

SYNCORA HOLDINGS LTD.

Consolidated Financial Statements

**As of September 30, 2019 (Unaudited) and December 31, 2018 and for
the Nine Months Ended September 30, 2019 and 2018 (Unaudited)**

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SYNCORA HOLDINGS LTD.
CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2019 (Unaudited) and DECEMBER 31, 2018
(U.S. dollars in thousands, except share and per share amounts)

ASSETS	2019	2018
Debt securities, available-for-sale, at fair value (amortized cost: \$3,087 and \$13,611).....	\$ 3,100	\$ 13,703
Cash and cash equivalents.....	33,002	26,299
Total cash and invested assets.....	36,102	40,002
Indefinite-lived intangible assets.....	449	3,210
Definite-lived intangible assets, net.....	7,643	8,427
Prepaid expenses and other assets.....	2,266	4,275
Assets of entity held-for-sale.....	1,264,457	1,634,468
Total assets.....	\$ 1,310,917	\$ 1,690,382
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable, accrued expenses and other liabilities.....	\$ 10,134	\$ 10,258
Liabilities of entity held-for-sale.....	814,132	1,030,600
Total liabilities.....	824,266	1,040,858
Shareholders' equity		
Preferred shares of entity held-for-sale - Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc. (2,000 shares authorized and issued; 372 and 1,345 shares outstanding, 1,628 and 655 shares held by subsidiary; \$37,196 and \$134,526 liquidation preference).....	3,720	13,453
Non-controlling interest in consolidated entity.....	1,917	2,247
Common shares (500,000,000 shares authorized; 90,102,159 and 90,013,135 shares issued; 87,057,571 and 86,968,547 shares outstanding, 3,044,588 shares held as treasury; \$0.01 par value) and additional paid-in capital.....	2,718,524	2,717,633
Accumulated deficit.....	(2,256,294)	(2,085,637)
Accumulated other comprehensive income.....	18,784	1,828
Total Syncora Holdings Ltd. shareholders' equity.....	481,014	633,824
Total shareholders' equity.....	486,651	649,524
Total liabilities and shareholders' equity.....	\$ 1,310,917	\$ 1,690,382

See accompanying Notes to Consolidated Financial Statements (Unaudited).

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (Unaudited)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018
(U.S. dollars in thousands, except share and per share amounts)

	2019	2018
Revenues		
Fee revenue.....	\$ 4,237	\$ 3,408
Net investment income.....	375	1,044
Net realized (losses) gains on investments, including other-than-temporary impairment losses of zero and \$(443).....	(319)	2
Other income.....	514	11,040
Total revenues.....	4,807	15,494
Expenses		
Impairment loss on indefinite-lived intangible assets.....	2,761	-
Operating expenses.....	11,117	4,760
Total expenses.....	13,878	4,760
(Loss) income before income tax expense from continuing operations.....	(9,071)	10,734
Income tax expense.....	63	23
(Loss) income from continuing operations.....	(9,134)	10,711
Loss from discontinued insurance operations before tax expense, including 2019 impairment loss of \$(132,685)....	(88,411)	(104,933)
Income from discontinued toll road operations, including gain on disposal of \$64,383.....	-	75,143
Loss from discontinued operations, net of tax.....	(88,411)	(29,790)
Net loss.....	(97,545)	(19,079)
Other comprehensive income (loss):		
Other comprehensive (loss) income from continuing operations.....	(79)	88
Other comprehensive income (loss) from discontinued operations.....	17,035	(19,166)
Other comprehensive income (loss).....	16,956	(19,078)
Comprehensive loss.....	\$ (80,589)	\$ (38,157)
Net income and comprehensive income attributable to non-controlling interest.....	\$ 115	\$ 260
Net loss and comprehensive income (loss) attributable to controlling interest:		
Net loss.....	\$ (97,660)	\$ (19,339)
Comprehensive loss.....	\$ (80,704)	\$ (38,417)
Calculation of basic and diluted earnings (loss) per share attributable to Syncora Holdings Ltd. common shareholders:		
(Loss) income from continuing operations.....	\$ (9,249)	\$ 10,451
<i>Per share</i>	\$ (0.11)	\$ 0.12
Loss from discontinued operations.....	\$ (88,411)	\$ (29,790)
Accounting effect for the purchases of Series B perpetual non-cumulative preference shares.....	(72,997)	-
Total.....	(161,408)	(29,790)
<i>Per share</i>	\$ (1.85)	\$ (0.34)
Loss.....	\$ (170,657)	\$ (19,339)
<i>Per share</i>	\$ (1.96)	\$ (0.22)
Weighted average common shares outstanding.....	87,042,571	86,924,997

See accompanying Notes to Consolidated Financial Statements (Unaudited).

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018
(U.S. dollars in thousands, except share amounts)

	<u>2019</u>	<u>2018</u>
Preferred shares of entity held-for-sale – Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc.		
Balance—beginning of period.....	\$ 13,453	\$ 13,453
Carrying value reduction related to the purchases of Series B perpetual non-cumulative preference shares.....	(9,733)	-
Balance—end of period.....	<u>3,720</u>	<u>13,453</u>
Non-controlling interest in consolidated entity		
Balance—beginning of period.....	2,247	2,578
Net income and comprehensive income attributable to non-controlling interest.....	115	260
Distributions.....	(445)	(706)
Balance—end of period.....	<u>1,917</u>	<u>2,132</u>
Common shares and additional paid-in capital		
Balance—beginning of period.....	2,717,633	2,716,798
Issuance of 89,024 and 201,512 common shares.....	348	479
Share-based compensation.....	543	260
Balance—end of period.....	<u>2,718,524</u>	<u>2,717,537</u>
Accumulated deficit		
Balance—beginning of period.....	(2,085,637)	(2,061,854)
Net loss attributable to controlling interest.....	(97,660)	(19,339)
Accounting effect for the purchases of Series B perpetual non-cumulative preference shares.....	(72,997)	-
Cumulative effect of change in accounting principle for equity securities.....	-	7,469
Balance—end of period.....	<u>(2,256,294)</u>	<u>(2,073,724)</u>
Accumulated other comprehensive income		
Balance—beginning of period.....	1,828	31,015
Other comprehensive income (loss) attributable to controlling interest.....	16,956	(19,078)
Cumulative effect of change in accounting principle for equity securities.....	-	(7,469)
Balance—end of period.....	<u>18,784</u>	<u>4,468</u>
Total common shareholders' equity—end of period.....	<u>481,014</u>	<u>648,281</u>
Total shareholders' equity—end of period.....	<u>\$ 486,651</u>	<u>\$ 663,866</u>

See accompanying Notes to Consolidated Financial Statements (Unaudited).

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018
(U.S. dollars in thousands)

	2019	2018
Cash flows from operating activities:		
Investment income collected.....	\$ 839	\$ 726
Fee revenue collected.....	4,237	3,408
Operating expenses paid.....	(13,258)	(10,244)
Income taxes (paid) received.....	(64)	20
Other cash receipts.....	10,664	17,310
Net cash provided by operating activities from continuing operations.....	2,418	11,220
Net cash used in operating activities from discontinued operations.....	(154,454)	(475,627)
Net cash used in operating activities.....	(152,036)	(464,407)
Cash flows from investing activities:		
Proceeds from sales of investments.....	1,503	21,711
Proceeds from maturity of investments.....	1,736	3,935
Net proceeds (purchases) of short-term securities.....	8,943	(56,779)
Purchases of investments.....	(1,472)	(4,014)
Net cash provided by (used in) investing activities from continuing operations.....	10,710	(35,147)
Net cash provided by investing activities from discontinued operations.....	244,339	478,264
Net cash provided by investing activities.....	255,049	443,117
Cash flows from financing activities:		
Distributions to non-controlling interest in consolidated entity.....	(445)	(706)
Net cash used in financing activities from continuing operations.....	(445)	(706)
Net cash used in financing activities from discontinued operations.....	(108,960)	(69,071)
Net cash used in financing activities.....	(109,405)	(69,777)
Decrease in cash and cash equivalents and restricted cash.....	(6,392)	(91,067)
Cash and cash equivalents and restricted cash and cash equivalents—beginning of period.....	161,020	351,434
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	\$ 154,628	\$ 260,367
Summary of cash and cash equivalents and restricted cash and cash equivalents- end of period:		
Cash and cash equivalents, including restricted cash.....	\$ 33,002	\$ 20,011
Cash and cash equivalents included in Assets of entity held-for-sale.....	105,083	235,987
Restricted cash included in Assets of entity held-for-sale.....	16,543	4,369
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	\$ 154,628	\$ 260,367
Supplemental non-cash transactions:		
Deconsolidation of variable interest entities.....	\$ -	\$ 57,564

See accompanying Notes to Consolidated Financial Statements (Unaudited).

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018
(U.S. dollars in thousands)

	2019	2018
Reconciliation of (loss) income from continuing operations to net cash provided by operating activities from continuing operations:		
(Loss) income from continuing operations.....	\$ (9,134)	\$ 10,711
Adjustments to reconcile (loss) income from continuing operations to net cash provided by operating activities from continuing operations:		
Depreciation and amortization.....	555	783
Net unrealized and realized losses (gains) on investments.....	319	(2)
Impairment of indefinite-lived intangible assets.....	2,761	-
Other operating activities.....	4,903	4,112
Changes in assets and liabilities:		
Other assets.....	2,010	(141)
Accounts payable, accrued expenses and other liabilities.....	1,004	(4,243)
Total adjustments.....	11,552	509
Net cash provided by operating activities from continuing operations.....	\$ 2,418	\$ 11,220

See accompanying Notes to Consolidated Financial Statements (Unaudited).

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

1. Organization and Business

Syncora Holdings Ltd. (“Syncora Holdings”) is a Bermuda holding company, which was formed on March 17, 2006 to provide, 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, SGI ceased writing substantially all new business in January 2008 and is no longer licensed to do so in certain states and other jurisdictions. 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.

On September 5, 2019, Syncora Holdings Ltd. (“SHL”) announced that it had entered into an amended agreement with Star Insurance Holdings LLC, an entity organized by GoldenTree Asset Management LP (“GoldenTree”) on behalf of GoldenTree’s managed funds and accounts, for Syncora’s previously announced sale of Syncora Guarantee Inc. (“SGI”) on August 15, 2019 pursuant to which the purchase price has been increased by \$36.5 million to \$429 million in cash, subject to adjustment. See Note 14 for further discussion. The Company expects to distribute substantially all of the cash sale proceeds, net of transaction-related expenses, as soon as practicable after the closing of the sale.

In addition to the cash purchase price, after the closing of the sale, Syncora will have cash and specified non-core assets currently held at SGI, including certain non-cash assets of Pike Pointe Holdings and an 80% interest in Swap Financial Group.

The closing of the transaction remains subject to customary conditions, including approval by the New York State Department of Financial Services (“NYDFS”), and is expected to take place by the end of the fourth quarter of 2019 or during the first quarter of 2020.

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 certain infrastructure assets, including 100% of the equity ownership of a number of its subsidiaries that previously owned and operated certain toll road facilities located in the United States and Canada (collectively, “American Roads LLC”). On July 16, 2018, the Company closed the sale of American Roads LLC, which is presented as discontinued operations (see Note 14 for further discussion).

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

Significant Risks and Uncertainties

Syncora Holdings is a holding company with no operations or significant assets other than \$1.8 million of debt securities and cash and cash equivalents and its common equity ownership of its subsidiaries as of September 30, 2019. 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 regulatory prohibitions and limitations and to the prior claims of 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 13 for financial information of Syncora Holdings.

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The Company is exposed to significant risks and uncertainties that may materially affect its operations, financial and liquidity position. 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.

- As described in Note 1, the Company announced that it has entered into an amended agreement with Star Insurance Holdings LLC ("Star Insurance"), an entity organized by GoldenTree Asset Management LP ("GoldenTree") on behalf of GoldenTree's managed funds and accounts, to sell Syncora Guarantee for a purchase price of \$429 million in cash, subject to adjustment. In addition, the Company announced its intention to distribute 100% of the net cash proceeds of sale as soon as practicable following the closing of the transaction which remains subject to customary conditions, including approval by the NYDFS. There can be no assurance that we will receive such approval or that the acquisition will close on the expected timeline or at all. In the event that the transaction does not close, no distribution will be made.
- 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 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.
- 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.
- 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 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

In addition to the sale announcement as discussed in Note 1, the Company, together with its subsidiaries, continues to pursue certain key initiatives in order to continue to deliver enhanced value to stakeholders. These initiatives include (i) continuing to focus on reducing the Company's retained insured exposures (through their purchase on the open market or otherwise, commutation, defeasance, reinsurance or other restructuring) to minimize potential claim payments, maximize recoveries and mitigate potential

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losses, (ii) continuing to evaluate when and how to utilize NOLs that were reallocated to Syncora Holdings US Inc. as part of the restructuring transaction completed on August 12, 2016, (iii) seeking to realize the maximum value of its assets, and from any other rights and remedies the Company may have, (iv) seeking to novate or purchase with a view towards novating to Assured, the policies reinsured to Assured, (v) further reducing operating expenses and improving operational efficiencies and, (vi) transitioning services to Assured in respect of the reinsurance agreement and the administrative services agreement.

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. Significant Accounting Policies

Specific accounting policies pertaining to SGI are presented in Note 14.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with 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.

Assets and Liabilities Held-for-Sale and Discontinued Operations

On August 14, 2019, management, with Board of Directors approval, committed to a sale of SGI. 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 during the third quarter of 2019, the Company has reflected these classifications in the accompanying consolidated financial statements and prior periods have been reclassified to conform to this presentation. The consolidated balance sheets as of September 30, 2019 and December 31, 2018 present the total assets and total liabilities of SGI 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 nine months ended September 30, 2019 and 2018 present the total revenues and total expenses of SGI in the line item "Income from discontinued operations". The consolidated statements of cash flows for the nine months ended September 30, 2019 and 2018 present the cash flows of SGI in the line items "net cash provided by (used in) operating and investing activities from discontinued operations", respectively. The significant accounting policies specific to SGI are presented in Note 14.

Fee Revenue

Fee revenue consists of consulting and advisory fees earned by the Company. To determine the amount and timing of fee revenue recognition, the Company must (1) identify the contract with the client, (2) identify the performance obligations in the

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contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize fee revenue when the Company satisfies a performance obligation. Services are either rendered as part of a retainer agreement or a single transaction where the Company is contacted by a potential customer to provide a specific service. Fees are recognized at the time services are performed and/or performance obligations are satisfied.

Other Income

Other income includes miscellaneous sources of income.

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, and other general and administrative expenses.

