 5% shareholder. A 5% shareholder for this purpose is defined in Syncora Holdings bye-laws by reference to Section 382 and the Treasury Regulations issued thereunder, and includes “public groups”. A prohibited transaction under Syncora Holdings bye-laws is void at inception.

### **11. Financial Instruments and Fair Value Measurements and Disclosures**

A number of the Company’s financial instruments are carried at fair value with changes in fair value recognized in earnings or loss each period. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). In determining fair value, the Company uses various valuation techniques and considers the fair value hierarchy.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical instruments (Level 1) and the lowest priority to valuation techniques using unobservable inputs (Level 3). Observable inputs are inputs that market participants would use in pricing the financial instruments that are based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company’s estimates of the assumptions market participants would use in pricing the financial instruments based on the best information available in the circumstances. These valuation techniques involve some level of management estimation and judgment. The degree to which management’s estimation and judgment is required is generally dependent upon the market price transparency for the instruments, the availability of observable inputs, frequency of trading in the instruments and the instrument’s complexity.

In measuring the fair market values of its financial instruments, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs based on the fair value hierarchy. The hierarchy is categorized into three levels based on the reliability of inputs as follows:

Level 1—Unadjusted quoted prices for identical instruments in active markets. The Company generally defines an active market as a market in which trading occurs at significant volumes. Active markets generally are more liquid and have a lower bid-ask spread than an inactive market.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.

Level 3—Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation techniques applied to the Company's assets and liabilities measured at fair value follows:

#### ***Valuation Techniques — Credit Default Swap Contracts***

The principal drivers of the fair value of the Company’s CDS contracts include: (i) general market credit spreads for the type(s) of assets referenced in CDS contracts, (ii) the specific quality and performance of the actual assets referenced in the contracts, (iii) the amount of subordination in the transaction before the Company’s liability attaches, (iv) other customized structural features of such contracts (*e.g.*, terms, conditions, covenants), (v) supply and demand factors, including the volume of new issuance, and (vi) the market perception of the Company’s ability to meet its obligations under its CDS contracts which is factored into the Company’s fair value estimates as discussed below.

The fair value of the Company’s in-force portfolio of CDS contracts represents the net present value of the difference between the remaining uncollected premiums that the Company originally charged for credit protection and management’s best estimate of what a financial guarantor of comparable credit worthiness would hypothetically charge to provide the same protection as of the measurement date. The hypothetical nature of this exit value is representative of the lack of a principal market for the

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Company's CDS contracts. In the absence of such a principal market, the Company believes other financial guarantors of comparable credit quality to the Company best represent the hypothetical exit market for the Company's CDS contracts. Fair value is defined as the price at which an asset or a liability could be bought or transferred in a current transaction between willing parties. Fair value is determined based on quoted market prices, if available. Quoted market prices are available only on a limited portion of the Company's in-force portfolio of CDS contracts. If quoted market prices are not available, fair value is estimated based on valuation techniques involving management's judgment. In determining the fair value of its CDS contracts, the Company uses various valuation approaches with priority given to observable market prices when they are available. Market prices are generally available for traded securities and market standard CDS contracts but are less available or unavailable for highly-customized CDS contracts. Most of the Company's CDS contracts are highly customized structured credit derivative transactions that are not traded and do not have observable market prices.

Key variables used in the Company's valuation of substantially all of its CDS contracts include the balance of unpaid notional, expected remaining term, fair values of the underlying reference obligations, reference obligation credit ratings, assumptions about current financial guarantee CDS fee levels relative to reference obligation spreads, the Non-Performance Risk (as defined and described below) of its in-force CDS contract exposure, and other factors. Fair values of the underlying reference obligations are obtained from broker quotes when available, or are derived from other market indications such as new issuance and secondary spreads and quoted values for similar transactions and indices, CDX (which index is comprised of investment grade corporate credits), or CMBX (which is comprised of commercial mortgage-backed securities). The Company's valuation of such CDS contracts does not generally provide for any adjustment to broker quotes. While such broker quotes are non-binding, the brokers from whom the Company obtains such quotes actively monitor and participate in the markets where such collateral is traded. Accordingly, the Company believes that such brokers rely on observable market information to the greatest extent possible when determining such quotes; however, such brokers may also rely on their internal models and unobservable inputs in making such determinations.

Implicit in the fair values obtained by the Company on the underlying reference obligations are the market's assumptions about default probabilities, default timing, correlation, recovery rates and collateral values. In general, the Company is using a percentage of the credit spread over proxy index (the "premium percentage") that management believes is consistent with (i) historical premium pricing for high credit spread transactions and (ii) levels attainable in the market just prior to the collapse of the market for CDS from financial guarantors. This data indicates that this premium percentage decreases as a function of increasing underlying credit spreads. A component of this relationship is the lack of liquidity reflected in the credit spread (the liquidity premium) that has historically flowed directly to the CDS counterparty as the funding institution and to cover the funders' additional funding costs and risks. Using the historical data available, a regression analysis was completed to determine the approximate rate of change of the premium percentage as underlying credit spreads move up and down. The resulting relationship from these analyses were applied to the current credit spread levels of the underlying reference securities, or their proxy index, to generate the expected current premium for each outstanding CDS.

In addition to that discussed above, the fair value of the Company's CDS contracts reflects the risk that SGI, as applicable, will not be able to honor its obligations under its CDS contracts, or its Non-Performance Risk. Generally, the Company would measure Non-Performance Risk as implied by the market price of buying credit protection on SGI as applicable. Since SGI does not have an observable market credit spread, SGI estimates its Non-Performance Risk based on the market observable credit spreads of comparable financial guarantee insurance companies. However, management reviews these spreads every quarter and makes adjustments as necessary. These adjustments may include eliminating idiosyncratic events specific to a particular company included in the market index, and focusing solely on spreads that represent a more suitable proxy for SGI's own credit risk. Management uses its judgment in making those adjustments, which are inherently subjective and judgmental in nature.

Such Non-Performance Risk was reflected in the fair value of SGI's CDS contracts by incorporating the estimated spreads at which the CDS contracts would trade on SGI, as discussed above, into the discount rate used. SGI estimated a discount rate for each CDS contract based on the swap rate and its estimated credit spread for the duration that is the closest to the remaining weighted average life of the obligation referenced in the CDS contract.

Since the estimate of fair value of the Company's CDS contracts reflects significant unobservable inputs related to the estimate of the Company's Non-Performance Risk and lack of market observable data, the Company's CDS contracts are categorized in Level 3 of the fair value hierarchy.

***Valuation Techniques — Interest Rate Swap Guarantees***

The Company's interest rate swap exposure consists primarily of financial guarantees that cover one party's payment obligations to another party under an interest rate swap contract. These interest rate swap guarantees are considered derivative financial instruments and are recorded at fair value. The fair value of these interest rate swap guarantees is included in the caption "credit default and other swap contracts, at fair value" on the consolidated balance sheets.



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The Company's interest rate swap guarantees cannot be legally traded and do not have observable market prices. The Company determines fair value based on valuation techniques involving management's judgment using internal valuation models. The estimated fair value of the interest rate swap guarantees are primarily based upon unobservable inputs, including estimated default probabilities of the obligor, contractual terms, estimated recovery rates and the application of credit value adjustments for the Company's own non-performance risk.

Since the estimate of fair value of the Company's interest rate swap guarantees reflects significant unobservable inputs, the Company's interest rate swap contracts are categorized in Level 3 of the fair value hierarchy.

***Valuation Techniques — Contingent Consideration***

Contingent consideration, which is included on the accompanying consolidated balance sheets in "Accounts payable, accrued expenses and other liabilities", represents a portion of the total purchase price consideration, as a result of an acquisition by Syncora Investment Holdings LLC, a wholly-owned subsidiary of SGI, on January 8, 2015. To determine the fair value of the contingent consideration, the Company utilized a discounted cash flow model based on inputs and assumptions of forecasted revenues and expenses. The inputs used in determining the fair value were mostly unobservable and as a result, the fair value of this contingent consideration is categorized into the Level 3 hierarchy.

