

SYNCORA HOLDINGS LTD.

**Consolidated Financial Statements
December 31, 2017 and 2016**

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Page</u>
Report of Independent Auditors.....	3
Consolidated Balance Sheets at December 31, 2017 and 2016.....	4
Consolidated Statements of Operations and Comprehensive Income for the years ended December 31, 2017 and 2016.....	5
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2017 and 2016.....	6
Consolidated Statements of Cash Flows for the years ended December 31, 2017 and 2016.....	7
Notes to Consolidated Financial Statements.....	9



Report of Independent Auditors

To the Board of Directors of Syncora Holdings Ltd.:

We have audited the accompanying consolidated financial statements of Syncora Holdings Ltd. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and December 31, 2016, and the related consolidated statements of operations and comprehensive income, of changes in shareholders' equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Syncora Holdings Ltd. and its subsidiaries as of December 31, 2017 and December 31, 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

March 27, 2018

SYNCORA HOLDINGS LTD.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2017 and 2016

(U.S. dollars in thousands, except share and per share amounts)

ASSETS	2017	2016
Debt securities, available-for-sale, at fair value (amortized cost: \$910,858 and \$1,257,670).....	\$ 928,044	\$ 1,272,641
Other invested assets, at fair value (cost: \$94,232 and \$79,284).....	117,110	93,888
Cash and cash equivalents.....	311,951	167,088
Total cash and invested assets.....	1,357,105	1,533,617
Restricted cash and cash equivalents.....	2,637	4,704
Accrued investment income.....	6,633	11,884
Deferred acquisition costs, net.....	34,930	42,614
Premiums receivable.....	92,824	117,728
Salvage and subrogation recoverable.....	422,687	101,207
Receivables on insurance cash flow certificates, net.....	109,869	203,764
Other assets.....	45,106	52,261
Assets of consolidated variable interest entities, at fair value.....	118,154	146,857
Assets of entity held-for-sale.....	195,540	179,757
Total assets.....	\$ 2,385,485	\$ 2,394,393
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Unpaid losses and loss adjustment expenses.....	\$ 674,999	\$ 742,236
Unearned premium revenue.....	224,885	292,816
Credit default and other swap contracts, at fair value.....	104,094	160,515
Notes payable (par value: \$677,117 and \$685,556).....	428,887	396,759
Accrued interest on notes payable.....	127,329	125,953
Reinsurance premiums payable.....	12,921	12,732
Accounts payable, accrued expenses and other liabilities.....	29,244	38,135
Liabilities of consolidated variable interest entities, at fair value.....	60,708	66,183
Liabilities of entity held-for-sale.....	20,428	17,884
Total liabilities.....	1,683,495	1,853,213
Shareholders' equity		
Non-controlling interest in subsidiary- Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc. (2,000 shares authorized and issued; 1,345 shares outstanding, 655 shares held by subsidiary; \$134,526 liquidation preference).....	13,453	13,453
Non-controlling interest in consolidated entity.....	2,578	3,066
Common shares (500,000,000 shares authorized; 89,811,623 and 89,613,270 shares issued; 86,767,035 and 86,568,682 shares outstanding, 3,044,588 shares held as treasury; \$0.01 par value) and additional paid-in capital.....	2,716,798	2,716,220
Accumulated deficit.....	(2,061,854)	(2,195,356)
Accumulated other comprehensive income.....	31,015	3,797
Total Syncora Holdings Ltd. shareholders' equity.....	685,959	524,661
Total shareholders' equity.....	701,990	541,180
Total liabilities and shareholders' equity.....	\$ 2,385,485	\$ 2,394,393

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2017 and 2016
(U.S. dollars in thousands, except share and per share amounts)