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 for the nine months ended September 30, 2019 and 2018, respectively.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

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. The Company adopted this standard as of January 1, 2019 and the adoption of this standard did not have a material effect on the Company’s consolidated financial statements.

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. A goodwill impairment will now be 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. The Company early adopted this standard effective January 1, 2018.

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 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 Securities and Exchange Commission (“SEC”) filers. At a July 17, 2019 meeting, the FASB voted to propose a delay of the effective date for all other entities until fiscal years beginning after December 15, 2022. The FASB staff will draft the proposed amendment to the effective date and provide them to the FASB Board to vote, after which it is expected to be exposed for a public comment period of 30 days. The FASB expects to issue the final amendment later this year.

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4. 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 reported 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 premiums are amortized on a level-yield basis to the earliest call date of securities acquired. Bond discounts 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.

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.

The amortized cost and fair value of investments as of September 30, 2019 and December 31, 2018 are as follows:

(U.S. dollars in thousands)	Cost or		Gross Unrealized		Gross Unrealized		Fair Value	
	Amortized Cost		Gains		Losses			
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Debt securities								
Mortgage-backed securities:								
RMBS.....	\$ 145	\$ 171	\$ 9	\$ 6		\$ -	\$ 154	\$ 177
U.S. Government and government agencies.....	1,248	11,586	4	1		(5)	1,252	11,582
Corporate and Other.....	1,694	1,854	-	90		-	1,694	1,944
Total debt securities.....	<u>\$ 3,087</u>	<u>\$ 13,611</u>	<u>\$ 13</u>	<u>\$ 97</u>		<u>\$ -</u>	<u>\$ 3,100</u>	<u>\$ 13,703</u>

The change in net unrealized gains (losses) consists of changes in the valuation and holdings of debt securities of \$78.9 thousand and \$(8.9) thousand for the nine months ended September 30, 2019 and 2018, respectively.

Proceeds from sales of debt securities including short-term investments, net of receivables, for the nine months ended September 30, 2019 and 2018 were \$3.9 million and \$10.2 million, respectively.

The gross realized gains and (losses), excluding other-than-temporary impairment losses, for the nine months ended September 30, 2019 and 2018 were \$0.1 million and \$1.1 million and \$(0.4) million and \$(0.7) 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.

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The amortized cost and fair value of bonds at September 30, 2019 and December 31, 2018 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.

	2019		2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(U.S. dollars in thousands)				
Due within one year	\$ 2,943	\$ 2,946	\$ 13,255	\$ 13,251
Due after five through ten years	-	-	186	276
Subtotal	2,943	2,946	13,441	13,527
Mortgage- and asset-backed securities	144	154	170	176
Total	<u>\$ 3,087</u>	<u>\$ 3,100</u>	<u>\$ 13,611</u>	<u>\$ 13,703</u>

Net investment income for the nine months ended September 30, 2019 and 2018 is derived from the following sources:

	2019	2018
(U.S. dollars in thousands)		
Debt securities and cash and cash equivalents	\$ 390	\$ 741
Equity securities	-	327
Less: Investment expenses	(15)	(24)
Net investment income	<u>\$ 375</u>	<u>\$ 1,044</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 amortized 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 nine months ended September 30, 2019 and 2018, the Company recorded other-than-temporary impairment charges of zero and \$0.4 million, respectively, on its debt securities. The other-than-temporary impairment charges recorded by the Company during the nine months ended September 30, 2018 were primarily due to the present value of projected cash flows expected to be collected being less than the carrying value of the securities.

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The following tables present the aggregate gross unrealized losses and fair value by investment category at September 30, 2019 and December 31, 2018, respectively. There were no securities in a gross unrealized loss position for greater than 12 months at September 30, 2019 and December 31, 2018.

(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>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
US Government and government agency..	\$ -	\$ (5)	\$ -	\$ 6,625	-	8
Total debt securities.....	\$ -	\$ (5)	\$ -	\$ 6,625	-	8

5. Intangible Assets

Definite-lived intangible assets include covenants not to compete and customer relationships. Definite-lived intangible assets are amortized over their respective useful lives, which are from 5-6 years (non-compete agreements) to 15 years (customer relationships). As the pattern of economic benefit for these definite-lived intangible assets cannot be determined, a straight-line amortization method is used. 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 asset is impaired, the related assets are written down to fair value. There was no impairment of definite-lived intangibles for the nine months ended September 30, 2019 and 2018.

Indefinite-lived intangible assets include trademark and goodwill. Management performs its annual impairment test as of December 31, or more frequently if facts and circumstances indicate that an impairment has occurred. In accordance with applicable guidance, the Company uses fair value techniques to evaluate indefinite-lived intangible assets for possible impairment. Management's test compares the fair value of the indefinite-lived intangible assets with their 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. See below for discussion of impairment losses related to goodwill and trademark for the nine months ended September 30, 2019. For the nine months ended September 30, 2018, management's test determined that goodwill and trademark were not impaired.

Goodwill reflects the excess of the purchase price of Swap Financial Group paid by SIH over the fair value of tangible and identifiable intangible assets, net of liabilities. Swap Financial Group does not amortize this goodwill; however, management performs its annual impairment test as of December 31, or more frequently if facts and circumstances indicate that an impairment has occurred. A qualitative assessment 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 quantitative assessment is not necessary. If the carrying value exceeds the fair value, the goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. To derive the fair value of the reporting units, the Company generally 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 the Company. See below for discussion of impairment losses related to goodwill and trademark for the nine months ended September 30, 2019. For the nine months ended September 30, 2018, management's test determined that goodwill and trademark were not impaired.

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Definite-lived intangible assets subject to amortization consist of the following at September 30, 2019 and 2018:

(U.S. dollars in thousands)					
Asset Class	Amortization Life	Gross		Net	
		2019	2018	2019	2018
Customer relationships	15 years	\$ 10,777	\$ 10,777	\$ 7,380	\$ 7,919
Covenants not to compete	5-6 years	1,805	1,805	263	508
Total		12,582	12,582	<u>\$ 7,643</u>	<u>\$ 8,427</u>
Less accumulated amortization		(4,939)	(4,155)		
Definite-lived intangible assets, net		<u>\$ 7,643</u>	<u>\$ 8,427</u>		

Amortization expense for the nine months ended September 30, 2019 and 2018 was \$0.8 million and \$1.0 million, respectively.

The following table represents estimated future amortization expense related to the definite-lived intangible assets based on the straight-line method over the estimated useful lives at September 30, 2019 and December 31, 2018:

(U.S. dollars in thousands)					
Customer relationships			Covenants not to compete		
	2019	2018		2019	2018
2018	\$ -	\$ -	2018	\$ -	\$ -
2019	180	718	2019	81	326
2020	718	718	2020	178	178
2021	718	718	2021	4	4
2022	718	718	2022	-	-
2023	718	718	2023	-	-
2024	718	-	2024	-	-
thereafter	3,610	4,329	thereafter	-	-
Total	<u>\$ 7,380</u>	<u>\$ 7,919</u>	Total	<u>\$ 263</u>	<u>\$ 508</u>

Indefinite-lived intangible assets not subject to amortization consist of the following at September 30, 2019 and December 31, 2018:

(U.S. dollars in thousands)					
	Gross		Net		
	2019	2018	2019	2018	
Trademark	\$ 1,302	\$ 1,302	\$ 449	\$ 1,302	
Goodwill	1,908	1,908	-	1,908	
Total	<u>\$ 3,210</u>	<u>\$ 3,210</u>	<u>\$ 449</u>	<u>\$ 3,210</u>	
Less impairment losses	(2,761)	-			
Indefinite-lived intangible assets, net	<u>\$ 449</u>	<u>\$ 3,210</u>			

In March 2019, Syncora Holdings Ltd.'s Board of Directors commenced a formal review process to explore and evaluate strategic alternatives, which included a sale of part or all of Syncora Holdings Ltd. or its wholly owned, subsidiary, SGI. During the third quarter of 2019, Syncora Holdings Ltd. received bids for the purchase of both SGI and SHL from third parties. As a result of these bids, management believed that it was more likely than not that its goodwill and trademark are impaired. As a result, management did not perform a qualitative impairment assessment but rather performed a quantitative impairment assessment. Based on the results of the impairment analysis, the Company recorded impairment losses of \$1.9 million and \$0.9 million on goodwill and trademark, respectively.

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6. 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 11 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.

7. Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income for the nine months ended September 30, 2019 and 2018 by component are as follows:

(U.S. dollars in thousands)	Total		Available-for-sale securities		Unrecognized pension and post-retirement costs	
	2019	2018	2019	2018	2019	2018
Other comprehensive (loss) income before reclassifications	\$ 15,857	\$ (1,496)	\$ 15,857	\$ (1,516)	\$ -	\$ 20
Amounts reclassified from accumulated other comprehensive income:						
Realized losses (gains) on sale of securities.....	1,324	(14,739)	1,324	(14,739)	-	-
Cumulative effect of change in accounting principle for equity securities.....	-	(7,469)	-	(7,469)	-	-
Other-than-temporary impairments.....	(225)	(2,471)	(225)	(2,471)	-	-
Effects of sale of American Roads LLC.....	-	(372)	-	-	-	(372)
Current period other comprehensive (loss) income, net.....	16,956	(26,547)	16,956	(26,195)	-	(352)
Balance, Beginning.....	1,828	31,015	1,828	30,663	-	352
Balance, Ending.....	\$ 18,784	\$ 4,468	\$ 18,784	\$ 4,468	\$ -	\$ -

8. 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.

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The Company's income tax provision for the nine months ended September 30, 2019 and 2018 was approximately \$1.0 million and \$0.2 million, respectively. The income tax provision for discontinued operations for the nine months ended September 30, 2019 and 2018 was \$0.9 million and \$0.2 million, respectively. In accordance with U.S. GAAP, for the nine months ended September 30, 2019 and 2018, the Company recorded income tax based on the estimated effective tax rate for the full year 2019 and 2018.

As of September 30, 2019 and December 31, 2018, 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 nine months ended September 30, 2019 and 2018. Tax years 2017 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 September 30, 2019.

At September 30, 2019, the Company had net operating loss carryforwards expiring from 2027 through 2038 of \$2.6 billion.

At September 30, 2019, the Company had capital loss carryforwards of \$149.0 million expiring from 2019 through 2024.

The most significant items giving rise to deferred tax assets as of September 30, 2019 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 September 30, 2019 and December 31, 2018. 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.

At September 30, 2019, the Company's cumulative NOLs, which may be carried forward to offset future taxable income, are \$2.6 billion. The Company's ability to utilize its NOLs at September 30, 2019 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 may reduce future U.S. tax liabilities 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 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.

9. 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 — 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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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, for 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.

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 September 30, 2019 and December 31, 2018:

(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	
	2019	2018	2019	2018	2019	2018	2019	2018
ASSETS								
Debt securities available for sale:								
Mortgage and asset-backed securities								
RMBS.....	\$ -	\$ -	\$ 154	\$ 176	\$ -	\$ -	\$ 154	\$ 176
U.S. Government and government agencies.....	1,252	11,582	-	-	-	-	1,252	11,582
Corporate and other.....	-	-	1,694	1,945	-	-	1,694	1,945
Total debt securities available for sale.....	1,252	11,582	1,848	2,121	-	-	3,100	13,703
Cash and cash equivalents.....	27,448	20,451	-	-	-	-	27,448	20,451
Restricted cash and cash equivalents.....	5,554	6,008	-	-	-	-	5,554	6,008
Total assets.....	\$ 34,254	\$ 38,041	\$ 1,848	\$ 2,121	\$ -	\$ -	\$ 36,102	\$ 40,162

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 September 30, 2019 and 2018:

LEVEL 3 ASSETS	Other Assets	
	2019	2018
Balance, beginning of period.....	\$ -	\$ 3,007
Realized gains (losses).....	-	(3,007)
Balance, end of period.....	\$ -	\$ -

There were no transfers into or out of Level 3 during the nine months ended September 30, 2019 and 2018.

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 nine months ended September 30, 2019 and 2018:

(U.S. dollars in thousands)	Contingent Consideration	
	2019	2018
LEVEL 3 LIABILITIES		
Balance, beginning of period.....	\$ -	\$ 2,043
Payment of contingent consideration.....	-	(2,043)
Balance, end of period.....	\$ -	\$ -

10. Commitments and Contingencies

a. Legal Matters

In September 2018, a service provider whose relationship with Swap Financial had been terminated filed a complaint in Federal Court claiming, in part, inaccurate payments by Swap Financial for services provided by the service provider. Swap Financial denied all of the service provider's claims. In September 2019, the Federal Court granted Swap Financial's motion to dismiss the complaint. The plaintiff has re-filed their lawsuit in State Court.

b. Lease and Other Commitments

The Company entered into a two year lease commitment for office premises at 555 Madison Avenue, New York, New York commencing on December 15, 2018. The Company had lease commitments for office premises at 76 South Orange Avenue, South Orange, New Jersey, which terminated on February 28, 2018 and at 135 West 50th Street, New York, New York, which terminated on January 31, 2019.

Effective April 1, 2018, the Company entered into an amended two year agreement with International Business Machines Corporation for information technology outsourcing services. Fees associated with the agreement are expected to be approximately \$1.0 million in 2019.

Net minimum aggregate lease commitments are \$0.6 million, \$0.5 million, \$22.0 thousand, \$0 and \$0 for the years ended December 31, 2019 through December 31, 2023.

Net rent expense was \$0.5 million and \$0.9 million for the nine months ended September 30, 2019 and 2018, respectively.

11. Dividend Restrictions

Syncora Holdings' Board of Directors did not declare a quarterly dividend with respect to its common shares for the year ended December 31, 2018 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 and regulatory requirements.

12. Assets on Deposit to Collateralize Certain of the Company's Contractual Obligations

As of September 30, 2019 and December 31, 2018, the Company had, in the aggregate, approximately \$5.7 million and \$6.9 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including lease and letter of credit agreements. Of such deposits, \$0.1 million and \$0.9 million and \$5.6 million and \$6.0 million are recorded on the accompanying consolidated balance sheet in "Other assets" and "Cash and cash equivalents", respectively.