***Valuation Techniques — VIE Assets and Liabilities***

The consolidated VIE assets and liabilities consist primarily of RMBS and other debt instruments. The fair value of the Company's consolidated VIE assets and liabilities is determined based on quoted market prices, if available. When observable quoted market prices are not available, fair value is determined based on internal discounted cash flow valuation models. The inputs to the valuation models primarily include estimated prepayment rates, market values of the underlying collateral, estimated default rates, market yields, credit spread indices, discount rates, estimated recovery rates, and for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing timely principal and interest for the VIE assets insured by the Company and the application of credit value adjustments for the Company's own non-performance credit risk. Since the majority of the significant inputs are unobservable, which reflect the Company's estimates of market assumptions, the fair value measurements of the consolidated VIE assets and liabilities are categorized as Level 3 in the fair value hierarchy.

***Valuation Techniques — Debt Securities Available for Sale***

*U.S. Government and government agencies*

U.S. Treasury securities are valued using unadjusted quoted market prices. Accordingly, U.S. Treasury securities are generally categorized in Level 1 of the fair value hierarchy. U.S. government agency securities are generally valued using quoted market prices obtained from an independent third-party investment service provider. U.S. government agency securities are generally categorized in Level 2 of the fair value hierarchy.

*Mortgage and asset-backed securities*

Mortgage and asset-backed securities are generally valued based on quoted prices or spread data, which are obtained from an independent third-party investment service provider. Mortgage and asset-backed securities are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, the Company will determine fair value using its own internal model estimates. In such cases, mortgage and asset-backed securities are categorized in Level 3 of the fair value hierarchy.

*Corporate*

The fair value of corporate bonds is determined using recently executed transactions or market price quotations obtained from an independent third-party investment service provider. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, the Company will determine fair value using its own internal model estimates. In such cases, these corporate securities are categorized in Level 3 of the fair value hierarchy.

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*U.S. State and political subdivisions*

The fair value of state and municipal securities is determined using recently executed transactions or market price quotations obtained from an independent third-party service provider. These bonds are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, the Company will determine fair value using its own internal model estimates. In such cases, these state and municipal securities are categorized in Level 3 of the fair value hierarchy.

***Valuation Techniques — Cash and Cash Equivalents and Restricted Cash and Cash Equivalents***

The carrying amounts of these items approximate fair value due to the short-term maturity of these instruments. Cash and cash equivalents include deposits in banks, commercial paper, money market accounts and money market funds, which fair value of these instruments is based upon quoted market prices. The Company does not adjust the quoted market price for such instruments. Cash and cash equivalents are categorized in Level 1 of the fair value hierarchy.

***Valuation Techniques — Other Invested Assets***

Other invested assets primarily include direct investments in equity securities and exchange-traded direct equity investments. Equity securities and exchange-traded equity securities are generally valued based on quoted prices. Such investments are categorized in Level 1 of the fair value hierarchy. Investment in a certain fund that is not actively traded but inputs that are observable in the market or can be derived principally from observable market data is categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, the Company will determine fair value using its own internal model estimates. In such cases, these other invested assets are categorized in Level 3 of the fair value hierarchy.

***Valuation Techniques — Other Receivable – City of Detroit***

The carrying amount of the City of Detroit credit certificate is carried at fair value, which is included on the accompanying consolidated balance sheets in “other assets”. The Company determines the fair value of this certificate using its own internal model incorporating estimated selling prices and any available market information. The most significant unobservable input is the credit and illiquidity discount which primarily ranges from 0% to 50%. Due to the limited availability of market information, the fair value could be subject to significant volatility. The inputs used in determining the fair value were mostly unobservable and as a result, the fair value of this certificate is categorized into the Level 3 hierarchy.

***Valuation Techniques — Interest Rate Derivative Instrument***

The fair value of the Company's interest rate swap contract is based upon observable market data including contractual terms, market prices and interest rates and is obtained from the counterparty. The interest rate derivative instrument is categorized in Level 2 of the fair value hierarchy.

***Valuation Techniques — Financial Guarantee Insurance Contracts***

The Company believes that the best estimate of fair value for its entire portfolio of insurance contracts is the discounted expected premiums less the discounted expected losses over the remaining life of each contract. To determine this fair value, the Company utilized a discounted cash flow model based on inputs that include assumptions of expected losses net of expected recoveries where loss reserves have been established (reserve contracts), and expected premiums and losses where loss reserves have not been recognized (non-reserve contracts). For non-reserve contracts, estimates of expected loss are driven by assumptions as to default and loss given default rates for each contract. Market-based discount rates that are credit adjusted for the premium payer and the Company's own credit risk are applied to the premium and loss cash flows, respectively, to ultimately determine the contract's fair value. The inputs used in determining fair value were mostly unobservable and as a result the fair value could change materially.

The fair value of the Company's financial guarantee insurance contracts related to its retained business was \$8.3 million and \$123.1 million at June 30, 2018 and December 31, 2017, respectively. The fair value of the Company's insurance contracts would be categorized into the Level 3 hierarchy since the significant inputs used were unobservable.

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**Fair Value Hierarchy Tables**

The following fair value hierarchy table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017:

(U.S. dollars in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)		Total Assets / Liabilities at Fair Value	
	2018	2017	2018	2017	2018	2017	2018	2017
<b>ASSETS</b>								
Debt securities available for sale:								
Mortgage and asset-backed securities								
RMBS.....	\$ -	\$ -	\$ 71,776	\$ 78,746	\$ 1,464	\$ 2,217	\$ 73,240	\$ 80,963
CMBS.....	-	-	25,268	26,874	-	-	25,268	26,874
Asset-backed securities.....	-	-	66,387	57,693	-	-	66,387	57,693
U.S. Government and government agencies.....	113,110	139,690	4,298	14,960	-	-	117,408	154,650
Corporate and other.....	-	-	334,684	509,839	-	45,444	334,684	555,283
U.S. states and political subdivisions.....	-	-	47,679	52,581	-	-	47,679	52,581
Total debt securities available for sale.....	113,110	139,690	550,092	740,693	1,464	47,661	664,666	928,044
Other invested assets.....	68,284	71,398	5,045	5,208	40,398	40,504	113,727	117,110
Other assets.....	-	-	-	-	-	3,007	-	3,007
Cash and cash equivalents.....	110,496	311,926	-	25	-	-	110,496	311,951
Restricted cash and cash equivalents.....	181	2,637	-	-	-	-	181	2,637
Assets of consolidated variable interest entities.....	-	-	-	-	17,068	118,154	17,068	118,154
Credit default and other swap contracts.....	-	-	-	-	203,441	-	203,441	-
Total assets.....	\$ 292,071	\$ 525,651	\$ 555,137	\$ 745,926	\$ 262,371	\$ 209,326	\$ 1,109,579	\$ 1,480,903
<b>LIABILITIES</b>								
Credit default and other swap contracts.....	\$ -	\$ -	\$ -	\$ -	\$ 211,662	\$ 104,094	\$ 211,662	\$ 104,094
Contingent consideration.....	-	-	-	-	-	2,043	-	2,043
Liabilities of consolidated variable interest entities.....	-	-	-	-	761	60,708	761	60,708
Total liabilities.....	\$ -	\$ -	\$ -	\$ -	\$ 212,423	\$ 166,845	\$ 212,423	\$ 166,845

**Level 3 Assets and Liabilities Reconciliation Tables**

**Level 3 Assets**

The following table provides a reconciliation of the Company's assets measured at fair value on a recurring basis using unobservable inputs (Level 3) as of June 30, 2018 and 2017:

(U.S. dollars in thousands)	Debt Securities Available for Sale					
	Mortgage and Asset-Backed Securities		Corporate and Other		U.S. States and Political Subdivisions	
	2018	2017	2018	2017	2018	2017
<b>LEVEL 3 ASSETS</b>						
Balance, beginning of period.....	\$ 2,217	\$ 1,819	\$ 45,444	\$ 52,858	\$ -	\$ 54,670
Deconsolidation of VIEs.....	-	-	-	-	-	-
Realized gains (losses).....	3,407	(490)	4,872	1,465	-	(7,936)
Unrealized gains (losses) included in earnings.....	-	-	6,113	(14,293)	-	-
Unrealized gains (losses) included in OCI.....	(24)	107	(9,501)	17,788	-	99
Purchases.....	2,207	890	54	312	-	-
Sales.....	(6,343)	(435)	(46,982)	(16,228)	-	-
Transfers into (out of) Level 3.....	-	-	-	-	-	-
Balance, end of period.....	\$ 1,464	\$ 1,891	\$ -	\$ 41,902	\$ -	\$ 46,833

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LEVEL 3 ASSETS	Other Invested Assets		Other Assets		Assets of Consolidated Variable Interest Entities		Credit default and other swap contracts	
	2018	2017	2018	2017	2018	2017	2018	2017
Balance, beginning of period.....	\$ 40,504	\$ 37,930	\$ 3,007	\$ 4,009	\$ 118,154	\$ 146,857	\$ -	\$ -
Deconsolidation of VIEs.....	-	-	-	-	(57,564)	-	-	-
Realized gains (losses).....	(19)	8	(3,007)	-	-	-	-	-
Unrealized gains (losses) included in earnings.....	-	6,384	-	-	(8,888)	(3,116)	82,582	-
Unrealized gains (losses) included in OCI.....	(87)	46	-	-	-	-	-	-
Purchases.....	-	1,094	-	-	-	-	120,859	-
Sales.....	-	(79)	-	-	-	-	-	-
Distributions.....	-	-	-	-	(34,634)	-	-	-
Transfers into (out of) Level 3.....	-	(5,000)	-	-	-	-	-	-
Balance, end of period.....	\$ 40,398	\$ 40,383	\$ -	\$ 4,009	\$ 17,068	\$ 143,741	\$ 203,441	\$ -

There were no transfers into or out of Level 3 during the six months ended June 30, 2018. For the six months ended June 30, 2017, transfers out of Level 3 were \$5.0 million, which related to other invested assets and was due to the availability of, or corroborated by, observable market inputs other than quoted market prices.

*Level 3 Liabilities*

The following table provides a reconciliation for the Company's liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) for the six months ended June 30, 2018 and 2017:

(U.S. dollars in thousands)	Credit Default and Other Swap Contracts		Contingent Consideration		Liabilities of Consolidated Variable Interest Entities	
	2018	2017	2018	2017	2018	2017
LEVEL 3 LIABILITIES						
Balance, beginning of period.....	\$ 104,094	\$ 160,515	\$ 2,043	\$ 3,021	\$ 60,708	\$ 66,183
Deconsolidation of VIEs.....	-	-	-	-	(57,563)	-
Payment of contingent consideration.....	-	-	(2,043)	(734)	-	-
Realized (gains) losses.....	120,407	(1,654)	-	-	-	-
Unrealized (gains) losses included in earnings.....	(12,839)	188	-	-	(2,384)	(521)
Balance, end of period.....	\$ 211,662	\$ 159,049	\$ -	\$ 2,287	\$ 761	\$ 65,662

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The following table provides quantitative information regarding the significant unobservable inputs used to measure the fair value of the Company's Level 3 assets and liabilities on a recurring basis as of June 30, 2018 and December 31, 2017:

(U.S. dollars in thousands)

Level 3 Assets / Liabilities	Fair Value		Valuation Techniques	Significant Unobservable Inputs	Range of Inputs	
	2018	2017			2018	2017
<b>Assets</b>						
Mortgage- and asset-backed securities	\$ 1,464	\$ 2,217	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield	0% - 13.0% 3% - 99.15% 50% - 100% 4.2% - 6.7%	0% - 12.0% 4.01% - 100% 36.2% - 100% 4.55% - 6.55%
Corporate and other	-	45,444	Discounted cash flows Transaction price	Yield	-	7.4%
Other invested assets	40,398	40,504	Market approach	Projected revenues Revenue multiples Liquidation preference	\$15.0 million- \$65.2 million 2.9x - 7.3x \$4.9 million	\$14.6 million- \$35.4 million 3.2x - 19.8x \$4.9 million
Other assets	-	3,007	Selling price scenarios	Credit and illiquidity discount	-	0% - 50%
Assets of consolidated VIEs	17,068	118,154	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield Non-performance risk	2.69% - 13% 3% - 34.5% 50% - 100% 4.2% - 6.7% 4.4% - 7.8%	0.07% - 12.0% 2.8% - 34.5% 33.7% - 100% 4.05% - 6.55% 9.1% - 12.6%
Credit default and other swap contracts	203,441	-	Discounted cash flows	Loss severity Default rate Market premiums Weighted average life Non-performance risk	10% - 60% 0.02% - 2.61% 23 bps - 246 bps 1.0 yrs - 35.0 yrs 3.2% - 4.6%	- - - - -
<b>Liabilities</b>						
Credit default and other swap contracts	\$211,662	\$104,094	Discounted cash flows	Loss severity Default rate Market premiums Weighted average life Non-performance risk	10% - 60% 0.02% - 2.61% 23 bps - 246 bps 1.0 yrs - 35.0 yrs 3.2% - 8.3%	10% - 60% 0.02% - 5.19% 23 bps - 199 bps 2.6 yrs - 35.6 yrs 9.1% - 10.6%
Contingent consideration	-	2,043	Discounted cash flows	Discount rate	-	0% - 2.0%
Liabilities of consolidated VIEs	761	60,708	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield Non-performance risk	2.69% - 13% 3% - 34.5% 57% - 100% 4.2% - 7.82% 4.4% - 7.82%	2.4% - 12.0% 4.9% - 34.5% 33.7% - 100% 4.05% - 6.55% 9.1% - 12.6%

The significant unobservable inputs used in the fair value measurement of the Company's assets and liabilities are shown in the table above. Significant changes in any of those inputs noted above in isolation can result in a materially lower or higher fair value measurement.

***Non-Performance Risk***

The Company considers the effect of nonperformance risk in determining the fair value of its CDS liabilities and the consolidated VIE liabilities. The fair value of the Company's CDS reflects the risk that SGI, as applicable, will not be able to honor its obligations under its CDS contracts, or its Non-Performance Risk. Since SGI does not have an observable market credit spread, SGI

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measures its Non-Performance Risk based on the market observable credit spread of a comparable financial guarantee insurance company.

The fair value of the Company's consolidated VIE liabilities reflects the Non-Performance Risk that the Company will not be able to honor VIE obligations where VIE liabilities exceed the value of the related pledged assets.