	2017	2016
Revenues		
Net premiums earned.....	\$ 51,081	\$ 77,154
Net investment income.....	45,313	48,843
Net realized losses on investments, including other-than-temporary impairment losses of \$(41,453) and \$(39,829).....	(17,735)	(19,789)
Net loss on insurance cash flow certificates, net of amortization of deferred gains of \$2,227 and \$2,464.....	(120,103)	(110,595)
Fees and other income.....	6,282	20,186
Net earnings (loss) on credit default and other swap contracts: net unrealized gains (losses) of \$56,351 and \$(60,923) and realized gains and other settlements of \$3,335 and \$4,500.....	59,686	(56,423)
Net change in fair value of consolidated variable interest entities.....	37,594	44,528
Total revenues.....	62,118	3,904
Expenses		
Net recoveries on losses and loss adjustment expenses.....	(197,687)	(179,261)
Amortization of deferred acquisition costs, net.....	7,684	11,629
Realized loss on interest rate derivative instrument.....	50	471
Interest expense, including accretion of \$40,705 and \$22,874.....	88,503	71,806
Operating expenses.....	46,974	74,269
Total expenses.....	(54,476)	(21,086)
Income before income tax (benefit) expense from continuing operations.....	116,594	24,990
Income tax (benefit) expense.....	(4,793)	4,755
Income from continuing operations.....	121,387	20,235
Income from discontinued operations.....	12,522	13,048
Net income.....	133,909	33,283
Other comprehensive income:		
Other comprehensive income from continuing operations.....	26,707	4,188
Other comprehensive income (loss) from discontinued operations.....	511	(797)
Other comprehensive income.....	27,218	3,391
Comprehensive income.....	\$ 161,127	\$ 36,674
Net income and comprehensive income attributable to non-controlling interest.....	\$ 407	\$ 633
Net income and comprehensive income attributable to controlling interest:		
Net income.....	\$ 133,502	\$ 32,650
Comprehensive income.....	\$ 160,720	\$ 36,041
Calculation of basic and diluted earnings per share attributable to Syncora Holdings Ltd. common shareholders:		
Income from discontinued operations.....	\$ 12,522	\$ 13,048
<i>Per share</i>	\$ 0.14	\$ 0.19
Income from continuing operations.....	\$ 120,980	\$ 19,602
Extinguishment of Series A perpetual non-cumulative preference shares.....	-	115,210
Total.....	\$ 120,980	\$ 134,812
<i>Per share</i>	\$ 1.40	\$ 1.99
Income.....	\$ 133,502	\$ 147,860
<i>Per share</i>	\$ 1.54	\$ 2.18
Weighted average common shares outstanding.....	86,718,669	67,942,207

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2017 and 2016
(U.S. dollars in thousands, except share amounts)

	<u>2017</u>	<u>2016</u>
Non-controlling interest in subsidiary – Series B perpetual non-cumulative preferred shares of Syncora Guarantee Inc.		
Balance—beginning of period.....	\$ 13,453	\$ 13,453
Balance—end of period.....	<u>13,453</u>	<u>13,453</u>
Non-controlling interest in consolidated entity		
Balance—beginning of period.....	3,066	3,146
Net income and comprehensive income attributable to non-controlling interest.....	407	633
Distributions.....	(895)	(713)
Balance—end of period.....	<u>2,578</u>	<u>3,066</u>
Series A perpetual non-cumulative preference shares		
Balance—beginning of period.....	-	163,162
Extinguishment of Series A perpetual non-cumulative preference shares.....	-	(163,162)
Balance—end of period.....	<u>-</u>	<u>-</u>
Common shares and additional paid-in capital		
Balance—beginning of period.....	2,716,220	2,678,346
Issuance of 198,353 and 30,299,066 common shares.....	434	37,874
Share-based compensation.....	144	-
Balance—end of period.....	<u>2,716,798</u>	<u>2,716,220</u>
Accumulated deficit		
Balance—beginning of period.....	(2,195,356)	(2,343,216)
Net income attributable to controlling interest.....	133,502	32,650
Extinguishment of Series A perpetual non-cumulative preference shares.....	-	115,210
Balance—end of period.....	<u>(2,061,854)</u>	<u>(2,195,356)</u>
Accumulated other comprehensive income		
Balance—beginning of period.....	3,797	406
Other comprehensive income attributable to controlling interest.....	27,218	3,391
Balance—end of period.....	<u>31,015</u>	<u>3,797</u>
Total common shareholders' equity—end of period.....	<u>685,959</u>	<u>524,661</u>
Total shareholders' equity—end of period.....	<u>\$ 701,990</u>	<u>\$ 541,180</u>