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13. 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 September 30, 2019 and December 31, 2018 and for the nine months ended September 30, 2019 and 2018 are set forth below:

(U.S. dollars in thousands)	<u>2019</u>	<u>2018</u>
Assets		
Debt securities available for sale, at fair value (amortized cost: \$1,393 and \$4,026)	\$ 1,406	\$ 4,118
Cash and cash equivalents	356	908
Accrued investment income	9	17
Investment in insurance operations held-for-sale	450,325	603,868
Other subsidiary investments	28,715	24,834
Other assets	249	467
Total assets	<u>\$ 481,060</u>	<u>\$ 634,212</u>
Liabilities and Shareholders' Equity		
Liabilities— accounts payable, accrued expenses, and other liabilities	<u>\$ 46</u>	<u>\$ 388</u>
Shareholders' equity		
Common shares and additional paid-in capital	2,718,524	2,717,633
Accumulated deficit	(2,256,294)	(2,085,637)
Accumulated other comprehensive income	18,784	1,828
Total shareholders' equity	<u>481,014</u>	<u>633,824</u>
Total liabilities and shareholders' equity	<u>\$ 481,060</u>	<u>\$ 634,212</u>

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(U.S. dollars in thousands)	<u>2019</u>	<u>2018</u>
Revenues		
Net investment income.....	\$ 52	\$ 74
Net realized gain on investments.....	102	-
Total revenues.....	<u>154</u>	<u>74</u>
Operating expenses.....	4,118	1,593
Loss before equity in net loss of subsidiaries	<u>(3,964)</u>	<u>(1,519)</u>
Equity in net loss of discontinued operations.....	(88,411)	(29,790)
Equity in net (loss) income of continuing operations.....	<u>(5,285)</u>	<u>11,970</u>
Equity in net loss of subsidiaries	<u>(93,696)</u>	<u>(17,820)</u>
Net loss attributable to Syncora Holdings Ltd.	<u>(97,660)</u>	<u>(19,339)</u>
Other comprehensive income (loss):		
Net unrealized losses on investments.....	(79)	88
Equity in other comprehensive income (loss) of discontinued operations..	<u>17,035</u>	<u>(19,166)</u>
Other comprehensive income (loss)	<u>16,956</u>	<u>(19,078)</u>
Comprehensive loss	<u>(80,704)</u>	<u>(38,417)</u>
Change in common shares and additional paid-in-capital.....	891	739
Purchases of Series B preferred shares.....	<u>(72,997)</u>	<u>-</u>
Change in shareholders' equity	<u>(152,810)</u>	<u>(37,678)</u>
Total shareholders' equity- beginning of period	633,824	685,959
Total shareholders' equity- end of period	<u>\$ 481,014</u>	<u>\$ 648,281</u>
	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Operating expenses paid.....	\$ (3,258)	\$ (1,549)
Investment income collected.....	44	53
Other cash (disbursements) receipts.....	<u>(87)</u>	<u>307</u>
Net cash used in operating activities.....	<u>(3,301)</u>	<u>(1,189)</u>
Cash flows from investing activities:		
Proceeds from sale of debt securities.....	1,503	697
Proceeds from maturity of debt securities.....	1,736	177
Purchases of debt securities.....	<u>(490)</u>	<u>-</u>
Net cash provided by investing activities.....	<u>2,749</u>	<u>874</u>
Decrease in cash and cash equivalents.....	(552)	(315)
Cash and cash equivalents—beginning of period.....	908	1,312
Cash and cash equivalents—end of period.....	<u>\$ 356</u>	<u>\$ 997</u>

14. Assets and Liabilities Held-for-Sale of SGI and Discontinued Operations

On September 5, 2019, Syncora Holdings Ltd. (“SHL”) announced that it had entered into an amended agreement with Star Insurance Holdings LLC, an entity organized by GoldenTree Asset Management LP (“GoldenTree”) on behalf of GoldenTree’s managed funds and accounts, for Syncora’s previously announced sale of Syncora Guarantee Inc. (“SGI”) on August 15, 2019 pursuant to which the purchase price has been increased by \$36.5 million to \$429 million in cash, subject to adjustment.

The closing of the transaction remains subject to customary conditions, including approval by the New York State Department of Financial Services (“NYDFS”), and is expected to take place by the end of the fourth quarter of 2019 or during the first quarter of 2020.

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, an impairment loss is recognized. Since the carrying amount of SGI exceeded the estimated fair value, an impairment loss of \$132.7 million was recognized during the nine months ended September 30, 2019. The impairment loss will fluctuate based on changes in SGI’s operations through the ultimate sale date.

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 during the third quarter of 2019, the Company has reflected these classifications in the accompanying consolidated financial statements and prior periods have been reclassified to conform to this presentation. The consolidated balance sheets as of September 30, 2019 and December 31, 2018 present the total assets and total liabilities of SGI 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 nine months ended September 30, 2019 and 2018 present the total revenues and total expenses of SGI in the line item “Loss from discontinued insurance operations”. The consolidated statements of cash flows for the nine months ended September 30, 2019 and 2018 present the cash flows of SGI in the line items “net cash provided by (used in) operating and investing activities from discontinued operations”, respectively.

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 net cash proceeds 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. 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.

On August 8, 2017, management, with Board of Directors approval, committed to a formal plan to sell American Roads LLC. Since the accounting criteria for discontinued operations were met on August 8, 2017, the Company has reflected this classification in the accompanying consolidated financial statements through July 16, 2018 (sale date of American Roads LLC). The consolidated statement of operations and comprehensive income for the nine months ended September 30, 2018 presents the total revenues and total expenses of American Roads LLC in the line item “Income from discontinued toll road operations”. The consolidated statement of cash flows for the nine months ended September 30, 2018 presents 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.

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The following table summarizes the components of assets and liabilities held-for-sale of SGI on the consolidated balance sheets as of September 30, 2019 and December 31, 2018.

(U.S. dollars in thousands)

ASSETS	2019	2018
Cash and invested assets:		
Debt securities, available-for-sale, at fair value (amortized cost: \$417,426 and \$599,556).....	\$ 435,065	\$ 599,786
Other invested assets, at fair value (cost: \$32,633 and \$91,364).....	33,348	87,504
Cash and cash equivalents.....	<u>105,083</u>	<u>130,097</u>
Total cash and invested assets.....	573,496	817,387
Insurance operating assets, retained business:		
Premiums receivable.....	13,281	14,260
Salvage and subrogation recoverable.....	192,609	147,866
Receivables on insurance cash flow certificates, net of deferred gains of \$111,381 and \$113,433.....	61,334	91,905
Deferred acquisition costs and deferred loss on reinsurance, net.....	17,140	18,423
Assets of consolidated variable interest entities, at fair value.....	<u>17,903</u>	<u>20,843</u>
Total insurance operating assets, retained business.....	302,267	293,297
Insurance operating assets, ceded business:		
Premiums receivable.....	39,034	42,458
Prepaid reinsurance premiums.....	104,434	112,011
Reinsurance recoverable on unpaid losses and loss adjustment expenses.....	109,717	120,011
Credit default and other swap contracts, at fair value.....	<u>242,611</u>	<u>227,052</u>
Total insurance operating assets, ceded business.....	495,796	501,532
Other assets.....	25,583	22,252
Impairment loss on held-for-sale assets.....	<u>(132,685)</u>	<u>-</u>
Total assets of entity held-for-sale.....	<u>\$ 1,264,457</u>	<u>\$ 1,634,468</u>

LIABILITIES

Insurance operating liabilities, retained business:		
Unpaid losses and loss adjustment expenses.....	\$ 277,422	\$ 365,774
Unearned premium revenue.....	25,983	28,500
Credit default and other swap contracts, at fair value.....	9,034	8,489
Liabilities of consolidated variable interest entities, at fair value.....	<u>278</u>	<u>340</u>
Total insurance operating liabilities, retained business.....	312,717	403,103
Insurance operating liabilities, ceded business:		
Reinsurance premiums payable.....	39,034	42,458
Unearned premium revenue.....	104,434	112,011
Unpaid losses and loss adjustment expenses.....	109,717	120,011
Credit default and other swap contracts, at fair value.....	<u>242,611</u>	<u>227,052</u>
Total insurance operating liabilities, ceded business.....	495,796	501,532
Notes payable (par value: zero and \$150,137).....	-	104,206
Accrued interest on notes payable.....	-	16,472
Other liabilities.....	<u>5,619</u>	<u>5,287</u>
Total liabilities of entity held-for-sale.....	<u>\$ 814,132</u>	<u>\$ 1,030,600</u>

The following table summarizes the expected sale transaction at September 30, 2019:

Net assets of entity held-for-sale.....	\$ 450,325
Preferred shares of entity held-for-sale.....	(3,720)
Unrealized gains on investments included in accumulated other comprehensive income.....	<u>(17,605)</u>
Total expected consideration for sale of SGI.....	<u>\$ 429,000</u>

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The following table summarizes the components of income (loss) from discontinued operations for SGI for the nine months ended September 30, 2019 and for both SGI and American Roads LLC for the nine months ended September 30, 2018.

(U.S. dollars in thousands)	<u>2019</u>	<u>2018</u>
Revenues		
Premiums earned, net of reinsurance ceded of \$10,452 and \$6,175.....	\$ 2,590	\$ 26,142
Net investment income.....	23,444	30,070
Net unrealized and realized gains on investments, including other-than-temporary impairment losses of \$(6,734) and \$(10,838).....	4,742	7,789
Net (loss) earnings on insurance cash flow certificates.....	(29,144)	21,389
Net loss on credit default and other swap contracts.....	(298)	(25,536)
Net change in fair value of consolidated variable interest entities.....	2,267	8,350
Toll revenue.....	-	13,252
Other income and fees.....	149	2,718
Total revenues	<u>3,750</u>	<u>84,174</u>
Expenses		
(Recoveries) losses and loss adjustment expenses, net of reinsurance ceded of \$(6,740) and \$(4,992).....	(117,248)	(17,915)
Amortization of deferred acquisition costs, including deferred loss on reinsurance.....	1,283	5,051
Interest expense, including accretion of \$4,220 and \$34,151.....	7,517	63,986
Loss on debt prepayment.....	41,711	91,416
Operating expenses.....	25,287	35,666
Total expenses	<u>(41,450)</u>	<u>178,204</u>
Impairment loss on discontinued insurance operations.....	(132,685)	-
Gain on disposal of discontinued toll road operations.....	-	64,383
Loss from discontinued operations before income tax expense	<u>(87,485)</u>	<u>(29,647)</u>
Income tax expense.....	926	143
Loss from discontinued operations, net of tax	<u>(88,411)</u>	<u>(29,790)</u>
Other comprehensive income (loss) from discontinued operations.....	17,035	(19,166)
Comprehensive loss from discontinued operations	<u>\$ (71,376)</u>	<u>\$ (48,956)</u>

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The following table summarizes the components of cash flow information from discontinued operations for SGI for the nine months ended September 30, 2019 and for both SGI and American Roads LLC for the nine months ended September 30, 2018.

(U.S. dollars in thousands)	2019	2018
Cash flows from operating activities:		
Premiums collected.....	\$ 5,359	\$ 6,822
Investment income collected.....	25,886	30,062
Fees received on credit default swaps.....	247	758
Claims paid to policyholders and loss adjustment expenses paid.....	(15,846)	(97,731)
Cash received from settlement.....	-	301,406
Cash paid to reinsurer upon closing of reinsurance agreement.....	-	(362,262)
Operating expenses paid.....	(31,653)	(47,579)
Interest paid on notes payable.....	(143,677)	(341,783)
Income taxes paid.....	(593)	(237)
Tolls collected.....	-	14,072
Other cash receipts.....	1,573	1,342
Cash paid for insurance cash flow certificates.....	-	(77)
Cash received on insurance cash flow certificates.....	-	723
Investment income collected by variable interest entities.....	4,363	22,328
Interest and other expenses paid by variable interest entities.....	(113)	(3,471)
Net cash provided by operating activities of discontinued operations.....	(154,454)	(475,627)
Cash flows from investing activities:		
Proceeds from sales of investments.....	320,399	280,905
Proceeds from maturity of investments.....	38,548	32,216
Net proceeds from sale of American Roads LLC.....	-	207,966
Net proceeds (purchases) of short-term securities.....	1,639	(4,000)
Purchases of investments.....	(117,141)	(75,045)
Purchases of property and equipment.....	-	(1,853)
Net proceeds from consolidated variable interest entities' assets.....	894	38,075
Net cash provided by investing activities of discontinued operations.....	244,339	478,264
Cash flows from financing activities:		
Net paydowns of consolidated variable interest entities' liabilities.....	-	(10,854)
Purchases of Series B perpetual non-cumulative preference shares.....	(82,731)	-
Paydowns on notes payable.....	(26,229)	(58,217)
Net cash used in financing activities of discontinued operations.....	(108,960)	(69,071)
Decrease in cash and cash equivalents and restricted cash.....	(19,075)	(66,434)
Cash and cash equivalents and restricted cash and cash equivalents—beginning of period.....	140,701	306,790
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	\$ 121,626	\$ 240,356
Summary of cash and cash equivalents and restricted cash and cash equivalents- end of period:		
Cash and cash equivalents—end of period.....	\$ 105,083	\$ 235,987
Restricted cash and cash equivalents—end of period.....	16,543	4,369
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	121,626	240,356

Reinsurance Agreement with Assured Guaranty Corp.

On June 1, 2018, SGI closed a 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 consideration for the transaction, which also involved a commutation of a small 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 was 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 surveillance activities and the obligation to administer and pay claims on behalf of SGI. SGI entered into with Assured a credit agreement and related security agreement, pursuant to which Assured agreed to make loans to SGI to fund its claims payments on remediated residential mortgage-backed securities (“RMBS”).

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SGI 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 potential for future adverse loss and claims development on its insured obligations or salvage, (ii) the amount or timing of anticipated recoveries of Puerto Rico related remediation bonds and salvage on related claims payments, and (iii) the performance of Assured under the reinsurance and related agreements.

Description of Significant Risks and Uncertainties Related to Puerto Rico Exposures

- As of September 30, 2019, SGI has \$302.6 million of net exposure to Puerto Rico (excluding interest outstanding of \$56.1 million), which includes direct insurance and reinsurance of bond policies, direct investments by SGI as a result of remediation transactions and salvage and subrogation rights on the Puerto Rico related claims payments. This exposure relates primarily to bonds issued by the Puerto Rico Electric Power Authority (“PREPA”) of \$173.6 million (excluding interest outstanding of \$28.1 million) and general obligation bonds of the Commonwealth of Puerto Rico (the “Commonwealth”) of \$107.0 million (excluding interest outstanding of \$20.4 million) and \$22.0 million of net exposure to other obligations of Puerto Rico (excluding interest outstanding of \$7.6 million). As of September 30, 2019, SGI paid approximately \$215.5 million in net claims, representing principal and interest due related to Commonwealth and PREPA exposures. Given that the Puerto Rico proceedings under PROMESA (as detailed below) may continue for an extended period, SGI may be required to make further material claims payments and therefore further increase the proportion of its assets that are comprised of salvage and subrogation rights. Recoveries relating to these rights and interests could be long-dated, which could have a material adverse effect on SGI’s short-term liquidity needs. During 2018, SGI had sold approximately \$108.3 million consisting of principal and interest of its salvage and subrogation rights related to these exposures.