Set forth below is information regarding the Company's in-force CDS and other swap contracts and VIE liabilities as of June 30, 2018 and December 31, 2017, including the fair value of such contracts and VIE liabilities, the Non-Performance Risk discount on such contracts and VIE liabilities which is embedded in the credit default and other swap contracts and the VIE liabilities on the accompanying consolidated balance sheets:

(U.S. dollars in millions)	<b>CDS and other swap</b>		<b>VIE liabilities</b>	
	<b><u>contract liabilities</u></b>			
	<b><u>2018</u></b>	<b><u>2017</u></b>	<b><u>2018</u></b>	<b><u>2017</u></b>
Fair value, before giving effect to Non-Performance Risk.....	\$ 278.1	\$ 291.9	\$ 0.8	\$ 60.8
Less:				
Non-Performance Risk.....	<u>66.4</u>	<u>187.8</u>	<u>-</u>	<u>0.1</u>
Fair value, after giving effect to Non-Performance Risk.....	<u>\$ 211.7</u>	<u>\$ 104.1</u>	<u>\$ 0.8</u>	<u>\$ 60.7</u>

***Financial Instruments Not Carried at Fair Value***

At June 30, 2018 and December 31, 2017, the carrying value of the Company's notes was \$257.6 million and \$428.9 million, respectively. The interest rate on these notes is 5.0% and 6.0% for each series with the first maturity date on such notes scheduled for December 2011 and in June 2024. The fair value of the Company's notes is difficult and complex to estimate as such notes are not listed on any exchange or publicly traded in any market. Any trading activity is inherently limited, and the prices may vary significantly between trades. Based on limited available market data obtained by management, the Company's short-term notes were found to have a price of approximately 96.0 and 88.0 and the Company's long-term notes were found to have a price of approximately 98.0 and 89.0 as of June 30, 2018 and December 31, 2017, respectively. These prices were based on total par, paid-in-kind interest and accrued but unpaid interest. Additionally, as described in Note 2, there are many risks and uncertainties affecting the Company that could affect its financial and liquidity position and consequently, the fair value of these notes is subject to significant volatility.

**12. Commitments and Contingencies**

**a. Legal Matters**

In the ordinary course of business, the Company may be subject to litigation or other legal proceedings. The Company intends to vigorously defend against any actions in which it is a defendant and against other potential actions, and the Company does not expect the outcome of any such matters to have a material adverse effect on the Company's financial position, results of operations or liquidity. The Company can provide no assurance that the ultimate outcome of these actions will not cause a loss nor have a material adverse effect on the Company's financial position, results of operations or liquidity.

Set forth below is a description of certain legal proceedings to which Syncora Guarantee is a party.

*US Bank v. GreenPoint Mortgage*

On February 5, 2009, U.S. Bank National Association, as Indenture Trustee ("US Bank") filed suit in the Supreme Court of the State of New York, New York County, against GreenPoint Mortgage Funding, Inc. ("GreenPoint"), alleging that GreenPoint breached representations and warranties that would require repurchase of the breaching mortgage loans and/or the entire loan pool and/or payment of damages in connection with the GreenPoint Mortgage Funding Trust 2006-HE1 transaction.

On December 29, 2017, the Company, together with US Bank and other parties, settled a dispute with GreenPoint Mortgage Funding, Inc. in relation to the GreenPoint Mortgage Funding Trust 2006-HE1 transaction. As a result of this settlement, the Company received cash payments of \$335 million on January 16, 2018 and expects to receive up to an additional approximately \$15 million over the remainder of the transaction.

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*Macquarie Litigation*

On April 18, 2012, Syncora Guarantee initiated an action in the Supreme Court of the State of New York against Macquarie Capital (USA) Inc. (“Macquarie”), among others. The case remains pending only against Macquarie, with Syncora Guarantee having entered into a stipulation dismissing the other defendants from the lawsuit. Syncora Guarantee alleges that Macquarie made misrepresentations and omissions in obtaining insurance in connection with a bond offering by American Roads LLC. Macquarie’s initial motion to dismiss the claims was denied in its entirety and decided in Syncora Guarantee’s favor. On September 28, 2015, Syncora Guarantee filed a motion to amend its complaint to include additional allegations against Macquarie. In May 2016, Macquarie filed a motion to dismiss Syncora Guarantee’s amended complaint and, in the alternative, to narrow Syncora Guarantee’s claims and damages. On February 15, 2017, the court ruled on Macquarie’s motion to dismiss, sustaining Syncora Guarantee’s fraud and negligent misrepresentation claims for compensatory damages but dismissing Syncora Guarantee’s claims for “rescissory” damages and punitive damages. The court also rejected Macquarie’s request to strike the amended complaint’s reference to Section 3105. Pretrial discovery has concluded. On January 17, 2018, Macquarie appealed the trial court’s ruling in respect of Syncora Guarantee’s compensatory damages. The appeal is fully briefed, and was argued on June 12, 2018. A decision has not been issued yet. Macquarie has also moved for summary judgment before the trial court; that motion was initially withdrawn at the direction of the trial court, pending a decision by the New York Court of Appeals on an issue of insurance law. Pretrial discovery has concluded. Pending a decision on Macquarie’s motion for summary judgment, and its appeal from the trial court’s decision on the motion to dismiss, trial is scheduled to begin on January 23, 2019.

*Puerto Rico*

On July 18, 2017, certain creditors of PREPA, including Syncora Guarantee, filed a motion in PREPA’s Title III case seeking relief from the automatic stay in order to commence an action to enforce their statutory right to appoint a receiver. On September 14, 2017, this motion was denied by Judge Swain. On September 28, 2017, the Company and the other creditors appealed the decision to the United States Court of Appeals for the First Circuit. On August 8, 2018, the First Circuit issued an opinion vacating Judge Swain’s decision and holding that sections 305 and 306 of PROMESA do not preclude the court from granting the requested relief to appoint a receiver. The First Circuit remanded the case back to Judge Swain and allowed the creditors to file a renewed motion to seek relief from the automatic stay.

On August 7, 2017, certain creditors of PREPA, including Syncora Guarantee, filed a complaint in PREPA’s Title III case in order to enforce their rights as holders of special revenue bonds. On October 13, 2017, in light of the impact of Hurricane Maria on Puerto Rico, the creditors filed a notice of voluntary dismissal without prejudice.

**b. Lease and Other Commitments**

The Company has a lease commitment for office premises at 135 West 50<sup>th</sup> Street, New York, New York. The Company had lease commitments for office premises at Merritt 7 Corporate Park, Norwalk, Connecticut, which terminated on December 31, 2017 and at 76 South Orange Avenue, South Orange, New Jersey, which terminated on February 28, 2018.

In March 2018, the Company entered into an amended two year agreement with International Business Machines Corporation for information technology outsourcing services, effective April 1, 2018. Fees associated with the agreement are expected to be approximately \$1.2 million in 2018.

Net minimum aggregate lease commitments are \$1.2 million, \$97.0 thousand, \$0, \$0 and \$0 for the years ended December 31, 2018 through December 31, 2022.

Net rent expense was \$0.6 million and \$0.6 million for the six months ended June 30, 2018 and 2017, respectively.

**13. Dividend Restrictions and Insurance Regulatory Requirements**

*Syncora Holdings*

Syncora Holdings’ Board of Directors did not declare a quarterly dividend with respect to its common shares for the year ended December 31, 2017 or at any time thereafter through to the issuance date of these financial statements. Any future dividends will be subject to the discretion and approval of the Syncora Holdings’ Board of Directors, applicable law, regulatory, and contractual requirements.

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*SGI*

The ability of SGI to declare and pay a dividend to shareholders is governed by applicable New York law, including the NYIL. Under Section 4105 of the NYIL, SGI is permitted to pay dividends to shareholders in any 12-month period, without the prior approval of the NYDFS in an amount equal to the lesser of 10% of its policyholders' surplus as of last financial statement filed with the NYDFS (annual or quarterly) or their adjusted net investment income for the 12-month period, as determined in accordance with Statutory Accounting Practices prescribed or permitted by the NYDFS. The NYIL also provides that SGI may distribute dividends to shareholders in excess of the aforementioned amount only upon approval thereof by the NYDFS. Even if these tests are satisfied, NYIL provides a further test in that SGI may not declare or distribute any dividends to shareholders except out of "earned surplus" (an amount equal to "unassigned funds (surplus)" as shown on SGI's statutory balance sheet, which as of June 30, 2018 and December 31, 2017 was \$442.8 million and \$554.1 million, less its "unrealized appreciation of assets"). As of June 30, 2018, SGI's unrealized appreciation of assets was \$11.1 million. The NYDFS may disapprove such dividends to shareholders if it finds that SGI will retain insufficient surplus to support its obligations and writings.

Pursuant to the terms of the 2009 MTA, SGI is not permitted to pay dividends or repurchase, redeem, exchange or convert any equity securities until such time as all notes issued by SGI (see Note 7) are paid in full.