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 and 2016
(U.S. dollars in thousands)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Premiums collected.....	\$ 9,995	\$ 13,890
Investment income collected.....	52,288	49,174
Fees received on credit default swaps.....	3,264	6,146
Claims paid to policyholders and loss adjustment expenses paid.....	(191,030)	(138,839)
Cash received from settlement.....	-	40,000
Operating expenses paid.....	(57,953)	(72,545)
Interest paid on notes payable.....	(46,561)	(45,930)
Income taxes paid.....	(953)	(1,922)
Other cash receipts.....	13,259	23,964
Cash paid for insurance cash flow certificates.....	(503)	(6,965)
Cash received on insurance cash flow certificates.....	7,948	5,872
Investment income collected by variable interest entities.....	4,735	4,839
Interest and other expenses paid by variable interest entities.....	(5,201)	(4,100)
Net cash used in operating activities from continuing operations.....	(210,712)	(126,416)
Net cash provided by operating activities from discontinued operations.....	16,846	18,895
Net cash used in operating activities.....	<u>(193,866)</u>	<u>(107,521)</u>
Cash flows from investing activities:		
Proceeds from sales of investments.....	493,258	869,537
Proceeds from maturity of investments.....	181,855	149,025
Purchases of investments.....	(335,941)	(1,006,313)
Payment for loan disbursement.....	(1,000)	-
Net proceeds from consolidated variable interest entities' assets.....	35,627	27,690
Net cash provided by investing activities from continuing operations.....	373,799	39,939
Net cash (used in) provided by investing activities from discontinued operations.....	(3,638)	15,503
Net cash provided by investing activities.....	<u>370,161</u>	<u>55,442</u>
Cash flows from financing activities:		
Net paydowns of consolidated variable interest entities' liabilities.....	(10,957)	(14,552)
Paydowns on note payable.....	(8,439)	(9,070)
Distributions to non-controlling interest in consolidated entity.....	(895)	(713)
Net cash used in financing activities from continuing operations.....	(20,291)	(24,335)
Net cash used in financing activities.....	<u>(20,291)</u>	<u>(24,335)</u>
Increase (decrease) in cash and cash equivalents and restricted cash.....	156,004	(76,414)
Cash and cash equivalents and restricted cash and cash equivalents—beginning of period.....	195,430	271,844
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	<u>\$ 351,434</u>	<u>\$ 195,430</u>
Summary of cash and cash equivalents and restricted cash and cash equivalents- end of period:		
Cash and cash equivalents.....	\$ 311,951	\$ 167,088
Restricted cash and cash equivalents.....	2,637	4,704
Cash and cash equivalents included in Assets of entity held-for-sale.....	36,652	21,533
Restricted cash and bank time deposits included in Assets of entity held-for-sale.....	194	2,105
Cash and cash equivalents and restricted cash and cash equivalents—end of period.....	<u>\$ 351,434</u>	<u>\$ 195,430</u>
Supplemental non-cash transactions:		
Deconsolidation of variable interest entities.....	\$ 34,907	\$ -
17.3 million newly issued common shares in exchange for \$70 million discount received on notes.....	-	21,642
13.0 million newly issued common shares and the \$40 million of reallocated notes in exchange for conversion of Series A preferred shares.....	-	\$ 47,950

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2017 and 2016
(U.S. dollars in thousands)

	2017	2016
Reconciliation of income from continuing operations to net cash used in operating activities		
from continuing operations:		
Income from continuing operations.....	\$ 121,387	\$ 20,235
Adjustments to reconcile income from continuing operations to net cash used in operating activities		
from continuing operations:		
Depreciation and amortization.....	1,045	1,073
Realized losses on investments.....	17,735	19,789
Unrealized (gains) losses on credit default and other swap contracts.....	(56,351)	60,923
Net change in variable interest entities.....	(37,594)	(44,528)
Foreign currency exchange (gain) loss.....	(1,596)	5,560
Accretion on insurance cash flow certificates.....	120,103	110,595
Other operating activities.....	4,067	(1,287)
Changes in assets and liabilities:		
Premiums receivable.....	24,904	15,788
Deferred acquisition costs, net.....	7,685	11,628
Salvage and subrogation recoverable.....	(321,480)	(13,378)
Other assets.....	11,310	1,477
Unpaid losses and loss adjustment expenses.....	(67,237)	(264,950)
Unearned premium revenue.....	(67,931)	(74,005)
Notes payable.....	40,567	30,522
Accrued interest on notes payable.....	1,375	(3,639)
Accounts payable, accrued expenses and other liabilities.....	(8,701)	(2,219)
Total adjustments.....	(332,099)	(146,651)
Net cash used in operating activities from continuing operations.....	\$ (210,712)	\$ (126,416)

See accompanying Notes to Consolidated Financial Statements.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Business

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

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

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

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

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

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

On August 8, 2017, management, with Board of Directors approval, committed to a formal plan to sell American Roads LLC (see Note 21 for further discussion).