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 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 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. SGI is participating in the mediation process.

The Oversight Board certified a revised fiscal plan for PREPA on August 1, 2018 and for the Commonwealth on October 23, 2018, which are intended to provide the bases for any plans of adjustment in the Title III cases of PREPA and the Commonwealth. Additional revisions to the certified fiscal plans are currently in process.

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. 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 October 19, 2018, the Oversight Board filed the COFINA plan of adjustment and the settlement agreement allocating the Commonwealth’s sales and use tax. These agreements do not allocate distributions among Commonwealth creditors, including holders of insured general obligation bonds. The Title III court approved the settlement agreement and confirmed the COFINA plan of adjustment on February 4, 2019, which went effective on February 12, 2019.

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. On April 9, 2019, the Oversight Board, PREPA and the Commonwealth announced that they had reached an agreement in principle for a definitive restructuring support agreement (the “Definitive RSA”) with Assured Guaranty Corp., Assured Guaranty Municipal Corp. and the ad hoc group of PREPA bondholders, which supersedes the July 2018 preliminary restructuring support agreement. On September 9, 2019, SGI became a party to the Definitive RSA pursuant to an Amendment that governs the bonds held or insured by SGI. A hearing to approve the Definitive RSA is currently scheduled for December 11, 2019.

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On February 15, 2019, the U.S. Court of Appeals for the First Circuit issued an opinion finding that the members of the Oversight Board were not appointed in compliance with the appointments clause of the U.S. Constitution, but declined to dismiss the Title III petitions previously filed by the Oversight Board and delayed the effectiveness of its ruling for 90 days so as to allow the President and the Senate to validate the current appointments or reconstitute the Oversight Board in accordance with the appointments clause. On June 20, 2019, the U.S. Supreme Court granted the Oversight Board's petition to review the First Circuit's decision. On July 2, 2019, the First Circuit granted the Oversight Board's motion to stay the mandate pending final disposition of the case by the Supreme Court. Oral arguments before the U.S. Supreme Court were held on October 15, 2019 and the court took the matter under advisement.

On May 2, 2019, the Oversight Board and the official committee of unsecured creditors filed a complaint challenging numerous proofs of claims relating to general obligation bonds, including those filed by SGI. Among other things, the complaint disputes the existence, extent, and enforceability of the consensual and statutory liens asserted in the proofs of claim and is seeking to reclassify such claims as unsecured obligations of the Commonwealth. On May 20, 2019, the Oversight Board and the official committee of unsecured creditors filed a similar complaint challenging numerous proofs of claims relating to bonds issued by the Puerto Rico Highways and Transportation Authority, including those filed by SGI. Both of these complaints are currently stayed by the court.

On September 27, 2019, the Oversight Board filed a joint plan of adjustment for the Commonwealth, the Employees Retirement System and the Puerto Rico Public Buildings Authority (the "PBA"). The plan contemplates a 60% reduction of the Commonwealth's debt. According to the Oversight Board, the plan has the support of 22% of all General Obligation and PBA bonds. The Title III court has not set a confirmation schedule.

On September 30, 2019, certain Fuel Line Lenders of PREPA filed a complaint against several parties, including The Oversight Board, PREPA and SGI. Among other things, the complaint is seeking priority payment for the plaintiffs' claims against PREPA prior to any payments to the PREPA bondholders and to limit the lien securing the PREPA power revenue bonds. Any motion to dismiss the complaint must be filed by November 6, 2019.

Due to the pending Title III cases, SGI may experience further losses on these insured obligations which could have a material adverse effect on SGI's liquidity and financial position.

- As of September 30, 2019, in respect of its Puerto Rico-related exposure, SGI has made substantial claim payments and anticipates that it may be requested to make further gross claim payments in the period 2019 to 2021 of at least approximately \$61.8 million, followed 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 SGI's accounting policy and guidance under Generally Accepted Accounting Principles ("GAAP"), the net present value of estimated claims and recoveries (including salvage and subrogation) are reflected in SGI's loss reserves and salvage and subrogation recoverable (see Note 14). 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 SGI's estimates, and such differences could materially and adversely affect SGI's results of operations, financial condition and liquidity. SGI may also experience significant adverse development on its insured obligations that may place further demands on SGI's liquidity and financial position. See Note 14 "*Schedule of Insured Financial Obligations with Credit Deterioration*" caption for further discussion.

Description of Other Significant Risks and Uncertainties and Other Matters

- Effective June 1, 2018, SGI entered into with Assured (i) a reinsurance agreement, pursuant to which SGI 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 certain reporting and making claims payments, and (iii) a credit agreement and related security agreement, pursuant to which Assured agreed to make loans to SGI to fund its claims payments on remediated RMBS. As a result of the reinsurance transaction, SGI 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 SGI's insurance operations and could increase operational costs and SGI's liquidity needs.
- SGI 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

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affect SGI. With respect to SGI's investment portfolio, a prolonged period of low interest rates, along with declining investment balances, may adversely affect SGI's ability to generate sufficient investment income to fund its future obligations. Issuers or borrowers whose securities or loans SGI insures or holds as well as SGI's counterparties under swaps and other derivative contracts may default on their obligations to SGI due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting securities that SGI has guaranteed may deteriorate further, causing these securities to incur losses.

- SGI 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 SGI's financial and liquidity position. As of September 30, 2019, SGI's net in-force guaranteed principal exposure to the European Union was approximately \$465.7 million of which \$237.7 million of exposure is to credits in the UK and denominated in British Pound sterling and \$228.0 million was specifically related to certain credits in higher risk countries, such as Portugal and Italy.
- The Financial Conduct Authority of the United Kingdom plans to phase out the London Interbank Offered Rate ("LIBOR") by the end of 2021. LIBOR is the benchmark rate that many banks and issuers use to set interest rates in loan documents. United States' authorities recognizing the need for a LIBOR replacement, convened the Alternative Reference Rate Committee ("ARRC") in 2014 to find a replacement. After three years of study the ARRC identified the Secured Overnight Financing Rate ("SOFR") – the broadest of three existing Repo rates, as its preferred alternative to LIBOR. SGI has LIBOR based gross and net par outstanding insured exposure of \$278.4 million and \$1.0 million, respectively. An increase in interest rates, the potential phase out of LIBOR and the difference between LIBOR and SOFR could have a material adverse effect on SGI's liquidity and financial position.
- SGI is materially exposed to foreign exchange risk as SGI'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 and the European Union euro. At September 30, 2019, approximately 52% of SGI's in-force guaranteed net par outstanding exposure of \$0.9 billion was denominated in such currencies. SGI 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 SGI's liquidity and financial position. In addition, SGI 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.
- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on SGI's in-force business requires the use and exercise of significant judgment and is based on certain assumptions made 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 SGI, these exposures may result in significant increases in claims beyond those assumed in SGI'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 SGI'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 SGI 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 SGI'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.

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- Notwithstanding the repayment in full of SGI's surplus notes, SGI remains subject to certain regulatory restrictions that limit its financial and operating flexibility and may materially and adversely impair its ability to execute on its strategic plan.
- SGI'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. No assurance can be given as to whether or when SGI may be able to pay any dividends on its preferred shares, or whether or when its preferred shares may be redeemed. As discussed in Note 11, SGI's ability to pay dividends is subject to regulatory constraints.

Completion of Restructuring Transactions and the 2009 MTA and Related Transactions

2016 Restructuring Transactions

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.

Description of the 2009 MTA

On April 30, 2019, SGI paid off its surplus notes in full. Following payment in full, the following restrictions in its master transaction agreement with certain of its financial counterparties to CDS contracts insured by SGI's financial guaranty insurance policies and certain related transactions (referred to collectively as the "2009 MTA") no longer apply: SGI may not (i) make any distribution, pay, redeem, repurchase, retire, exchange or otherwise acquire its surplus notes, except on a pro rata basis and on the same terms; (ii) merge, consolidate or sell, assign, transfer or dispose of all or any material portion of its assets; (iii) pay any dividend, repurchase, redeem, exchange or convert any of its equity securities (or of any of its direct or indirect parent); (iv) issue any surplus notes; or (v) incur any indebtedness. Accordingly, the restrictive covenants in the 2009 MTA are no longer operative.

Significant Accounting Policies

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.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

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. SGI adopted this standard as of January 1, 2019 and the adoption of this standard did not have a material effect on SGI'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

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standard requires that financial assets measured at amortized cost be presented at the net amount expected to be collected by recording 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 Securities and Exchange Commission (“SEC”) filers. At a July 17, 2019 meeting, the FASB voted to propose a delay of the effective date for all other entities until fiscal years beginning after December 15, 2022. The FASB staff will draft the proposed amendment to the effective date and provide them to the FASB Board to vote, after which it is expected to be exposed for a public comment period of 30 days. The FASB expects to issue the final amendment later this year.

Insurance Operations

Premiums Receivable and Unearned Premium Revenue

SGI 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, SGI 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, SGI 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. SGI 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. SGI reports the accretion of the discount on installment premiums receivable as premium revenue. SGI 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.

SGI’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 SGI. Also, premiums earned may be accelerated as a result of SGI’s remediation transactions, which result in SGI no longer being at risk (hereafter collectively with refunding referred to as “Premium Accelerations”).

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 September 30, 2019, SGI reported gross and retained premium receivable of \$52.3 million and \$13.3 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 2.5% and the weighted average collection term of

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the premium receivable was 11.7 years. For the nine months ended September 30, 2019, 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 September 30, 2019, SGI reported a reinsurance premium payable of \$39.0 million, which represents the portion of SGI’s premium receivable that is due to reinsurers. The reinsurance premium payable will be accreted and paid, as premiums due to SGI are accreted and collected.

The following tables present a roll forward of SGI’s premium receivable and unearned premium net liability for the nine months ended September 30, 2019 and 2018:

(U.S. dollars in thousands)	Retained business		Ceded business		Total	
	2019	2018	2019	2018	2019	2018
Nine months ended September 30,						
Recognition of unearned premium reserve, including commutations and other changes in policy terms	\$ 2,517	\$ 178,656	\$ 7,577	\$ (102,500)	\$ 10,094	\$ 76,156
Reduction in previously written premiums and reinsurance	(197)	(153,510)	2,061	108,068	1,864	(45,442)
Accretion of premium receivable discount	270	996	814	607	1,084	1,603
Premiums earned, including net premium accelerations of zero and \$15,667	\$ 2,590	\$ 26,142	\$ 10,452	\$ 6,175	\$ 13,042	\$ 32,317
Nine months ended September 30,	2019	2018	2019	2018	2019	2018
Premiums collected	\$ (952)	\$ (4,808)	\$ (4,407)	\$ (2,014)	\$ (5,359)	\$ (6,822)
Accretion of premium receivable discount	270	996	814	607	1,084	1,603
Policy commutations and other changes in policy terms	(297)	(17,077)	169	(7,840)	(128)	(24,917)
Transfer of premiums under reinsurance agreement	-	(41,768)	-	41,768	-	-
Change in premiums receivable	(979)	(62,657)	(3,424)	32,521	(4,403)	(30,136)
Premium receivable, beginning of period	14,260	79,903	42,458	12,921	56,718	92,824
Premium receivable, end of period	\$ 13,281	\$ 17,246	\$ 39,034	\$ 45,442	\$ 52,315	\$ 62,688
Nine months ended September 30,	2019	2018	2019	2018	2019	2018
Recognition of unearned premiums, including commutations and other changes in policy terms	\$ (2,517)	\$ (62,437)	\$ (7,577)	\$ (13,719)	\$ (10,094)	\$ (76,156)
Transfer of unearned premiums under reinsurance agreement	-	(116,219)	-	116,219	-	-
Change in unearned premium revenue	(2,517)	(178,656)	(7,577)	102,500	(10,094)	(76,156)
Change in unearned premium revenue due to derecognition of variable interest entities	-	472	-	-	-	472
Unearned premium revenue, beginning of period	28,500	209,320	112,011	15,565	140,511	224,885
Unearned premium revenue, end of period	\$ 25,983	\$ 31,136	\$ 104,434	\$ 118,065	\$ 130,417	\$ 149,201

Note: Activity in the liability reinsurance premiums payable for ceded business mirrors the activity in the ceded business asset above. Activity in the asset prepaid reinsurance for ceded business mirrors the activity in the ceded business liability above.

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The following table presents SGI'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 SGI's in-force business as of and for the periods presented. In addition to that presented in the table below, SGI had installment premiums receivable of \$1.7 million (on a present value basis) and unearned premium revenue of \$3.9 million relating to assumed reinsurance business at September 30, 2019:

(U.S. dollars in thousands)	Expected Collection of Premiums	Unearned Premium Revenue	Expected Premium Earnings		
			Combined Upfront & Installments	Accretion	Total
Retained business					
Three months ended:					
December 31, 2019	\$ 106	\$ 20,401	\$ 515	\$ 87	\$ 602
Twelve months ended:					
December 31, 2020	751	18,390	2,010	331	2,341
December 31, 2021	702	16,491	1,899	310	2,209
December 31, 2022	666	14,721	1,769	291	2,060
December 31, 2023	656	13,073	1,649	272	1,921
December 31, 2024	648	11,551	1,522	255	1,777
Five years ended:					
December 31, 2029	3,256	6,321	5,230	991	6,221
December 31, 2034	3,306	2,468	3,853	516	4,369
December 31, 2039	1,895	204	2,264	110	2,374
December 31, 2044	114	-	205	2	207
December 31, 2049	-	-	-	-	-
December 31, 2054	-	-	-	-	-
December 31, 2059	-	-	-	-	-
Total	\$ 12,100		\$ 20,916	\$ 3,165	\$ 24,081
Ceded business					
Three months ended:					
December 31, 2019	\$ 1,973	\$ 102,648	\$ 1,627	\$ 203	\$ 1,830
Twelve months ended:					
December 31, 2020	4,087	93,135	9,513	745	10,258
December 31, 2021	3,462	84,523	8,612	658	9,270
December 31, 2022	3,179	76,829	7,694	586	8,280
December 31, 2023	3,100	69,664	7,165	517	7,682
December 31, 2024	2,999	63,018	6,646	453	7,099
Five years ended:					
December 31, 2029	9,385	38,728	24,290	1,527	25,817
December 31, 2034	6,088	22,465	16,263	745	17,008
December 31, 2039	2,493	12,303	10,162	225	10,387
December 31, 2044	419	7,497	4,806	59	4,865
December 31, 2049	200	3,891	3,606	12	3,618
December 31, 2054	5	565	3,325	-	3,325
December 31, 2059	-	-	566	-	566
Total	\$ 37,390		\$ 104,275	\$ 5,730	\$ 110,005

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(U.S. dollars in thousands)	Expected Collection of Premiums	Unearned Premium Revenue	Expected Premium Earnings		
			Combined Upfront & Installments	Accretion	Total
Total					
Three months ended:					
December 31, 2019	\$ 2,079	\$ 123,049	\$ 2,142	\$ 290	\$ 2,432
Twelve months ended:					
December 31, 2020	4,838	111,525	11,523	1,076	12,599
December 31, 2021	4,164	101,014	10,511	968	11,479
December 31, 2022	3,845	91,550	9,463	877	10,340
December 31, 2023	3,756	82,737	8,814	789	9,603
December 31, 2024	3,647	74,569	8,168	708	8,876
Five years ended:					
December 31, 2029	12,641	45,049	29,520	2,518	32,038
December 31, 2034	9,394	24,933	20,116	1,261	21,377
December 31, 2039	4,388	12,507	12,426	335	12,761
December 31, 2044	533	7,497	5,011	61	5,072
December 31, 2049	200	3,891	3,606	12	3,618
December 31, 2054	5	565	3,325	-	3,325
December 31, 2059	-	-	566	-	566
Total	\$ 49,490		\$ 125,191	\$ 8,895	\$ 134,086

Deferred Acquisition Costs, Deferred Loss on Reinsurance 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 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.