Among other requirements, Article 69 of the NYIL provides that financial guarantee insurance companies maintain minimum policyholders' surplus of \$66 million. In accordance with accounting practices prescribed or permitted by the NYDFS, as of June 30, 2018 and December 31, 2017, SGI reported policyholders' surplus of \$972.4 million and \$1,317.6 million, respectively. For the six months ended June 30, 2018 and 2017, SGI reported net income (loss) of \$(165.5) million and \$(44.2) million, respectively.

*SGI Statutory Insurance Regulatory Requirements*

SGI prepares its statutory basis financial statements in accordance with accounting practices prescribed or permitted by the NYDFS. The NYDFS recognizes only statutory accounting practices prescribed or permitted by the State of New York for determining and reporting the financial condition and results of operations of an insurance company and for determining its solvency under insurance law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures manual ("NAIC SAP"), has been adopted as a component of prescribed or permitted practices by the State of New York. The state has adopted certain prescribed accounting practices that differ with those found in NAIC SAP. The NYDFS has the right to permit other specific practices which deviate from prescribed practices.



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Set forth below are reconciliations of the net income (loss) and capital and surplus (deficit) of SGI reported in accordance with NAIC SAP to such amounts prepared in accordance with statutory accounting practices prescribed or permitted by the NYDFS for the six months ended June 30, 2018 and 2017 and as of June 30, 2018 and December 31, 2017.

(U.S. dollars in thousands)

Description	Net Income (Loss)		Capital and Surplus	
	2018	2017	2018	2017
NAIC SAP Basis	\$ (225,337)	\$ (12,731)	\$ (259,643)	\$ 182,000
Effect of NY prescribed practices				
(a)	-	-	-	-
Effect of NY permitted practices				
(b)	-	-	921,561	878,669
(c)	33,972	(22,139)	241,763	207,791
(d)	-	-	-	-
(e)	25,856	(9,350)	68,673	49,164
(f)	-	-	-	-
NY Basis	\$ (165,509)	\$ (44,220)	\$ 972,354	\$ 1,317,624

*Permitted or Prescribed Practices*

- (a) Pursuant to certain prescribed accounting practices under Articles 14 and 69 of the NYIL that differ with those found in NAIC SAP, the admissible carrying value of a share of an insurer is limited to a stipulated percentage of policyholders' surplus, and investments in certain securities (including the Uninsured Cash Flow Certificates) are also subject to limitations. In connection with the 2009 MTA, the NYDFS permitted the Company to admit these assets notwithstanding the otherwise applicable limitations, which resulted in no difference between NAIC SAP and NY basis.
- (b) Pursuant to approval granted by the NYDFS in accordance with section 6903 of the NYIL, as of June 30, 2018 and December 31, 2017, SGI has de-recognized \$921.6 million and \$878.7 million, respectively, in the aggregate, of contingency reserves on terminated policies, and policies on which the Company has established case reserves, whereas under NAIC SAP the Company would still be required to carry such reserves. The Company applied the permitted practice described above to release contingency reserves on an obligation by obligation basis under policies insuring multiple obligations rather than on a policy by policy basis. In addition to the foregoing, the Company released contingency reserves based on a methodology pursuant to a permitted practice granted by the NYDFS. In connection with the reinsurance agreement with Assured, which closed on June 1, 2018, the NYDFS permitted the Company to set a fixed contingency reserve balance of \$5 million going forward. The fixed reserve balance will not increase through accretion nor decrease through releases.
- (c) The NYDFS granted the SGI a permitted practice to de-recognize reserves for unpaid losses, unearned premium reserve and contingency reserves relating to, and expense payments (which are reflected in "Net losses and loss adjustment expenses" on the Statements of Operations and Changes in Capital and Surplus ("Statements of Operations")) made to effect, certain transactions executed in connection with its continued remediation efforts which effectively defeased or, in-substance, commuted, in whole or in part, the policies relating thereto, whereas under NAIC SAP such reserves would continue to be carried until such time the underlying contracts were legally extinguished and the payments made to effect the transactions would have resulted in the recording of an asset, as such payments were made in exchange for the assignment to the Company or an affiliate of the Company of all rights under the aforementioned policies. As of June 30, 2018, such de-recognized reserves for unpaid losses, unearned premium reserve and contingency reserves (as of the date of the effective defeasance or, in-substance commutations) aggregated \$6.3 billion, \$17.4 million and \$4.9 million, respectively. As of December 31, 2017, such de-recognized reserves for unpaid losses, unearned premium reserve and contingency reserves (as of the date of the effective defeasance or, in-substance commutations) aggregated \$6.2 billion, \$17.4 million and \$4.9 million, respectively. As of December 31, 2015, the Company no longer sought approval for the de-recognition of unpaid losses, unearned premium reserves and contingency reserves relating to, and expense payments made which effectively defeased or, in-substance, commuted certain CDS contracts executed in connection with the consummation of the 2009 MTA and that were previously disclosed on an aggregate basis. As such CDS contracts were legally extinguished as of December 31, 2015, the associated reserves were released under NAIC SAP resulting in no difference between NAIC SAP and NY basis, and therefore the permitted practice is no longer required.
- (d) The NYDFS granted the Company a permitted practice to value the surplus notes issued by the Company in settlement of certain policy obligations in connection with the 2009 MTA at original face value of \$625.0 million in the aggregate, as compared to the estimated fair value thereof, that the Company would otherwise have been required to reflect such surplus notes in accordance with NAIC SAP. Any adjustment to the carrying value of surplus notes would result in an equal and offsetting adjustment to unassigned funds. As both surplus notes and unassigned funds are elements of policyholders' surplus, a change in the value of the surplus notes would not affect policyholders' surplus.
- (e) The NYDFS granted the Company a permitted practice to account for its ownership of the common stock of American Roads LLC entities as salvage recoverable, which is deducted from the liability for unpaid claims or losses, whereas under NAIC SAP, the Company would be required to record its 100% equity ownership of the American Roads LLC entities using GAAP equity value.
- (f) In connection with the Restructuring Transactions (as defined in Note 1) completed on August 12, 2016, the NYDFS granted the Company permission to increase its earned surplus to the greatest extent possible given its current gross paid in and contributed surplus by allocating the entire balance of that account to earned surplus. As both earned surplus and gross paid in and contributed surplus are elements of policyholders' surplus, this permitted practice has no effect on total policyholders' surplus.

**SYNCORA HOLDINGS LTD.**  
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**14. Assets on Deposit to Collateralize Certain of the Company’s Contractual Obligations**

As of June 30, 2018 and December 31, 2017, the Company had, in the aggregate, approximately \$29.5 million and \$41.2 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including reinsurance, lease and letter of credit agreements. Of such deposits, \$11.7 million and \$13.0 million and \$17.8 million and \$28.2 million are recorded on the accompanying consolidated balance sheet in “Other assets” and “Debt securities, available for sale, at fair value”, respectively. In connection with the reinsurance agreement with Assured, the Company agreed to maintain \$15.6 million on deposit through June 1, 2023. In addition, debt securities with an amortized cost and fair value of \$5.5 million and \$5.6 million at June 30, 2018 and \$6.3 million and \$6.5 million at December 31, 2017, respectively, were on deposit with various regulatory authorities as required by insurance laws.