In connection with the restructuring transactions discussed below, the Board of Managers of Pike Pointe approved a distribution of \$50.0 million to SGI conditioned upon the successful closing of the restructuring transactions which took place on August 12, 2016. As Pike Pointe is a wholly-owned subsidiary, this distribution did not have an effect on shareholders equity, but increased SGI’s liquidity position by such amount. This distribution was completed on August 12, 2016.

The Company has one reportable operating business segment, which is Financial Guarantee Insurance. The Company’s financial guarantee business segment is conducted primarily through its operating subsidiaries, SGI and Syncora Investment Holdings LLC, which invests in private debt and equity securities. Previously, the Company’s other business segment related to the operations of American Roads LLC, which are now presented as discontinued operations. See Note 21 for further discussion.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Description of 2016 Restructuring Transactions

On August 12, 2016, Syncora Holdings US Inc., a wholly-owned subsidiary of Syncora Holdings, completed a surplus note exchange offer and proxy solicitation for the variation of rights to the SHL Preferred Shares, which are part of its restructuring transactions. Upon closing of the transactions, the following interrelated events occurred:

- Holders of SGI's outstanding long-term and short-term surplus notes provided a \$70.0 million discount (\$55.2 million and \$14.8 million of long-term and short-term surplus notes, respectively) including principal, paid-in-kind interest and accrued interest, in exchange for 17.3 million newly issued common shares of SHL.

The discount received in the Exchange Offers (principal, paid-in-kind interest and accrued and unapproved interest) is being accounted for as a debt modification since the creditors before and after the discount remain the same and the change in the terms is not considered substantial. A substantial change is considered to be a change in cash flows of greater than 10% as a result of the modification of terms. As the change in cash flows is less than 10%, modification accounting is appropriate. Under debt modification accounting, no gain or loss is recorded, and a new effective interest rate is established based on the new carrying value of the surplus notes and new cash flows. Additionally, any consideration paid to the creditors including non-cash consideration is capitalized and amortized as part of the effective yield calculation. The fair value of the common shares issued is accounted for as consideration paid to the creditors in exchange for the reduction in principal, paid-in-kind interest, and accrued and unapproved interest. SHL issued 17.3 million common shares and the share price used (\$1.25) was as of August 12, 2016.

- The rights attached to all externally held Syncora Holdings Preferred Shares were varied such that they were automatically converted into 13.0 million newly issued Syncora Holdings common shares and \$40.0 million of reallocated surplus notes (\$31.5 million and \$8.5 million of long-term and short-term surplus notes, respectively) provided from the discount described above. In addition, upon completion of the variation, all of the Syncora Holdings Preferred Shares held by Syncora Holdings, or its affiliates were cancelled and no Syncora Holdings preferred shares remain outstanding.

As the Existing Syncora Holdings Preferred Shares are considered to be extinguished as part of the Exchange Offers, the difference between the consideration paid (15% SHL Common Shares issued and outstanding after giving effect to the Restructuring Transactions, plus the estimated fair value of \$40.0 million of Existing SGI Surplus Notes comprised of principal, paid-in-kind interest and accrued and unapproved interest) and the carrying value of the original preferred shares is recognized as a reduction of the accumulated deficit. SHL issued 13.0 million common shares and the share price used (\$1.25) was as of August 12, 2016. The estimated fair value of the \$40.0 million of Existing SGI Surplus Notes principal, paid-in-kind interest and accrued and unapproved interest is also reflected as an increase to notes payable and accrued interest in the consolidated balance sheet. For purposes of earnings per share to common shareholders, the gain on extinguishment noted above was reflected as net income available to common shareholders.