As a result of the reinsurance transaction with Assured discussed above, SGI recorded a deferred loss, which is being amortized over the life of the reinsurance contracts.

For policies reinsured with third parties, SGI receives ceding commissions to compensate for acquisition costs incurred. SGI 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 the refunded insured issue is recognized at such time.

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Deferred acquisition costs, net of deferred ceding commission revenue, as well as related amortization, for the retained business only as of and for the nine months ended September 30, 2019 and 2018 are as follows:

(U.S. dollars in thousands)	Retained business	
Nine months ended September 30,	2019	2018
Amortization of deferred acquisition costs	\$ 216	\$ 4,162
Amortization of ceding commission revenue	(2)	(18)
Amortization of deferred loss on reinsurance	1,069	907
Amortization of deferred acquisition costs, including deferred loss on reinsurance	<u>\$ 1,283</u>	<u>\$ 5,051</u>
Amortization of deferred acquisition costs, including deferred loss on reinsurance	(1,283)	(5,051)
Change in deferred acquisition costs, net	(1,283)	(5,051)
Deferred loss on reinsurance	-	17,556
Transfer of acquisition costs under reinsurance agreement	-	(27,812)
Deferred acquisition costs and deferred loss on reinsurance, net, beginning of period	18,423	34,930
Deferred acquisition costs and deferred loss on reinsurance, net, end of period	<u>\$ 17,140</u>	<u>\$ 19,623</u>

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 SGI'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, SGI 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 September 30, 2019 and December 31, 2018 was 1.7% and 2.7%, 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. SGI 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 SGI'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

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

In assessing reserves for unpaid losses, SGI 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 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, SGI will make qualitative judgments with respect to the amount by which certain other structural protections built into the transaction are expected to limit SGI'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 SGI'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. SGI'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 September 30, 2019 and December 31, 2018, the range of risk free rates used to discount SGI's liability for losses and loss adjustment expenses was 0.0% to 1.89% and 0.0% to 2.85%, respectively.

Salvage and Subrogation Recoverable

SGI 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 SGI 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 are included in salvage and subrogation recoverable on the accompanying consolidated balance sheets.

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Activity in SGI's liability for unpaid losses and loss adjustment expenses and net liability for the nine months ended September 30, 2019 and 2018 are summarized as follows:

(U.S. dollars in thousands)	Retained business		Ceded business		Total	
Nine months ended September 30,	2019	2018	2019	2018	2019	2018
Accretion of reserve discount	\$ 4,913	\$ 7,491	\$ 2,566	\$ 1,438	\$ 7,479	\$ 8,929
Change in reserve discount rates	40,667	(25,430)	17,612	(5,278)	58,279	(30,708)
Changes in loss timing and other assumptions	(162,828)	24	(26,918)	(1,152)	(189,746)	(1,128)
Net (recoveries) losses and loss adjustment expenses	\$ (117,248)	\$ (17,915)	\$ (6,740)	\$ (4,992)	\$ (123,988)	\$ (22,907)
	2019	2018	2019	2018	2019	2018
Net (recoveries) losses and loss adjustment expenses	(117,248)	(17,915)	(6,740)	(4,992)	(123,988)	(22,907)
Losses and loss adjustment expenses paid or payable	(15,847)	(97,731)	-	-	(15,847)	(97,731)
Losses and loss adjustment expenses recovered or recoverable	-	301,406	(3,554)	(2,244)	(3,554)	299,162
Transfer of losses and loss adjustment expenses under reinsurance agreement	-	(155,892)	-	155,892	-	-
Change in net liability	(133,095)	29,868	(10,294)	148,656	(143,389)	178,524
Net liability, beginning of period	217,908	252,312	120,011	-	337,919	252,312
Net liability, end of period	\$ 84,813	\$ 282,180	\$ 109,717	\$ 148,656	\$ 194,530	\$ 430,836
Unpaid losses and loss adjustment expenses, end of period	\$ 277,422	\$ 414,184	\$ 109,717	\$ 148,656	\$ 387,139	\$ 562,840
Salvage and subrogation recoverable, end of period	\$ 192,609	\$ 132,004	\$ -	\$ -	\$ 192,609	\$ 132,004

Note: Activity in the asset reinsurance recoverable on unpaid losses and loss adjustment expenses for ceded business mirrors the activity for the ceded business liability above.

Case Basis Reserves for Losses and Loss Adjustment Expenses

A summary of case basis reserves for losses and loss adjustment expenses as of September 30, 2019 and December 31, 2018 are as follows:

(U.S. dollars in thousands)	Retained business		Ceded business		Total	
September 30 and December 31,	2019	2018	2019	2018	2019	2018
HELOC, CES and Alt-A mortgage loan collateral	\$ 235,152	\$ 255,895	\$ 109,685	\$ 119,565	\$ 344,837	\$ 375,460
Public finance	40,709	108,592	32	446	40,741	109,038
CDOs	1,548	13	-	-	1,548	13
Structured single risk	13	1,274	-	-	13	1,274
Net unpaid losses and loss adjustment expenses, end of period	\$ 277,422	\$ 365,774	\$ 109,717	\$ 120,011	\$ 387,139	\$ 485,785

RMBS

Reserves for unpaid losses and loss adjustment expenses on SGI's guarantees of obligations supported by HELOC, CES and Alt-A mortgage loan collateral 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.

SGI 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.

SGI generally observed peak defaults for the second lien transactions in 2009 and 2010. Default rates at September 30, 2019 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.

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SGI assumes a steady state constant default rate taking into account historical performance. Net losses will be greater if default rates exceed SGI's current assumptions. The constant default rate is a function of several factors, one of which is the state of the economy and unemployment.

SGI's default assumptions for the first lien transactions at September 30, 2019 and December 31, 2018 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 40% to 75% at September 30, 2019 and from 40% to 70% at December 31, 2018 based upon actual loss severity observances and collateral characteristics to determine the expected loss on the collateral in those transactions.

Schedule of Insured Financial Obligations with Credit Deterioration

SGI's surveillance department is responsible for monitoring the performance of its in-force portfolio. As previously discussed, SGI entered into an administrative services agreement with Assured, where Assured provides certain administrative services, including surveillance activities related to loss reserve modeling and exposure data monitoring with respect to the reinsured policies. 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 SGI 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, SGI 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.

SGI 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 SGI'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 SGI 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 SGI's closely monitored credits as of September 30, 2019 and December 31, 2018, 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)	Loss List		Red Flag List		Yellow Flag List		Special Monitoring List	
	2019	2018	2019	2018	2019	2018	2019	2018
Retained business								
Insured contractual payments outstanding:								
Principal	\$ 179	\$ 186	\$ -	\$ 15	\$ 238	\$ 254	\$ 225	\$ 130
Interest	56	64	-	9	95	103	89	60
Total	<u>\$ 235</u>	<u>\$ 250</u>	<u>\$ -</u>	<u>\$ 24</u>	<u>\$ 333</u>	<u>\$ 357</u>	<u>\$ 314</u>	<u>\$ 190</u>
Number of policies	73	64	-	1	1	1	3	1
Remaining weighted-average contract period (in years)	<u>6.7</u>	<u>7.0</u>	<u>-</u>	<u>13.4</u>	<u>14.7</u>	<u>15.1</u>	<u>11.6</u>	<u>16.9</u>
Unpaid loss and loss adjustment expenses:								
Gross amount before reductions	\$ 580	\$ 809	\$ -	\$ 3	\$ 6	\$ 6	\$ 5	\$ -
Gross estimated recoveries	(231)	(298)	-	-	(2)	(2)	-	-
Unearned premium revenue ⁽¹⁾	(8)	(9)	-	-	(2)	-	(2)	-
Present value discount	(69)	(143)	-	-	-	-	-	-
Total	<u>\$ 272</u>	<u>\$ 359</u>	<u>\$ 0</u>	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ 4</u>	<u>\$ 3</u>	<u>\$ -</u>
Ceded business								
Insured contractual payments outstanding:								
Principal	\$ 259	\$ 271	\$ 8	\$ 6	\$ 181	\$ 184	\$ 34	\$ 268
Interest	63	95	1	1	139	144	16	20
Total	<u>\$ 322</u>	<u>\$ 366</u>	<u>\$ 9</u>	<u>\$ 7</u>	<u>\$ 320</u>	<u>\$ 328</u>	<u>\$ 50</u>	<u>\$ 288</u>
Number of policies	11	11	2	1	9	8	5	6
Remaining weighted-average contract period (in years)	<u>12.4</u>	<u>13.1</u>	<u>2.1</u>	<u>3.3</u>	<u>14.5</u>	<u>15.2</u>	<u>9.8</u>	<u>4.8</u>
Unpaid loss and loss adjustment expenses:								
Gross amount before reductions	\$ 152	\$ 187	\$ -	\$ -	\$ 1	\$ -	\$ -	\$ -
Gross estimated recoveries	-	-	-	-	-	-	-	-
Unearned premium revenue ⁽¹⁾	(3)	(3)	-	-	-	-	-	-
Present value discount	(39)	(64)	-	-	-	-	-	-
Total	<u>\$ 110</u>	<u>\$ 120</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

⁽¹⁾ 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 SGI 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 SGI's consolidated balance sheets. See below 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 SGI generally only require SGI 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 SGI's CDS contracts, SGI is precluded from transferring such contracts to other market participants without the consent of the counterparty.

Securities or assets referenced in SGI'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, SGI's CDS contracts do not contain the typical CDS market standard features as described above but have been customized to replicate SGI's financial guarantee insurance. SGI'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 SGI's liability. SGI is not required to post collateral and, upon an underlying default, SGI generally makes payments on a "pay-as-you-go" basis after the subordination in a transaction is exhausted.

SGI'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.

SGI'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 SGI's CDS contracts provided for mark-to-market termination payments following the occurrence of events that are outside SGI'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 SGI's guarantees of CDS contracts were amended to remove any events triggering mark-to-market termination payments except for (pre-merger in 2017) failing to make payment under the applicable contract or being placed into receivership or rehabilitation or a regulator taking control of SGI. Under current market conditions, if SGI were required to pay such termination payments, it may result in a liability to SGI which may be in excess of that currently recorded by SGI. An additional difference between SGI'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 SGI's CDS contracts unless SGI, at its option, elects to accelerate. Furthermore, by law, SGI'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. In connection with SGI's reinsurance agreement with Assured, substantially all of the CDS contracts insured by SGI have been reinsured by Assured. However, the reinsurance agreement does not generally cover any mark-to-market termination payments.

Credit Default and Other Swap Contract Assets

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

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contracts, which will offset SGI'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.

The following tables provide the components of net (loss) earnings on credit default and other swap contracts for the nine months ended September 30, 2019 and 2018 and certain information regarding SGI's in-force CDS and other swap contracts as of September 30, 2019 and December 31, 2018, including the aggregate notional amount outstanding, the weighted average life of such contracts, and the ratings of obligations referenced in such contracts.

(U.S. dollars in thousands)	Retained business		Ceded business		Total	
Nine months ended September 30,	2019	2018	2019	2018	2019	2018
Contract premiums earned	\$ 216	\$ 521	\$ -	\$ -	\$ 216	\$ 521
Net realized losses on contract liabilities transferred under reinsurance agreement	-	(120,859)	-	-	-	(120,859)
Net unrealized gains (losses) on contract liabilities	(514)	94,802	(15,304)	(103,417)	(15,818)	(8,615)
Net unrealized gains (losses) on contract assets	-	-	15,304	103,417	15,304	103,417
Net (loss) earnings on credit default and other swap contracts ⁽¹⁾	\$ (298)	\$ (25,536)	\$ -	\$ -	\$ (298)	\$ (25,536)
	2019	2018	2019	2018	2019	2018
Net loss (earnings) on credit default and other swap contracts	\$ 298	\$ 25,536	\$ 15,304	\$ 103,417	\$ 15,602	\$ 128,953
Transfer of credit default contracts liabilities under reinsurance agreement	-	(120,859)	-	\$ 120,859	-	-
Other	247	757	255	-	502	757
Change in credit default swaps and other swap contract liabilities	545	(94,566)	15,559	224,276	16,104	129,710
Credit default swaps and other swap contract liabilities, beginning of period	8,489	104,094	227,052	-	235,541	104,094
Credit default swaps and other swap contract liabilities, end of period	\$ 9,034	\$ 9,528	\$ 242,611	\$ 224,276	\$ 251,645	\$ 233,804
	2019	2018	2019	2018	2019	2018
September 30 and December 31,						
Fair value of credit default and other swap contracts	\$ 9,034	\$ 8,489	\$ 242,611	\$ 227,052	\$ 251,645	\$ 235,541
Notional amount outstanding	\$ 145,077	\$ 145,857	\$ 2,904,691	\$ 2,978,319	\$ 3,049,768	\$ 3,124,176
Weighted average life (years)	19.7	20.3	21.2	21.9	21.1	21.9
Percentage of referenced assets by rating ⁽²⁾						
AAA	-	-	23.6%	7.6%		
At or above investment grade but below AAA	100.0%	100.0%	76.4%	92.4%		
Below investment grade	-	-	-	-		
Total	100.0%	100.0%	100.0%	100.0%		
Liability fair value before giving effect to non-performance risk	\$ 12,523	\$ 14,385	\$ 283,130	\$ 294,019	\$ 295,653	\$ 308,404
Non-performance risk	(3,489)	(5,896)	(40,519)	(66,967)	(44,008)	(72,863)
Fair value of liabilities, as above	\$ 9,034	\$ 8,489	\$ 242,611	\$ 227,052	\$ 251,645	\$ 235,541

⁽¹⁾ The change in net realized/unrealized gains (losses) relating to the CDS and other swap contracts still held as of September 30, 2019 and 2018 was \$(0.3) million and \$(25.5) million, respectively.