**15. Financial Information of Syncora Holdings (Parent Company Only)**

The condensed balance sheets, statements of operations and shareholders’ equity, and statements of cash flows of Syncora Holdings as of June 30, 2018 and December 31, 2017 and for the six months ended June 30, 2018 and 2017 are set forth below:

(U.S. dollars in thousands)	<b>2018</b>	<b>2017</b>
<b>Assets</b>		
Debt securities available for sale, at fair value (amortized cost: \$4,725 and \$5,333) .....	\$ 4,813	\$ 5,442
Cash and cash equivalents. ....	1,001	1,312
Accrued investment income.....	23	23
Investment in subsidiaries on an equity basis:		
Syncora Guarantee Inc.....	533,682	659,149
Other subsidiaries. ....	19,981	19,878
Other assets.....	664	155
Total assets.....	\$ 560,164	\$ 685,959
<b>Liabilities and Shareholders’ Equity</b>		
Liabilities— accounts payable, accrued expenses, and other liabilities	\$ —	\$ —
Shareholders’ equity		
Common shares and additional paid-in capital.....	2,717,440	2,716,798
Accumulated deficit.....	(2,161,875)	(2,061,854)
Accumulated other comprehensive income.....	4,599	31,015
Total shareholders’ equity.....	560,164	685,959
Total liabilities and shareholders’ equity.....	\$ 560,164	\$ 685,959

**SYNCORA HOLDINGS LTD.**  
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	<u>2018</u>	<u>2017</u>
<b>Revenues</b>		
Net investment income.....	\$ 48	\$ 24
Total revenues.....	<u>48</u>	<u>24</u>
Operating expenses .....	<u>1,097</u>	<u>1,394</u>
<b>Loss before equity in net loss of subsidiaries</b> .....	<u>(1,049)</u>	<u>(1,370)</u>
Equity in net loss of Syncora Guarantee Inc.....	(106,539)	(68,156)
Equity in net income of other subsidiaries.....	<u>98</u>	<u>48</u>
<b>Equity in net loss of subsidiaries</b> .....	<u>(106,441)</u>	<u>(68,108)</u>
<b>Net loss attributable to Syncora Holdings Ltd.</b> .....	<u>(107,490)</u>	<u>(69,478)</u>
<b>Other comprehensive (loss) income:</b>		
Net unrealized losses on investments .....	(19)	(12)
Equity in other comprehensive (loss) income of Syncora Guarantee Inc. ..	<u>(18,928)</u>	<u>21,015</u>
<b>Other comprehensive (loss) income</b> .....	<u>(18,947)</u>	<u>21,003</u>
<b>Comprehensive loss</b> .....	<u>(126,437)</u>	<u>(48,475)</u>
Change in common shares and additional paid-in-capital .....	<u>642</u>	<u>506</u>
<b>Change in shareholders' equity</b> .....	<u>(125,795)</u>	<u>(47,969)</u>
<b>Total shareholders' equity- beginning of period</b> .....	<u>685,959</u>	<u>524,661</u>
<b>Total shareholders' equity- end of period</b> .....	<u>\$ 560,164</u>	<u>\$ 476,692</u>

	<u>2018</u>	<u>2017</u>
<b>Cash flows from operating activities:</b>		
Operating expenses paid .....	\$ (722)	\$ (1,705)
Investment income collected.....	38	23
Other cash receipts.....	<u>204</u>	<u>3,785</u>
Net cash (used in) provided by operating activities .....	<u>(480)</u>	<u>2,103</u>
<b>Cash flows from investing activities:</b>		
Proceeds from sale of debt securities.....	-	500
Proceeds from maturity of debt securities.....	163	798
Proceeds from sale of debt securities.....	6	-
Purchases of debt securities .....	<u>-</u>	<u>(3,150)</u>
Net cash provided by (used in) investing activities .....	<u>169</u>	<u>(1,852)</u>
(Decrease) increase in cash and cash equivalents .....	(311)	251
Cash and cash equivalents—beginning of period .....	<u>1,312</u>	<u>512</u>
Cash and cash equivalents—end of period.....	<u>\$ 1,001</u>	<u>\$ 763</u>

## **16. Assets and Liabilities Held-for-Sale and Discontinued Operations of American Roads LLC**

On August 8, 2017, management, with Board of Directors approval, committed to a formal plan to sell American Roads LLC. On July 16, 2018, the Company announced that Pike Pointe closed the sale of American Roads LLC to American Roads AcquireCo LLC, a wholly owned subsidiary of DIF Infrastructure V for cash consideration of approximately \$220 million, before payment of related expenses, with provisions that provide for payment of additional amounts if specified conditions are met within 12 months of the date of the agreement. The Company reports a business as held-for-sale when it has received approval to sell the business and is committed to a formal plan, the business is available for immediate sale, the business is being actively marketed, the sale is anticipated to occur during the next 12 months and other specified criteria are met. Assets and liabilities related to the business classified as held-for-sale are separately reported in the consolidated balance sheets in the period in which the business is classified as held-for-sale. A business classified as held-for-sale is recorded at the lower of carrying amount or estimated fair value less cost to sell. If the carrying amount of the business exceeds its estimated fair value, a loss is recognized. The Company reports a discontinued operation if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results and meets the criteria to be classified as held-for-sale, is disposed of by sale or is disposed of other than by sale. Once a disposal group is classified as held-for-sale, the order of impairment testing starts with the indefinite-lived intangible assets, then goodwill, and then the disposal group which is measured at the lower of carrying amount or estimated fair value less to sell.

Since the accounting criteria for held-for-sale and discontinued operations were met on August 8, 2017, the Company has reflected these classifications in the accompanying consolidated financial statements. The consolidated balance sheets as of June 30, 2018 and December 31, 2017 present the total assets and total liabilities of American Roads LLC in the line items "assets of entity held-for-sale" and "liabilities of entity held-for-sale", respectively. The consolidated statements of operations and comprehensive income for the six months ended June 30, 2018 and 2017 present the total revenues and total expenses of American Roads LLC in the line item "Income from discontinued operations". The consolidated statements of cash flows for the six months ended June 30, 2018 and 2017 present the cash flows of American Roads LLC in the line items "net cash provided by (used in) operating and investing activities from discontinued operations", respectively.

American Roads is involved in the following operations: management and operational rights to the Detroit Windsor Tunnel ("DWT"), owner and operator of four toll bridges in Alabama (between the mainland and resort communities of Orange Beach and Gulf Shores, between Montgomery and Elmore Counties, between towns in Elmore and Autauga Counties, and on a portion of the western bypass of Tuscaloosa), and the development of tolling and transportation software and technology for third parties.

The U.S. portion of the DWT is leased through 2040 from the City of Detroit and the operations are included in the accompanying consolidated financial statements. The Canadian portion of the DWT is owned by the City of Windsor. DWT and the City of Windsor operated through December 31, 2017 under a Joint Operating Agreement and amounts from operations attributable to the City of Windsor are excluded from the accompanying consolidated financial statements. In November 2017, the City of Windsor provided notice to terminate the Joint Operating Agreement, with an effective termination date of December 31, 2017. See "Commitment and Contingencies" below in this note for additional information.

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The following table summarizes the components of assets and liabilities held-for-sale of American Roads LLC on the consolidated balance sheets as of June 30, 2018 and December 31, 2017.

(U.S. dollars in thousands)	<b>2018</b>	<b>2017</b>
<b>ASSETS</b>		
Debt securities, available-for-sale, at fair value.....	\$ -	\$ 2,810
Cash and cash equivalents .....	11,414	36,652
Total cash and invested assets .....	11,414	39,462
Restricted cash.....	-	194
Property and equipment, net.....	53,533	51,655
Leasehold rights and other definite-lived intangible assets, net.....	6,451	6,451
Toll rights and other indefinite-lived intangible assets .....	94,492	94,492
Other assets.....	1,482	3,286
Total assets of entity held-for-sale.....	\$ 167,372	\$ 195,540
<b>LIABILITIES</b>		
Accounts payable, accrued expenses and other liabilities.....	5,141	8,635
Pension and other postretirement liabilities .....	7,234	11,793
Total liabilities of entity held-for-sale .....	\$ 12,375	\$ 20,428

The following table summarizes the components of Income from discontinued operations for American Roads LLC for the six months ended June 30, 2018 and 2017.