- The remaining \$30.0 million of discounted long-term and short-term surplus notes were transferred from Syncora Holdings to SGI and cancelled by SGI, which did not have any effect on the consolidated balance sheet.
- 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 retained net operating losses. The amendments to the tax sharing agreement did not have any effect on the consolidated balance sheet.
- SGI made a net cash payment of \$55.0 million on its long-term and short-term externally held surplus notes after receiving approval from the NYDFS. This payment was reflected as a \$9.1 million reduction to principal of the Existing Short-Term Surplus Notes and a \$45.9 million reduction to accrued interest.
- 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. SGI reflected this permitted practice in its third quarter 2016 (and subsequent) statutory quarterly financial statements and resulted in a positive earned surplus balance. This permitted practice had no effect on the GAAP consolidated financial statements.

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

Significant Risks and Uncertainties

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

Syncora Holdings is a holding company with no operations or significant assets other than \$6.8 million of debt securities and cash and cash equivalents and its common equity ownership of its subsidiaries as of December 31, 2017. In January 2017, Syncora Holdings collected \$2.5 million of cash from amounts included in other assets. Syncora Holdings' only potential sources of funds are dividends and/or reimbursements for certain expenses related to the general services agreement with its subsidiaries to provide funds for its working capital needs and to pay operating expenses. The remainder of its capital is held at SGI, and any dividends and/or distributions from SGI are subject to contractual and regulatory prohibitions and limitations and to the prior claims of SGI's surplus noteholders and its preferred shareholders. There can be no assurance that Syncora Holdings will be able to maintain adequate capital or have sufficient liquidity in the future to pay its operating expenses. See Note 20 for financial information of Syncora Holdings.

The Company is exposed to significant risks and uncertainties that may materially affect its financial and liquidity position. These relate to, among other things, (i) the potential for future adverse loss and claims development on its insured obligations and (ii) a potential liquidity mismatch resulting from the timing of anticipated future claims payments and subsequent cash recoveries (including recovery of salvage on Puerto Rico and other credits) related to these claims payments. These risks and uncertainties are discussed more fully below and could materially and adversely affect the Company's results of operations, financial condition and liquidity.

Description of Significant Risks and Uncertainties and Other Matters

- As of December 31, 2017, the Company has \$252.1 million of net exposure to Puerto Rico (excluding interest outstanding of \$75.4 million), which includes direct insurance and reinsurance of bond policies and direct investments by the Company as a result of remediation transactions. This exposure relates primarily to bonds issued by the Puerto Rico Electric Power Authority ("PREPA") of \$141.6 million (excluding interest outstanding of \$37.6 million) and general obligation bonds of the Commonwealth of Puerto Rico (the "Commonwealth") of \$85.2 million (excluding interest outstanding of \$28.1 million) and \$25.3 million of net exposure to other obligations of Puerto Rico (excluding interest outstanding of \$9.7 million). In July 2017, SCAI (pre-merger) paid approximately \$112.6 million in net claims, representing principal and interest due on July 1, 2017 maturities primarily related to Commonwealth and PREPA exposures. Syncora Guarantee, as a result of the merger with SCAI, now directly owns all rights and interests of the bondholders with respect to these payments. Recoveries relating to these rights and interests could be long-dated, which could have a material adverse effect on the Company's short-term liquidity needs. Given that the Puerto Rico proceedings under PROMESA (as detailed below) may continue for an extended period, the Company may be required to make further material claims payments and therefore further increasing the proportion of its assets that are comprised of salvage and subrogation rights.
- On June 30, 2016, the President enacted the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), which provides Puerto Rico and its instrumentalities with both an in-court (Title III) and out-of-court (Title VI) process to restructure debts and bind holdouts. PROMESA provides for the establishment of an Oversight Board, which the President appointed on August 31, 2016, with the authority to approve adjustments of debt of Puerto Rico and its instrumentalities, including PREPA.

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

On July 18, 2017, certain creditors of PREPA, including Syncora Guarantee, filed a motion in PREPA's Title III case seeking relief from the automatic stay in order to commence an action to enforce their statutory right to appoint a receiver. On September 14, 2017, this motion was denied by Judge Swain. On September 28, 2017, the Company and the other creditors appealed the decision to the United States Court of Appeals for the First Circuit.