⁽²⁾ 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.

Note: Activity in the asset credit default and other swap contracts for ceded business mirrors the activity for the ceded business liability above.

Consolidation of VIEs

SGI 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, SGI 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, SGI typically is not deemed to control a VIE; however, once a trigger event occurs, SGI's control of the VIE typically increases. In addition, SGI has exposure to VIEs through the ownership of Uninsured Cash Flow Certificates ("UCFs") and other interests from its remediation transactions.

SGI is not primarily liable for the debt obligations issued by the VIEs; however, where SGI has issued an insurance contract, SGI 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. SGI or SGI's creditors do not have any rights with regard to the assets of the VIEs.

The following table presents the revenues and expenses and a rollforward of fair value of consolidated VIEs included in SGI's consolidated balance sheets and statements of operations as of September 30, 2019 and 2018 and for the nine months ended

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September 30, 2019 and 2018. In addition, the table presents the fair value of the consolidated VIE assets and liabilities of the retained business only in SGI's consolidated balance sheets, segregated by the types of assets held by VIEs that collateralize their respective debt obligations as of September 30, 2019 and December 31, 2018. As of September 30, 2019 and December 31, 2018, SGI'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)	Retained business	
Nine months ended September 30,	2019	2018
Investment income	\$ 4,363	\$ 22,180
Interest and other expenses	(113)	(3,323)
Net realized and unrealized (losses) gains	(1,983)	(10,507)
Net change in fair value of consolidated variable interest entities	2,267	8,350
Distribution of investment income, net of interest and other expenses	(4,251)	(18,871)
Other distributions from variable interest entities	(894)	(38,075)
Paydowns of liabilities	-	10,854
Net change in consolidated variable interest entities' net assets	(2,878)	(37,742)
Consolidated variable interest entities' net assets, beginning of period	20,503	57,446
Net assets of consolidated variable interest entities, end of period	\$ 17,625	\$ 19,704

September 30 and December 31,	Net Assets		Assets		Liabilities	
	2019	2018	2019	2018	2019	2018
Prime (HELOC)	\$ 10,346	\$ 13,456	\$ 10,572	\$ 13,770	\$ 226	\$ 314
Alt-A (2nd lien)	5,725	6,291	5,725	6,291	-	-
Alt-A (1st lien)	1,554	756	1,606	782	52	26
	\$ 17,625	\$ 20,503	\$ 17,903	\$ 20,843	\$ 278	\$ 340

SGI'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 \$630.8 million (includes principal of \$467.2 million and interest of \$163.6 million) and \$682.3 million (includes principal of \$502.8 and interest of \$179.5 million) at September 30, 2019 and December 31, 2018, respectively. SGI's retained business net principal outstanding was \$892 million and \$933 million as of September 30, 2019 and December 31, 2018, respectively.

Exposures Under Guarantees

While SGI establishes reserves for losses and loss adjustment expenses on obligations it has guaranteed or reinsured, the risk of loss under SGI'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 SGI's in-force principal and interest exposure at September 30, 2019 and December 31, 2018.

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The following table sets forth SGI's in-force guaranteed principal by bond sector as of September 30, 2019 and December 31, 2018, respectively:

Bond Exposure
(U.S. dollars in millions)

	Retained business		Ceded business		Total	
	2019	2018	2019	2018	2019	2018
Public Finance						
Special Revenue	\$ 232	\$ 237	\$ 2,651	\$ 2,748	\$ 2,883	\$ 2,985
General Obligation	100	106	916	969	1,016	1,075
Utility	82	82	676	611	758	693
Non Ad Valorem	7	7	546	513	553	520
Other	2	3	-	-	2	3
Appropriation	-	-	324	302	324	302
Total Public Finance	\$ 423	\$ 435	\$ 5,113	\$ 5,143	\$ 5,536	\$ 5,578
Asset-Backed Securities						
RMBS	\$ 1	\$ 1	\$ 302	\$ 323	\$ 303	\$ 324
Total Asset-Backed Securities	\$ 1	\$ 1	\$ 302	\$ 323	\$ 303	\$ 324
Collateralized Debt Obligations						
Cashflow CDO	\$ 2	\$ 2	\$ 13	\$ 15	\$ 15	\$ 17
Total Collateralized Debt Obligations	\$ 2	\$ 2	\$ 13	\$ 15	\$ 15	\$ 17
Structured Single Risk						
Global Infrastructure	\$ 343	\$ 365	\$ 1,723	\$ 1,850	\$ 2,066	\$ 2,215
Specialized Risk	123	130	50	50	173	180
Power & Utilities	-	-	3,494	3,565	3,494	3,565
Total Structured Single Risk	\$ 466	\$ 495	\$ 5,267	\$ 5,465	\$ 5,733	\$ 5,960
Total Outstanding	\$ 892	\$ 933	\$ 10,695	\$ 10,946	\$ 11,587	\$ 11,879

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The following table sets forth the number of years to maturity of SGI's in-force guaranteed principal and interest exposure at September 30, 2019:

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

	Retained business		Ceded Business		Total	
	Scheduled Net Debt Amortization	Principal and Interest Outstanding	Scheduled Net Debt Amortization	Principal and Interest Outstanding	Scheduled Net Debt Amortization	Principal and Interest Outstanding
2019 Q3	\$ -	\$ 1,357	\$ -	\$ 17,789	\$ -	\$ 19,146
2019 Q4	29	1,328	148	17,641	177	18,969
Total 2019	\$ 29		\$ 148		\$ 177	
2020	\$ 70	\$ 1,258	\$ 887	\$ 16,754	\$ 957	\$ 18,012
2021	73	1,185	1,133	15,621	1,206	16,806
2022	66	1,119	855	14,766	921	15,885
2023	86	1,033	686	14,080	772	15,113
Total 2020-2023	\$ 295		\$ 3,561		\$ 3,856	
2024-2028	\$ 388	\$ 645	\$ 3,652	\$ 10,428	\$ 4,040	\$ 11,073
2029-2033	207	438	2,025	8,403	2,232	8,841
2034-2038	186	252	2,045	6,358	2,231	6,610
2039 and thereafter	252	-	6,358	-	6,610	-
Total 2024-thereafter	\$ 1,033		\$ 14,080		\$ 15,113	
Total	\$ 1,357		\$ 17,789		\$ 19,146	

⁽¹⁾ PIO represents Principal and Interest Outstanding.

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The following table sets forth SGI's in-force guaranteed principal exposure by geographic concentration at September 30, 2019 and December 31, 2018, respectively:

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

	Retained business				Ceded business			
	Amount		%		Amount		%	
	2019	2018	2019	2018	2019	2018	2019	2018
United States								
Puerto Rico	\$ 173	\$ 180	19.4 %	19.3 %	\$ -	\$ -	- %	- %
Multi-state ⁽¹⁾⁽²⁾	148	148	16.7	16.0	300	320	2.8	2.9
New York	88	92	9.8	9.8	606	612	5.7	5.6
California	15	15	1.6	1.6	2,013	2,000	18.7	18.4
Michigan	2	3	0.3	0.3	21	22	0.2	0.2
Other ⁽³⁾	-	-	-	-	673	767	6.3	7.0
Virginia	-	-	-	-	587	596	5.5	5.4
District of Columbia	-	-	-	-	403	416	3.8	3.8
Florida	-	-	-	-	262	223	2.5	2.0
Washington	-	-	-	-	223	201	2.1	1.8
New Jersey	-	-	-	-	211	161	2.0	1.5
Massachusetts	-	-	-	-	195	169	1.8	1.5
Georgia	-	-	-	-	189	240	1.8	2.2
Missouri	-	-	-	-	163	169	1.5	1.5
Ohio	-	-	-	-	130	130	1.2	1.2
Nebraska	-	-	-	-	129	131	1.2	1.2
Total United States	\$ 426	\$ 438	47.8 %	47.0 %	\$ 6,105	\$ 6,157	57.1 %	56.2 %
International								
United Kingdom	\$ 238	\$ 254	26.6 %	27.3 %	\$ 3,688	\$ 3,813	34.4 %	34.8 %
Italy	123	130	13.8	13.9	-	-	-	-
Portugal	105	111	11.8	11.8	-	-	-	-
New Zealand	-	-	-	-	285	306	2.7	2.8
Chile	-	-	-	-	231	272	2.2	2.5
Australia	-	-	-	-	223	233	2.1	2.1
Canada	-	-	-	-	98	98	0.9	0.9
Mexico	-	-	-	-	50	50	0.5	0.5
Panama	-	-	-	-	15	17	0.1	0.2
Total International	\$ 466	\$ 495	52.2 %	53.0 %	\$ 4,590	\$ 4,789	42.9 %	43.8 %
Total Par Outstanding	\$ 892	\$ 933	100.0 %	100.0 %	\$ 10,695	\$ 10,946	100.0 %	100.0 %

⁽¹⁾ Deals with underlying securities in multiple states.

⁽²⁾ Consists of \$145 million and \$145 million of Public Finance net par in 2019 and 2018, respectively, \$2 million and \$2 million of CDO net par in 2019 and 2018, respectively, and \$1 million and \$1 million of ABS net par in 2019 and 2018, respectively.

⁽³⁾ Single state with par outstanding < 1% of the total exposure in the current period.

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

In connection with the 2009 MTA, SGI invested in a fund (the "RMBS Fund") that executed certain transactions designed to effectively defease or, in-substance, commute SGI'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 SGI'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 SGI. SGI will, should the cash flows from the underlying RMBS transaction be sufficient, receive certain reimbursement payments in respect of insurance payments previously made by SGI on such RMBS. SGI also entered into several alternative transactions effectively replicating the economics of the RMBS Offer.

In addition to the RMBS Offer, SGI directly purchased certain RMBS and other securities that it had insured. Certain of these directly purchased securities were exchanged by SGI 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 SGI. In connection with the reinsurance transaction as discussed above, SGI has substantially ceded all of its RMBS exposure to Assured.

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As the Insurance Cash Flow Certificates do not legally extinguish the RMBS or other insured securities, SGI regards the effective purchase of the Insurance Cash Flow Certificates as providing protection on the underlying securities upon the occurrence of an event of default and consequently follows reinsurance accounting principles. Upon the indirect or direct purchase of insured securities a deferred gain is recorded that represents the excess of the estimated ultimate claim payments relating to the insured securities at the time of the transaction over the cost SGI paid for those Insurance Cash Flow Certificates. The deferred gain is recognized in the consolidated statements of operations in “Net (loss) earnings on insurance cash flow certificates” based on the anticipated claim payments at the time of the transaction. The assumptions used in estimating the receivables on the Insurance Cash Flow Certificates for any given period are recognized in a manner consistent with the measurement and recognition of the loss reserves associated with the insured securities.

The following table presents the activity in SGI’s receivables on insurance cash flow certificates, net of deferred gains for the nine months ended September 30, 2019 and 2018:

(U.S. dollars in thousands)	Retained business	
Nine months ended September 30,	2019	2018
Amortization of deferred gains	\$ 2,052	\$ 2,327
Change in estimated cash flows underlying anticipated claim payments	(31,196)	19,062
Net (loss) earnings on insurance cash flow certificates	(29,144)	21,389
Cash paid for insurance cash flow certificates	-	77
Cash received on insurance cash flow certificates	-	(723)
Effects of reinsurance	(1,427)	(1,528)
Change in receivables on insurance cash flow certificates	(30,571)	19,215
Receivables on insurance cash flow certificates, beginning of period	91,905	109,869
Receivables on insurance cash flow certificates, end of period	\$ 61,334	\$ 129,084

Exposure to RMBS

The following table presents the net principal outstanding for SGI’s insured RMBS portfolio by type of collateral⁽¹⁾ as of September 30, 2019 and December 31, 2018, respectively:

RMBS Exposure
(U.S. dollars in millions)

	Retained business				Ceded business					
	Amount		%		Amount		%			
	2019	2018	2019	2018	2019	2018	2019	2018		
Prime (1st lien)	\$ -	\$ -	-	%	\$ 13	\$ 14	4.3	%	4.4	%
Prime (2nd lien)	-	-	-	-	4	5	1.2	-	1.5	-
Prime (HELOC)	1	1	100.0	100.0	41	51	13.6	-	15.9	-
Alt-A (1st lien)	-	-	-	-	18	20	5.8	-	6.1	-
Alt-A (2nd lien)	-	-	-	-	1	2	0.3	-	0.5	-
Subprime (1st lien)	-	-	-	-	206	210	68.6	-	65.2	-
Subprime (2nd lien)	-	-	-	-	4	4	1.4	-	1.2	-
Subprime (1st lien) - International	-	-	-	-	15	17	4.8	-	5.2	-
Total RMBS Outstanding	\$ 1	\$ 1	100.0	%	\$ 302	\$ 323	100.0	%	100.0	%

⁽¹⁾ Collateral type is defined as follows: Prime (1st 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.

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Investments and Cash

Investments

SGI determines the appropriate classification of investments at the time of purchase, which are recorded on the trade date. All of SGI's investments in debt (including UCFs) and equity securities are considered available-for-sale and accordingly are reported 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 SGI'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 premiums are amortized on a level-yield basis to the earliest call date of securities acquired. Bond discounts 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

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

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents are restricted as to withdrawal and use by SGI. 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 September 30, 2019 and December 31, 2018 are as follows:

(U.S. dollars in thousands)	Cost or		Gross Unrealized		Gross Unrealized		Fair Value	
	Amortized Cost		Gains		Losses			
	2019	2018	2019	2018	2019	2018	2019	2018
Debt securities								
Mortgage-backed securities:								
RMBS ⁽¹⁾	\$ 59,801	\$ 70,053	\$ 3,087	\$ 1,945	\$ (22)	\$ (137)	\$ 62,866	\$ 71,861
CMBS.....	34,827	29,805	892	70	(654)	(702)	35,065	29,173
Asset-backed securities.....	60,138	67,893	580	153	-	(2,942)	60,718	65,104
U.S. Government and government agencies.....	37,470	83,820	788	235	-	(23)	38,258	84,032
Corporate and Other.....	195,154	316,669	8,143	689	(183)	(3,033)	203,114	314,325
U.S. states and political subdivisions of the states....	30,036	31,316	5,028	3,982	(20)	(7)	35,044	35,291
Total debt securities.....	<u>\$ 417,426</u>	<u>\$ 599,556</u>	<u>\$ 18,518</u>	<u>\$ 7,074</u>	<u>\$ (879)</u>	<u>\$ (6,844)</u>	<u>\$ 435,065</u>	<u>\$ 599,786</u>
Total other invested assets ⁽²⁾	<u>\$ 32,633</u>	<u>\$ 91,364</u>	<u>\$ 1,245</u>	<u>\$ 2,368</u>	<u>\$ (530)</u>	<u>\$ (6,228)</u>	<u>\$ 33,348</u>	<u>\$ 87,504</u>

⁽¹⁾ At September 30, 2019, residential mortgage-backed securities include \$1.4 million of fair value and \$0.3 million of amortized cost related to UCFs. At December 31, 2018, residential mortgage-backed securities include \$1.5 million of fair value and \$0.1 million of amortized cost related to UCFs.