(U.S. dollars in thousands)	<b>2018</b>	<b>2017</b>
<b>Revenues</b>		
Toll revenue.....	\$ 13,252	\$ 14,249
Net investment income .....	26	50
Fees and other income .....	1,813	1,627
<b>Total revenues</b> .....	15,091	15,926
<b>Expenses</b>		
Foreign currency exchange gain .....	(148)	(101)
Gain on pension and other post-retirement benefits settlement .....	(4,099)	-
Operating expenses .....	8,578	9,984
<b>Total expenses</b> .....	4,331	9,883
<b>Income from discontinued operations</b> .....	10,760	6,043
Other comprehensive (loss) income from discontinued operations .....	41	2,115
<b>Comprehensive income from discontinued operations</b> .....	\$ 10,801	\$ 3,928

The income from discontinued operations does not include any income taxes since American Roads LLC is not a tax paying entity and is part of a consolidated U.S. federal tax return with Syncora Holdings U.S. Inc. See Note 10 for further discussion.

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The following table summarizes the components of cash flow information for American Roads LLC for the six months ended June 30, 2018 and 2017.

(U.S. dollars in thousands)	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Tolls collected .....	\$ 14,072	\$ 14,574
Management fees received.....	270	432
Other operating cash receipts.....	1,618	1,710
Cash paid for operating expenses.....	(11,475)	(9,239)
Interest and dividend income collected.....	112	47
Net cash provided by operating activities of discontinued operations.....	4,597	7,524
<b>Cash flows from investing activities:</b>		
Proceeds from sale of investments.....	2,950	403
Purchases of investments.....	(188)	(447)
Purchases of property and equipment, net of proceeds from sale of \$110 and zero.....	(1,853)	(693)
Net cash provided by (used in) investing activities of discontinued operations.....	909	(737)
<b>Cash flows from financing activities:</b>		
Distribution to parent company.....	(30,938)	-
Net cash used in financing activities of discontinued operations.....	(30,938)	-
(Decrease) increase in cash and cash equivalents and restricted cash.....	(25,432)	6,787
Cash and cash equivalents and restricted cash- beginning of period.....	36,846	21,533
Cash and cash equivalents and restricted cash - end of period.....	\$ 11,414	\$ 28,320
<b>Summary of cash and cash equivalents and restricted cash- end of period:</b>		
Cash and cash equivalents.....	\$ 11,414	\$ 28,320
Restricted cash .....	-	2,178
Cash and cash equivalents and restricted cash - end of period.....	\$ 11,414	\$ 30,498

**Summary of Significant Accounting Policies specific to American Roads LLC**

*Toll Revenue*

Toll revenue is recognized at the time a vehicle travels on or through one of American Roads LLC's tunnel or bridges. Revenue recognition is deferred for automated tolls collected in advance and recognized at the time of travel.

*Property and Equipment*

Property and equipment consists of land, leasehold improvements, roadways, bridges and facilities, buildings and toll plazas, furniture, computers, equipment, and construction in progress. All additions and improvements to property and equipment are recorded at cost and, except for land and construction in progress, are depreciated over the appropriate useful life of the asset using the straight-line method. Expenditures for maintenance, repairs and inspections are charged to operating expenses as incurred.

Property and equipment are tested for impairment whenever events or changes in circumstances suggest that an asset or asset group's carrying value may not be fully recoverable. An impairment, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the expected undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value. There was no impairment of property and equipment at June 30, 2018 and December 31, 2017. Property and equipment related to American Roads LLC have been included in assets of entity held-for-sale on the consolidated balance sheets and included in the measurement of the disposal group at lower of cost or fair value, less cost of sale.

*Intangible Assets*

Definite-lived intangible assets consist of leasehold rights and software. Definite-lived intangible assets are amortized over their respective useful lives, which range from 3 to 7 years. Definite-lived intangible assets are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows derived from the use of the assets. When a definite-lived intangible asset is impaired, the related assets are written

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down to fair value. There was no impairment of definite-lived intangibles at June 30, 2018 and December 31, 2017. Definite-lived intangible assets related to American Roads LLC have been included in assets of entity held-for-sale on the consolidated balance sheets and included in the measurement of the disposal group at lower of cost or fair value, less cost of sale.

Indefinite-lived intangible assets include toll rights and goodwill. Management performs its annual impairment test as of August 31, or more frequently if facts and circumstances indicate that an impairment has occurred. In accordance with applicable guidance, American Roads LLC uses fair value techniques to evaluate indefinite-lived intangible assets for possible impairment. Management evaluates events and circumstances to determine if it is more likely than not that the fair value of indefinite-lived intangible assets is less than its carrying amount. If the fair value of the indefinite-lived intangible asset is less than the carrying amount, an impairment is recognized in an amount equal to the difference. The fair value of the indefinite-lived intangible is generally established using discounted cash flows. In accordance with the policy as described above, an impairment test was performed as of August 31, 2017. An impairment test was not performed during the six months ended June 30, 2018, in accordance with the policy as described above. For the year ended December 31, 2017, management's assessment determined that indefinite-lived assets were not impaired. Indefinite-lived intangible assets related to American Roads LLC are included in assets of entity held-for-sale on the consolidated balance sheets.

Goodwill reflects the excess of the reorganization value of American Roads LLC over the fair value of tangible and identifiable intangible assets, net of liabilities, from the adoption of fresh start reporting. American Roads LLC recorded goodwill upon emergence from bankruptcy and does not amortize goodwill; however, management performs its annual impairment test as of August 31, or more frequently if facts and circumstances indicate that an impairment has occurred. This impairment test is calculated at the reporting unit level, which was determined to be each toll road facility. The goodwill impairment test has three steps. The first step evaluates events and circumstances to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If the qualitative assessment concludes that the fair value of the reporting units exceeds the carrying amount, goodwill is not impaired and the additional steps are not necessary. The second step identifies potential impairments by comparing the fair value of a reporting unit with its book value, including goodwill. If the fair value of the reporting units exceeds the carrying amount, goodwill is not impaired and the third step is not necessary. If the carrying value exceeds the fair value, the third step calculates the possible impairment by comparing the implied fair value of goodwill with the carrying amount. If the implied goodwill is less than the carrying amount, a write-down is recorded. To derive the fair value of the reporting units, American Roads LLC utilizes the income approach, given the lack of comparable publicly-traded information. Under the income approach, fair value was determined based on estimated future cash flows discounted at an appropriate risk-adjusted discount rate which represents the rate of return an outside investor would expect to earn. Although the cash flow forecasts are based on assumptions that are considered reasonable by management and consistent with the plans and estimates used to manage the underlying business, there is significant judgment in determining the expected future cash flows attributable to these reporting units. Management believes the fair values estimated are reasonable, however actual performance in the short-term and long-term could be materially different from forecasts, which could impact future estimates of fair value of the reporting units and may result in impairment of goodwill. In accordance with the policy as described above, an impairment test was performed as of August 31, 2017. An impairment test was not performed during the six months ended June 30, 2018, in accordance with the policy as described above. For the year ended December 31, 2017, management's test determined that goodwill was not impaired. Goodwill related to American Roads LLC is included in assets of entity held-for-sale on the consolidated balance sheets.

*Retirement and Other Post Retirement Benefits*

American Roads LLC has non-contributory defined benefit pension and post-retirement plans, which provide certain benefits to its eligible employees. Pension and other postretirement benefit costs and obligations are determined primarily based upon employees' length of service, the employee's average compensation during the last ten years of service, rates of return on pension plan assets, future health care costs and a contractually established rate for union employees represented by collective bargaining agreements. Benefits provided under the other post retirement plans include medical and prescription drug, life insurance and dental benefits. American Roads LLC recognizes the underfunded or overfunded status of a defined benefit pension and other post-retirement plan as an asset or liability and recognizes actuarial gains and losses in the year in which they occur through accumulated other comprehensive income, which is a component of shareholder's equity. These are amortized through the consolidated statements of operations and comprehensive income.