On September 20, 2017, Hurricane Maria made landfall on Puerto Rico causing extensive and widespread damage to property and infrastructure, including loss of electric power throughout the island. The effects of Hurricane Maria are still being assessed but it is expected to have a negative effect on the local economy. It will also likely delay any restructuring resolution and reduce ultimate recoveries to bondholders.

As Puerto Rico and certain of its instrumentalities have defaulted on their debt obligations and given the effects of Hurricane Maria on Puerto Rico, the Company may experience further losses on these insured obligations which could have a material adverse effect on the Company's liquidity and financial position.

- The Company faces a potential liquidity mismatch between expected future claims payments and recoveries relating to these claims. As of December 31, 2017, the Company anticipates that it may be requested to make gross claim payments in the period 2018 to 2029 of at least approximately \$338.7 million, excluding remediated RMBS claims, followed in later years (in some cases significantly later years) by recoveries of these claims payments. The Company also remains exposed to a number of other credits with exposure to refinancing risk and the risk of material principal repayments with an aggregate par outstanding of \$2.9 billion, in each case as of December 31, 2017. The amount and timing of the recoveries related to future claims payments are subject to greater uncertainty than the amount and timing of such future claims payments themselves. Pursuant to the Company's accounting policy and guidance under Generally Accepted Accounting Principles ("GAAP"), the net present value of estimated claims and recoveries (including salvage and subrogation) are reflected in the Company's loss reserves and salvage and subrogation recoverable (see Note 4). Because of the inherent uncertainty in estimating future claim payments and recoveries (including, whether, when and to what extent investment grade and non-investment grade credits may be able to refinance), no assurance can be given that the amount or timing of claims payments, related recoveries, or ultimate losses match the Company's estimates, and such differences could materially and adversely affect the Company's results of operations, financial condition and liquidity. The Company may also experience significant adverse development on its insured obligations that may place further demands on the Company's liquidity and financial position. See Note 10 "*Schedule of Insured Financial Obligations with Credit Deterioration*" caption for further discussion.
- Any payment of principal or interest on the short-term and long-term surplus notes issued by SGI is subject to the satisfaction of conditions precedent, including, without limitation, prior regulatory approval by the NYDFS. SGI remains exposed to significant risks and uncertainties that may materially and adversely affect its financial condition, liquidity position and ability to make future payments on its surplus notes. Consequently, there can be no assurance as to whether and when the NYDFS will approve any future payments on the short-term or long-term surplus notes.
- The Company has significant exposure to public finance transactions (including specifically Puerto Rico), which pose a risk of material adverse development, including but not limited to event driven developments, such as adverse outcomes or rulings in bankruptcy proceedings, political, operational, legal and regulatory actions, over which the Company has no control. Such adverse developments could have a material adverse effect on the Company's liquidity and financial position, on the Company's estimate of reserves for losses, and on the various assumptions underlying such reserves for losses. Under certain conditions, many of which are outside the Company's control, these exposures to public finance transactions may result in significant increases in claims beyond that assumed in the Company's current reserve estimate, which could have a material adverse effect on the Company's liquidity and financial position.
- The Company also continues to have significant exposure to a number of large structured single risk transactions (3 transactions with an aggregate insured net principal outstanding of \$695.0 million) with material risk of adverse development, including event driven risks, such as political, operational, bankruptcy, legal and regulatory actions. Such adverse events could have a material adverse effect on the Company's liquidity and financial position.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- The Company and its financial position will continue to be subject to risk of global financial and economic conditions that could materially and adversely affect the amount of potential losses (including the timing and amount of potential claims and subsequent recoveries) incurred on transactions it guarantees, the value of its investment portfolio, and otherwise materially and adversely affect the Company. With respect to the Company's investment portfolio, a prolonged period of low interest rates, along with declining investment balances, may adversely affect the Company's ability to generate sufficient investment income to fund its future obligations. Issuers or borrowers whose securities or loans the Company insures or holds as well as the Company's counterparties under swaps and other derivative contracts may default on their obligations to the Company due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting securities that the Company has guaranteed may deteriorate further, causing these securities to incur losses