⁽²⁾ At September 30, 2019 and December 31, 2018, other invested assets, which consist of common stock and private equity investments, include \$(0.8) million and \$(8.4) million, respectively, of net unrealized gains (losses) that were recorded through net income on the consolidated statement of operations on investments in which SGI has elected the fair value option.

The change in net unrealized gains (losses) consists of changes in the valuation and holdings of debt securities of \$17.4 million and \$(14.3) million for the nine months ended September 30, 2019 and 2018, respectively.

Proceeds from sales of debt securities including short-term investments, net of receivables, for the nine months ended September 30, 2019 and 2018 were \$261.9 million and \$279.0 million, respectively.

The gross realized and unrealized gains and gross realized and unrealized (losses) recognized in income, excluding other-than-temporary impairment losses, for the nine months ended September 30, 2019 and 2018 were \$11.8 million and \$21.8 million and \$(0.3) million and \$(3.1) 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.

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The amortized cost and fair value of bonds at September 30, 2019 and December 31, 2018 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.

	2019		2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(U.S. dollars in thousands)				
Due within one year	\$ 7,988	\$ 8,050	\$ 25,203	\$ 25,161
Due after one through five years	168,644	173,651	317,855	316,794
Due after five through ten years	76,236	82,911	71,559	73,221
Due after ten years	9,792	11,804	17,188	18,470
Subtotal	<u>262,660</u>	<u>276,416</u>	<u>431,805</u>	<u>433,646</u>
Mortgage- and asset-backed securities	154,766	158,649	167,751	166,140
Total	<u>\$ 417,426</u>	<u>\$ 435,065</u>	<u>\$ 599,556</u>	<u>\$ 599,786</u>

Net investment income for the nine months ended September 30, 2019 and 2018 is derived from the following sources:

(U.S. dollars in thousands)	2019	2018
Debt securities and cash and cash equivalents	\$ 19,583	\$ 27,100
Equity securities	3,991	3,484
Other invested assets	476	528
Less: Investment expenses	(606)	(1,042)
Net investment income	<u>\$ 23,444</u>	<u>\$ 30,070</u>

SGI has a formal review process for all debt securities in SGI'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 SGI intends to sell the security prior to its recovery in fair value.

SGI'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 SGI believes a decline in the value of a particular investment is temporary, SGI records the decline as an unrealized loss on SGI's consolidated balance sheets in "accumulated other comprehensive income" in shareholders' equity. SGI recognizes an other-than-temporary impairment loss in the consolidated statements of operations for a debt security in an unrealized loss position when either SGI has the intent to sell the debt security or it is more-likely-than not that SGI will be required to sell the debt security before its anticipated recovery.

Any credit-related impairment on debt securities SGI 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 SGI has the intent to sell the security or where SGI will more-likely-than not be required to sell or where the entire impairment is deemed by SGI 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 amortized 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.

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

For the nine months ended September 30, 2019 and 2018, SGI recorded other-than-temporary impairment charges of \$(6.7) and \$(10.8) million, respectively, on its debt securities. The other-than-temporary impairment charges recorded by SGI during the nine months ended September 30, 2019 were primarily due to the present value of projected cash flows expected to be collected being less than the carrying value of the securities. The other-than-temporary impairment charges recorded by SGI during the nine months ended

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September 30, 2018 were primarily due to SGI's conclusion that it was more-likely-than not that SGI would be required to sell certain debt securities (including its UCFs) before recovering their cost.

The following tables present the aggregate gross unrealized losses and fair value by investment category at September 30, 2019 and December 31, 2018, respectively. There were no securities in a gross unrealized loss position for greater than 12 months at December 31, 2018.

(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>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Mortgage-backed securities:						
RMBS.....	\$ (22)	\$ (137)	\$ 9,676	\$ 53,046	3	50
CMBS.....	(214)	(702)	6,383	25,940	6	37
Asset-backed securities.....	-	(2,942)	-	34,099	-	24
US Government and government agency..	-	(23)	-	56,669	-	8
Corporate and other.....	(179)	(3,033)	1,850	256,667	5	248
US states & political subdivisions.....	(20)	(7)	440	2,243	1	3
Total debt securities.....	<u>\$ (435)</u>	<u>\$ (6,844)</u>	<u>\$ 18,349</u>	<u>\$ 428,664</u>	<u>15</u>	<u>370</u>
Total other invested assets.....	<u>\$ (270)</u>	<u>\$ (6,228)</u>	<u>\$ 4,225</u>	<u>\$ 56,485</u>	<u>2</u>	<u>28</u>
<u>12 Months or More</u>	<u>Unrealized loss</u>		<u>Fair value</u>		<u>Number of securities</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Mortgage-backed securities:						
RMBS.....	\$ (1)	\$ -	\$ 26	\$ -	3	-
CMBS.....	(440)	-	10,051	-	12	-
Corporate and other.....	(3)	-	712	-	2	-
Total debt securities.....	<u>\$ (444)</u>	<u>\$ -</u>	<u>\$ 10,789</u>	<u>\$ -</u>	<u>17</u>	<u>-</u>
Total other invested assets.....	<u>\$ (259)</u>	<u>\$ -</u>	<u>\$ 716</u>	<u>\$ -</u>	<u>1</u>	<u>-</u>

Notes Payable and Interest

As part of the consideration paid in connection with the effective defeasance, or in-substance commutation, of certain of SGI's guarantees of CDS contracts pursuant to the 2009 MTA discussed above, 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 had 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 SGI 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. The short-term surplus notes had a 5.00% interest rate and matured on December 28, 2011, and the long-term surplus notes had a 6.00% interest rate and were scheduled to mature on June 27, 2024. SGI originally 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 accreted 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 was 30.11%. The estimated yield-to-maturity on the reallocated surplus notes (long-term surplus notes only) was 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.

On March 28, 2019 the NYDFS approved a net payment of \$169.9 million, which represented the remaining principal and accrued interest on SGI's surplus notes through the payment date, which was made on April 30, 2019. In connection with this payment in full, SGI incurred a loss on debt prepayment of \$41.7 million on the consolidated statement of operations for the nine months ended September 30, 2019.

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See table below for additional information on the surplus notes, accrued interest thereon, and interest expense as of September 30, 2019 and 2018 and December 31, 2018 and for the nine months ended September 30, 2019 and 2018:

(U.S. dollars in thousands)	Total		Short-term		Long-term	
	2019	2018	2019	2018	2019	2018
Interest expense:						
Accretion of debt discount	\$ 4,220	\$ 34,151	\$ -	\$ -	\$ 4,220	\$ 34,151
Interest accrual	3,297	29,835	592	5,426	2,705	24,409
Interest expense, including accretion of debt discount	7,517	63,986	592	5,426	6,925	58,560
Loss on debt prepayment	41,711	91,416	-	-	41,711	91,416
Total interest expense and loss on debt prepayment	49,228	155,402	592	5,426	48,636	149,976
Debt repayment, including accrued interest	(169,906)	(400,000)	(35,242)	(83,517)	(134,664)	(316,483)
Change in notes payable and accrued interest	(120,678)	(244,598)	(34,650)	(78,091)	(86,028)	(166,507)
Notes payable and accrued interest, beginning of period	120,678	556,216	34,650	168,826	86,028	387,390
Notes payable and accrued interest, end of period	<u>\$ -</u>	<u>\$ 311,618</u>	<u>\$ -</u>	<u>\$ 90,735</u>	<u>\$ -</u>	<u>\$ 220,883</u>
Notes payable, end of period	\$ -	\$ 104,206	\$ -	\$ 22,236	\$ -	\$ 81,970
Accrued interest, end of period	-	16,472	-	12,414	-	4,058
Notes payable and accrued interest, end of period	<u>\$ -</u>	<u>\$ 120,678</u>	<u>\$ -</u>	<u>\$ 34,650</u>	<u>\$ -</u>	<u>\$ 86,028</u>
Par value of notes payable, end of period	<u>\$ -</u>	<u>\$ 150,137</u>	<u>\$ -</u>	<u>\$ 22,236</u>	<u>\$ -</u>	<u>\$ 127,901</u>

Preferred shares of entity held-for-sale – 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, SGI 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, 2019 and 2018.

On January 14, 2019, SGI made a purchase from third parties of \$76.4 million of aggregate face amount of Pass-Through Trust Preferred Securities issued by the Twin Reefs Pass-Through Trust for \$64.9 million. The Twin Reefs Securities purchased correspond to 764 shares of SGI’s Series B preferred shares. On June 4, 2019, SGI made another purchase from third parties of \$20.9 million of aggregate face amount of Pass-Through Trust Preferred Securities issued by the Twin Reefs Pass-Through Trust for \$17.8 million, in which the Twin Reefs Securities purchased correspond to 209 shares of SGI’s Series B Preferred shares. As a result of these purchases and based on accounting guidance for extinguishment of preferred shares, SGI recorded an increase to accumulated deficit for the difference between the cash paid and reduction to the carrying value of the Series B preferred shares during the nine

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months ended September 30, 2019. For purposes of earnings per share to common shareholders for the nine months ended September 30, 2019, these purchases were reflected as a reduction to net income available to common shareholders.

As of September 30, 2019, as a result of the above purchases, SGI currently holds 1,628 shares of its issued 2,000 Series B preferred shares, which includes the previously held 655 shares transferred to SGI from BAC in connection with the 2012 BAC settlement.

Financial Instruments and Fair Value Measurements and Disclosures

A number of SGI'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, SGI 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 SGI. Unobservable inputs reflect SGI'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, SGI 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. SGI 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 SGI's assets and liabilities measured at fair value follows:

Valuation Techniques — Credit Default Swap Contracts

The principal drivers of the fair value of SGI'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 SGI'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 SGI's ability to meet its obligations under its CDS contracts which is factored into SGI's fair value estimates as discussed below.

The fair value of SGI's in-force portfolio of CDS contracts represents the net present value of the difference between the remaining uncollected premiums that SGI 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 SGI's CDS contracts. In the absence of such a principal market, SGI believes other financial guarantors of comparable credit quality to SGI best represent the hypothetical

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exit market for SGI'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 SGI'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, SGI 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 SGI'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 SGI'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. SGI'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 SGI obtains such quotes actively monitor and participate in the markets where such collateral is traded. Accordingly, SGI 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 SGI on the underlying reference obligations are the market's assumptions about default probabilities, default timing, correlation, recovery rates and collateral values. In general, SGI 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 SGI'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, SGI 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 SGI's CDS contracts reflects significant unobservable inputs related to the estimate of SGI's Non-Performance Risk and lack of market observable data, SGI's CDS contracts are categorized in Level 3 of the fair value hierarchy.

Valuation Techniques — Interest Rate Swap Guarantees

SGI'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.

SGI's interest rate swap guarantees cannot be legally traded and do not have observable market prices. SGI determines fair value based on valuation techniques involving management's judgment using internal valuation models. The estimated fair value of

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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 SGI's own non-performance risk.

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

Valuation Techniques — VIE Assets and Liabilities

The consolidated VIE assets and liabilities consist primarily of RMBS securities. The fair value of SGI'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 SGI, the benefit from SGI's insurance policy guaranteeing timely principal and interest for the VIE assets insured by SGI and the application of credit value adjustments for SGI's own non-performance credit risk. Since the majority of the significant inputs are unobservable, which reflect SGI'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, SGI 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, SGI 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.

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, SGI 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, for which fair value of these instruments is based upon quoted market prices. SGI 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. Investments in certain funds that are not actively traded but have inputs that are observable in the market or can be derived principally from observable market data are categorized in Level 2 of the fair value hierarchy. If external prices or significant inputs are unobservable, SGI 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 — Financial Guarantee Insurance Contracts

SGI 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, SGI 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 SGI'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 SGI's financial guarantee insurance contracts related to its retained business was \$109.9 million and \$49.9 million at September 30, 2019 and December 31, 2018, respectively. The fair value of SGI'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 SGI's assets and liabilities measured at fair value on a recurring basis as of September 30, 2019 and December 31, 2018:

(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	
	2019	2018	2019	2018	2019	2018	2019	2018
ASSETS								
Debt securities available for sale:								
Mortgage and asset-backed securities								
RMBS.....	\$ -	\$ -	\$ 61,462	\$ 70,347	\$ 1,404	\$ 1,515	\$ 62,866	\$ 71,862
CMBS.....	-	-	35,065	29,174	-	-	35,065	29,174
Asset-backed securities.....	-	-	60,718	65,104	-	-	60,718	65,104
U.S. Government and government agencies.....	38,258	84,032	-	-	-	-	38,258	84,032
Corporate and other.....	-	-	203,114	314,323	-	-	203,114	314,323
U.S. states and political subdivisions.....	-	-	35,044	35,291	-	-	35,044	35,291
Total debt securities available for sale.....	38,258	84,032	395,403	514,239	1,404	1,515	435,065	599,786
Other invested assets.....	21,868	74,336	5,000	5,017	6,480	8,151	33,348	87,504
Cash and cash equivalents.....	103,083	129,936	2,000	-	-	-	105,083	129,936
Restricted cash and cash equivalents.....	16,543	10,631	-	-	-	-	16,543	10,631
Assets of consolidated variable interest entities.....	-	-	-	-	17,903	20,843	17,903	20,843
Credit default and other swap contracts.....	-	-	-	-	242,611	227,052	242,611	227,052
Total assets.....	\$ 179,752	\$ 298,935	\$ 402,403	\$ 519,256	\$ 268,398	\$ 257,561	\$ 850,553	\$ 1,075,752
LIABILITIES								
Credit default and other swap contracts.....	\$ -	\$ -	\$ -	\$ -	\$ 251,645	\$ 235,541	\$ 251,645	\$ 235,541
Liabilities of consolidated variable interest entities.....	-	-	-	-	278	340	278	340
Total liabilities.....	\$ -	\$ -	\$ -	\$ -	\$ 251,923	\$ 235,881	\$ 251,923	\$ 235,881