The determination of defined benefit pension and postretirement plan obligations and their associated expenses requires the use of actuarial valuations to estimate participant plan benefits employees earn while working as well as the present value of those benefits. Inherent in these valuations are financial assumptions including discount rates at which liabilities can be settled, rates of increase of health care costs, as well as employee demographic assumptions such as retirement patterns, mortality and turnover. Management reviews these assumptions annually with its actuarial advisors. The actuarial assumptions used may differ materially from actual results due to changing market and economic conditions, higher or lower turnover rates or longer or shorter life spans of participants.

## **Accounting Pronouncements**

### Recently Adopted Accounting Pronouncement

In May of 2014, the Financial Accounting Standards Board (“FASB”) issued “Revenue from Contracts with Customers”. This standard amends the accounting guidance for recognizing revenue for the transfer of goods or services from contracts with customers unless those contracts are within the scope of other accounting standards. In August 2015, the FASB issued “Revenue from Contracts with Customers – Deferral of the Effective Date” which defers the effective date of this standard to annual periods beginning January 1, 2018, and is applied on a retrospective or modified retrospective basis. American Roads LLC adopted this standard effective January 1, 2018, using the modified retrospective basis. Toll revenue is within the scope of the standard, and after evaluating the standard, toll revenue will continue to be recorded in the same manner and no material transition adjustments are expected to be recorded. Management fee revenue is within the scope of the standard; however, management fee revenue will not be earned in 2018 due to the termination of the Joint Operating Agreement; therefore no material transition adjustments were recorded. Accordingly, the adoption of this guidance did not have a material effect on the consolidated financial statements.

In March 2017, the FASB issued “Compensation – Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost”. This standard requires the separation of net periodic cost components. The service cost component will continue to be presented within operating expenses, and all other components will be required to be separately reported outside of operating expenses within other income (expense) on the consolidated statements of operations, comprehensive income and member’s equity. This standard is effective for fiscal years beginning after December 15, 2017 and earlier application is permitted. American Roads adopted this standard effective January 1, 2018, and the adoption of this standard did not have a material effect on the consolidated financial statements.

### Accounting Pronouncements Pending Adoption

In February 2016, the FASB issued “Leases”. This standard amends the accounting guidance for leasing transactions, which requires lessees to recognize right-of-use assets and lease liabilities, initially measured at the present value of the lease payments, on the balance sheet. This standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. American Roads LLC is evaluating the effect of adopting this standard.

In January 2017, the FASB issued “Intangibles – Goodwill and Other: Simplifying the Accounting for Goodwill Impairment.” This standard removes the second step of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now represent the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This standard is effective for fiscal years beginning after December 15, 2020 and earlier application is permitted. American Roads LLC is evaluating the effect of adopting this standard.



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**Long-lived Assets**

Long-lived assets consist of the following at June 30, 2018 and December 31, 2017:

(U.S. dollars in thousands)

Asset Class	Depreciation/ Amortization Life	Gross		Net	
		2018	2017	2018	2017
<i>Property and Equipment</i>					
Land	-	\$ 2,137	\$ 2,137	\$ 2,137	\$ 2,137
Leasehold improvements	Shorter of life of lease or asset	12,324	12,263	5,827	5,767
Roadways	15 years	3,460	3,460	2,831	2,831
Bridges and facilities	75 years	37,587	37,587	35,106	35,105
Buildings and toll plazas	3-20 years	1,740	1,715	953	928
Furniture, computers and equipment	3-5 years	1,208	1,395	574	609
Construction in progress	-	6,105	4,278	6,105	4,278
Total		64,561	62,835	\$ 53,533	\$ 51,655
Less accumulated depreciation and amortization		(11,028)	(11,180)		
Property and equipment, net		\$ 53,533	\$ 51,655		
<i>Definite-lived Intangible Assets</i>					
Lease rights	7 years	\$ 13,954	\$ 13,954	\$ 6,357	\$ 6,357
Software	3-5 years	1,516	1,516	94	94
Total		15,470	15,470	\$ 6,451	\$ 6,451
Less accumulated amortization		(9,019)	(9,019)		
Definite-lived intangible assets, net		\$ 6,451	\$ 6,451		
<i>Indefinite-lived Intangible Assets</i>					
Toll rights	-	\$ 66,307	\$ 66,307	\$ 66,307	\$ 66,307
Goodwill	-	28,185	28,185	28,185	28,185
Indefinite-lived intangible assets, net		\$ 94,492	\$ 94,492	\$ 94,492	\$ 94,492

Depreciation and amortization expense on property and equipment and definite-lived intangible assets for the six months ended June 30, 2018 and 2017 was zero and \$2.4 million, respectively. Depreciation ceased on August 8, 2017, the date the sale was approved and the assets were held-for-sale.

**Commitments and Contingencies**

*Detroit Lease Agreement*

American Roads LLC has a lease agreement with the City of Detroit, Michigan, that provides for the right to operate the U.S. portion of the DWT through December 31, 2040. A portion of this leased office space and off-site facilities is sublet through December 31, 2020 to the United States Federal Agency which also includes reimbursement for maintenance and operating services.

***Joint Operating Agreement***

The Canadian portion of the tunnel was operated by DWT pursuant to the Joint Operating Agreement with the City of Windsor, which expired October 31, 2007. Under the agreement, the contract automatically continued until one party provided ninety days notice to the other party to terminate the agreement. During 2017, the agreement was amended to provide either party only thirty days notice to terminate the agreement. The Joint Operating Agreement governed the distribution of costs related to the operating, maintaining and repairing of the tunnel. Under the Joint Operating Agreement, generally the City of Windsor reimbursed DWT for 50% of the direct operating expenses of the tunnel and reimburses DWT for certain overhead expenses in the form of a management fee.

On November 30, 2017, the City of Windsor provided notice to terminate the Joint Operating Agreement, with an effective termination date of December 31, 2017. Effective January 1, 2018, pursuant to an Assignment and Assumption Agreement executed between DWT and the City of Windsor, the City of Windsor agreed to assume the Canadian Hourly pension plan. In addition, the City of Windsor agreed to become the successor employer of the Canadian collective bargaining agreement and assumed all obligations of DWT under the Canadian collective bargaining agreement, which included the assumption of all the Canadian unionized employees, and all their benefits including the Canadian Hourly portion of the post retirement benefit plan. In 2018, the City of Windsor assumed prepaid pension benefits of approximately \$0.3 million for the Canadian Hourly pension plan and a projected benefit obligation of approximately \$4.4 million for the Canadian Hourly portion of the post retirement benefit plan.

Also as part of the termination, DWT and the City of Windsor negotiated a Transition and Termination Agreement in order to set out the terms of the termination, as well as transition the Canadian portion of the operations, management, improvement and maintenance plans, to the City of Windsor.

DWT and the City of Windsor entered into (or “are party to”) a Shared Services Agreement, which governs the use and provides for the operation, management, repair, replacement and improvement of the tunnel. DWT and the City of Windsor executed the Transition and Termination Agreement and the Shared Services Agreement in May 2018.

***Other Contingencies***

American Roads LLC is exposed to certain uncertainties related to its toll road facilities, operations and toll collections. The carrying value of American Roads LLC assets includes long-lived tangible and intangible assets whose recovery is predicated on toll collections. American Roads LLC assets may be subject to additional competition. American Roads LLC faces the prospect of a new non-tolled bridge approximately one mile to the west in Orange Beach, Alabama. Any impairment of such assets could have a material adverse effect on the financial position of American Roads LLC.

**17. Subsequent Events**

On July 16, 2018, the Company announced that Pike Pointe closed the sale of American Roads LLC to American Roads AcquireCo LLC, a wholly owned subsidiary of DIF Infrastructure V for cash consideration of approximately \$220 million, before payment of related expenses, with provisions that provide for payment of additional amounts if specified conditions are met within 12 months of the date of the agreement.

The Company has evaluated all subsequent events through August 14, 2018, the date the consolidated financial statements were available to be issued.