Level 3 Assets and Liabilities Reconciliation Tables

Level 3 Assets

The following table provides a reconciliation of SGI's assets measured at fair value on a recurring basis using unobservable inputs (Level 3) as of September 30, 2019 and 2018:

(U.S. dollars in thousands)	Debt Securities Available for Sale					
	Mortgage and Asset- Backed Securities		Corporate and Other		Other Invested Assets	
	2019	2018	2019	2018	2019	2018
LEVEL 3 ASSETS						
Balance, beginning of period.....	\$ 1,515	\$ 2,217	\$ -	\$ 45,444	\$ 8,151	\$ 40,504
Realized gains (losses).....	(52)	3,446	-	4,872	(1,297)	(32)
Unrealized gains (losses) included in earnings.....	-	-	-	6,113	-	2,081
Unrealized gains (losses) included in OCI.....	(288)	(130)	-	(9,501)	(374)	(97)
Purchases.....	595	2,311	-	54	-	-
Sales.....	(366)	(6,515)	-	(46,982)	-	-
Transfers into (out of) Level 3.....	-	-	-	-	-	-
Balance, end of period.....	\$ 1,404	\$ 1,329	\$ -	\$ -	\$ 6,480	\$ 42,456

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	Assets of Consolidated		Credit default and other	
	Variable Interest		swap contracts	
	Entities			
LEVEL 3 ASSETS	2019	2018	2019	2018
Balance, beginning of period.....	\$ 20,843	\$ 118,154	\$ 227,052	\$ -
Deconsolidation of VIEs.....	-	(57,564)	-	-
Realized gains (losses).....	-	-	-	-
Unrealized gains (losses) included in earnings..	(2,940)	(5,915)	15,559	103,417
Unrealized gains (losses) included in OCI.....	-	-	-	-
Purchases.....	-	-	-	120,859
Sales.....	-	-	-	-
Distributions.....	-	(34,634)	-	-
Transfers into (out of) Level 3.....	-	-	-	-
Balance, end of period.....	<u>\$ 17,903</u>	<u>\$ 20,041</u>	<u>\$ 242,611</u>	<u>\$ 224,276</u>

There were no transfers into or out of Level 3 during the nine months ended September 30, 2019 and 2018.

Level 3 Liabilities

The following table provides a reconciliation for SGI's liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) for the nine months ended September 30, 2019 and 2018:

(U.S. dollars in thousands)	Credit Default and Other		Liabilities of Consolidated	
	Swap Contracts		Variable Interest Entities	
	2019	2018	2019	2018
LEVEL 3 LIABILITIES				
Balance, beginning of period.....	\$ 235,541	\$ 104,094	\$ 340	\$ 60,708
Deconsolidation of VIEs.....	-	-	-	(57,563)
Realized (gains) losses.....	(216)	120,338	-	-
Unrealized (gains) losses included in earnings.....	16,320	9,372	(62)	(2,808)
Balance, end of period.....	<u>\$ 251,645</u>	<u>\$ 233,804</u>	<u>\$ 278</u>	<u>\$ 337</u>

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The following table provides quantitative information regarding the significant unobservable inputs used to measure the fair value of SGI's Level 3 assets and liabilities on a recurring basis as of September 30, 2019 and December 31, 2018:

(U.S. dollars in thousands)

Level 3 Assets / Liabilities	Fair Value		Valuation Techniques	Significant Unobservable Inputs	Range of Inputs	
	2019	2018			2019	2018
Assets						
Mortgage- and asset-backed securities	\$ 1,404	\$ 1,515	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield	4.71% - 16% 3.0% - 35% 40% - 100% 4.25% - 6.75%	1.16% - 16% 1.44% - 35% 40% - 100% 5.0% - 7.5%
Other invested assets	6,480	8,151	Market approach	Liquidation preference	\$4.9 million	\$4.9 million
Assets of consolidated VIEs	17,903	20,843	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield Non-performance risk	3.83% - 99.87% 2.08% - 35.00% 40% - 100% 4.25% - 6.75% 3.97% - 4.13%	1.16% - 36.04% 1.44% - 35.00% 40% - 100% 5.0% - 7.50% 5.36% - 6.86%
Credit default and other swap contracts	242,611	227,052	Discounted cash flows	Loss severity Default rate Market premiums Weighted average life Non-performance risk	10% - 30% 0.06% - 1.02% 29 bps - 191 bps 1.07 yrs - 33.8 yrs 1.86% - 2.58%	10% - 60% 0.02% - 1.11% 35 bps - 235 bps 0.5 yrs - 34.6 yrs 2.99% - 4.50%
Liabilities						
Credit default and other swap contracts	\$251,645	\$235,541	Discounted cash flows	Loss severity Default rate Market premiums Weighted average life Non-performance risk	10% - 30% 0.06% - 1.02% 29 bps - 191 bps 1.07 yrs - 33.8 yrs 1.86% - 4.51%	10% - 60% 0.02% - 1.11% 35 bps - 235 bps 0.5 yrs - 34.6 yrs 2.99% - 8.25%
Liabilities of consolidated VIEs	278	340	Discounted cash flows	Constant prepayment rate Constant default rate Loss severity Yield Non-performance risk	4.09% - 99.87% 4.00% - 35.00% 70% - 100% 4.25% - 4.53% 3.97% - 4.13%	2.45% - 36.04% 2.64% - 35.00% 70% - 100% 5.0% - 6.86% 5.36% - 6.86%

The significant unobservable inputs used in the fair value measurement of SGI'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

SGI considers the effect of nonperformance risk in determining the fair value of its CDS liabilities and the consolidated VIE liabilities. The fair value of SGI'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 measures its Non-Performance Risk based on the market observable credit spread of a comparable financial guarantee insurance company.

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

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Set forth below is information regarding SGI's in-force CDS and other swap contracts and VIE liabilities as of September 30, 2019 and December 31, 2018, 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)	CDS and other		VIE liabilities	
	swap contracts			
	2019	2018	2019	2018
Fair value, before giving effect to Non-Performance Risk.....	\$ 295.6	\$ 308.4	\$ 0.3	\$ 0.3
Less:				
Non-Performance Risk.....	<u>44.0</u>	<u>72.9</u>	<u>-</u>	<u>-</u>
Fair value, after giving effect to Non-Performance Risk.....	<u>\$ 251.6</u>	<u>\$ 235.5</u>	<u>\$ 0.3</u>	<u>\$ 0.3</u>

Financial Instruments Not Carried at Fair Value

At September 30, 2019 and December 31, 2018, the carrying value of SGI's surplus notes as described above was zero and \$104.2 million, respectively. The interest rate on these surplus notes was 5.0% and 6.0% for each series with the first maturity date on such surplus notes scheduled for December 2011 and in June 2024. On March 28, 2019, the NYDFS approved a net payment of \$169.9 million, which represents the remaining principal and accrued interest on SGI's surplus notes and payment was made on April 30, 2019. The fair value of SGI's surplus notes was difficult and complex to estimate as such surplus notes were not listed on any exchange or publicly traded in any market. Any trading activity was inherently limited, and the prices may vary significantly between trades. Based on limited available market data obtained by management, SGI's short-term notes and long-term notes were found to have a price of approximately 97.7 and 98.2, respectively, as of December 31, 2018. These prices were based on total par, paid-in-kind interest and accrued but unpaid interest.

Commitments and Contingencies

Legal Matters

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

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, SGI 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 October 3, 2018, certain monoline insurers, including Syncora Guarantee, filed a renewed motion in PREPA's Title III case for relief from the automatic stay in order to commence an action to enforce their statutory right to appoint a receiver. On March 27, 2019, the Official Committee of Unsecured Creditors filed an objection to the renewed motion disputing, among other things, the collateral securing the PREPA bonds. On September 9, 2019, SGI became a party to the Definitive RSA. Pursuant to the Definitive RSA, upon court approval of the agreement, the renewed motion will be voluntarily withdrawn by all of the movants.

On May 2, 2019, the Oversight Board and the official committee of unsecured creditors filed a complaint challenging numerous proofs of claims relating to general obligation bonds, including those filed by SGI. Among other things, the complaint disputes the existence, extent, and enforceability of the consensual and statutory liens asserted in the proofs of claim and is seeking to reclassify such claims as unsecured obligations of the Commonwealth. On May 20, 2019, the Oversight Board and the official

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committee of unsecured creditors filed a similar complaint challenging numerous proofs of claims relating to bonds issued by the Puerto Rico Highways and Transportation Authority, including those filed by SGI. Both of these complaints are currently stayed by the court.

On September 30, 2019, certain Fuel Line Lenders of PREPA filed a complaint against several parties, including SGI. Among other things, the complaint is seeking priority payment for the plaintiffs' claims against PREPA prior to any payments to the PREPA bondholders and to limit the lien securing the PREPA power revenue bonds. Any motion to dismiss the complaint must be filed by November 6, 2019.

As of September 30, 2019, in 24 states or jurisdictions Syncora Guarantee's license to conduct insurance business in such states or jurisdictions was suspended, revoked, had an order of impairment placed against it, expired, was voluntarily surrendered by Syncora Guarantee, or Syncora Guarantee agreed to cease writing business in such states or jurisdictions, or Syncora Guarantee opted not to renew its license in such states or jurisdictions. Management anticipates that Syncora Guarantee will be able to continue to collect premiums on existing business in such states or jurisdictions. Additional states or jurisdictions may suspend Syncora Guarantee's license, place an order of impairment against it or, in lieu of a suspension or order, Syncora Guarantee may voluntarily agree to cease writing business and let such licenses expire or opt not to renew its licenses in additional states or jurisdictions.

Insurance Regulatory Requirements

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 September 30, 2019 and December 31, 2018 was \$507.6 million and \$475.0 million, less its "unrealized appreciation of assets"). As of September 30, 2019, SGI's unrealized appreciation of assets was \$7.9 million. The NYDFS may disapprove such dividends to shareholders if it finds that SGI will retain insufficient surplus to support its obligations and writings.

On April 30, 2019, SGI paid its surplus notes in full. Following payment in full, the following restrictions in its master transaction agreement with certain of its financial counterparties to CDS contracts insured by SGI's financial guaranty insurance policies and certain related transactions (referred to collectively as the "2009 MTA") no longer apply: SGI may not (i) make any distribution, pay, redeem, repurchase, retire, exchange or otherwise acquire its surplus notes, except on a pro rata basis and on the same terms; (ii) merge, consolidate or sell, assign, transfer or dispose of all or any material portion of its assets; (iii) pay any dividend, repurchase, redeem, exchange or convert any of its equity securities (or of any of its direct or indirect parent); (iv) issue any surplus notes; or (v) incur any indebtedness. Accordingly, the restrictive covenants in the 2009 MTA are no longer operative.

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 September 30, 2019 and December 31, 2018, SGI reported policyholders' surplus of \$639.9 million and \$811.0 million, respectively. For the nine months ended September 30, 2019 and 2018, SGI reported net income (loss) of \$30.3 million and \$(128.1) 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 nine months ended September 30, 2019 and 2018 and as of September 30, 2019 and December 31, 2018.

(U.S. dollars in thousands)

Description	Net Income (Loss)		Capital and Surplus	
	2019	2018	2019	2018
NAIC SAP Basis	\$ 80,887	\$ (181,392)	\$ (404,722)	\$ (284,236)
Effect of NY prescribed practices				
(a)	-	-	-	-
Effect of NY permitted practices				
(b)	-	-	921,561	921,561
(c)	(50,632)	26,904	123,073	173,705
(d)	-	-	-	-
(e)	-	26,347	-	-
(f)	-	-	-	-
NY Basis	\$ 30,255	\$ (128,141)	\$ 639,912	\$ 811,030

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 SGI to admit these assets notwithstanding the otherwise applicable limitations, which resulted in no difference between NAIC SAP and NY basis.
- (b) In connection with the reinsurance agreement with Assured, which closed on June 1, 2018, the NYDFS permitted SGI to set a fixed contingency reserve balance of \$5 million. This fixed reserve balance will not increase through accretion nor decrease through releases. Pursuant to prior approvals granted by the NYDFS in accordance with section 6903 of the NYIL, as of September 30, 2019 and December 31, 2018, SGI has de-recognized \$921.6 million and \$921.6 million, respectively, in the aggregate, of contingency reserves on terminated policies, and policies on which SGI has established case reserves, whereas under NAIC SAP SGI would still be required to carry such reserves. SGI previously 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, SGI released contingency reserves based on a methodology pursuant to a permitted practice granted by the NYDFS.
- (c) The NYDFS granted 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 SGI or an affiliate of SGI of all rights under the aforementioned policies. As of September 30, 2019, 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, 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, 2015, SGI 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 SGI a permitted practice to value the surplus notes issued by SGI 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 SGI 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. As of April 30, 2019, SGI paid off in full the remaining principal and accrued interest on its surplus notes.
- (e) The NYDFS previously granted SGI a permitted practice to account for its ownership of the common stock of American Roads entities and Pike Pointe Holdings, LLC as salvage recoverable, which is deducted from the liability for unpaid claims or losses, whereas under NAIC SAP, SGI would be required to record its 100% equity ownership of these entities using GAAP equity values. As of December 31, 2018, SGI no longer applies such permitted practice.
- (f) In connection with the Restructuring Transactions completed on August 12, 2016, the NYDFS granted SGI 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.

Assets on Deposit to Collateralize Certain of SGI's Contractual Obligations

As of September 30, 2019 and December 31, 2018, SGI had, in the aggregate, approximately \$21.1 million and \$23.0 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including reinsurance, lease and letter of credit agreements. Of such deposits, \$21.1 million and \$15.4 million and zero and \$7.6 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, SGI agreed to maintain \$15.6 million on deposit through June 1, 2023. In addition, debt securities with an amortized cost and fair value of \$5.3 million and \$5.5 million at September 30, 2019 and \$5.5 million and \$5.6 million at December 31, 2018, respectively, were on deposit with various regulatory authorities as required by insurance laws.

15. Subsequent Events

On November 8, 2019, Pike Pointe sold its interest in an infrastructure asset for \$2.0 million in cash, which will be recorded as other income in the fourth quarter of 2019 as part of continuing operations.

On November 12, 2019, SGI made another purchase from a third party of \$3.0 million of aggregate face amount of Pass-Through Trust Preferred Securities issued by the Twin Reefs Pass-Through Trust for \$2.3 million, in which the Twin Reefs Securities purchased correspond to 30 shares of SGI's Series B Preferred shares. As part of the sale agreement with Star Insurance, the purchase price will be increased by \$375 thousand related to this transaction.

The Company has evaluated all subsequent events through November 14, 2019, the date the consolidated financial statements were available to be issued.