- The Company has direct insurance and reinsurance exposure to certain credits within European countries. Global economic conditions have been negatively affected with concerns about the continued sovereign debt crisis within the European region and the possibility that certain European Union member states will default on their debt obligations or leave the European Union. The continued uncertainty over the outcome of the European Union governments' efforts to provide financial support for sovereigns and sub-sovereigns and the possibility of further deteriorating conditions in Europe could have a material adverse effect on the Company's financial and liquidity position. As of December 31, 2017, the Company's in-force guaranteed principal exposure to the European Union was approximately \$5.4 billion of which \$4.9 billion of net exposure is to credits in the UK and denominated in British Pound sterling and \$256.4 million was specifically related to certain credits in higher risk countries, such as Portugal and Italy. The United Kingdom held a referendum on June 23, 2016, in which a majority of voters voted to exit the European Union ("Brexit"). Negotiations have commenced to determine the future terms of the United Kingdom's relationship with the European Union. Brexit has caused currency exchange rate fluctuations that resulted in the weakening of the British Pound, in which a portion of the Company's insured portfolio is denominated. Until there is greater certainty on the terms and conditions of the United Kingdom's relationship with the European Union, the Company cannot provide any assurance of its effect on its business, results of operations and liquidity, which could be material and adverse.
- The Company is materially exposed to foreign exchange risk as the Company's insured debt obligations are denominated in a number of foreign currencies and the U.S. dollar. The principal currencies creating foreign exchange risk are the British Pound sterling, Australian dollar and the European Union euro. At December 31, 2017, approximately 38% of the Company's in-force guaranteed net par outstanding exposure of \$14.8 billion was denominated in such currencies. The Company translates foreign currencies into U.S. dollars at the current market exchange rates. Changes in the exchange rates between foreign currencies and U.S. dollars may have an adverse effect on the settlement of potential claims or the value of salvage/recoveries and therefore could have a material adverse effect on the Company's liquidity and surplus position. In addition, the Company is materially exposed to risks associated with its financial guarantees covering foreign denominated inflation indexed-linked bonds in connection with the bonds issued by UK and European utility and project finance issuers.
- The Company is involved in legal proceedings. Management cannot predict the outcomes of these legal proceedings with certainty. A favorable outcome could have a material effect on the Company's financial and liquidity position. Prosecuting these legal proceedings involves significant expense and diversion of management's attention and resources from other matters.
- In addition to exposure to general economic factors including stress in the energy sector, the Company is exposed to the specific risks faced by the particular businesses, municipalities or pools of assets covered by its financial guarantee products. In light of the continuing economic and financial stresses in the United States and Europe, various businesses and municipalities are facing financial difficulties. In addition, catastrophic events or terrorist acts could adversely affect the ability of public sector issuers to meet their obligations with respect to securities insured by the Company and the Company may incur material losses due to these exposures if the economic stress caused by these or other events is more severe than the Company currently foresees. Other events, such as interest rate changes or volatility, could, in certain instances, also materially affect the Company or its insured obligations.
- Obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, may be adversely affected by revenue declines resulting from reduced demand, changing demographics or other factors associated with the global economy. These obligations, which may not necessarily benefit from financial support from other tax revenues or governmental authorities, may also experience increased losses if the revenue streams are insufficient to pay scheduled interest and principal payments.
- Many municipalities that issue some of the obligations the Company insures have experienced significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

If the issuers of the obligations in the Company's public finance portfolio do not have sufficient funds to cover their expenses, are unable to access the capital markets and are unable or unwilling to raise taxes, decrease spending or receive state, federal and other assistance, the Company may experience increased levels of losses or impairments on its public finance obligations, which could materially and adversely affect its business, financial condition and results of operations.

- Changes in laws and regulations or the adoption of new laws such as the Puerto Rico Recovery Act affecting insurance companies, the municipal and structured securities markets, the frequency with which municipalities file for protection under Chapter 9 of the bankruptcy code or similar insolvency laws and the loss severities associated therewith, the financial guarantee insurance and reinsurance markets and the credit derivatives markets, as well as other governmental regulations, or acts may subject the Company, its affiliates and subsidiaries to additional legal liability and regulatory requirements, affect the credit performance of the securities that the Company insures and otherwise affect the Company's financial condition.
- The Company continues to be materially exposed (directly and indirectly) to risks associated with deterioration in the residential mortgage market through its guarantees of RMBS, as well as other bond sectors to which the Company has material exposure, including the structured single risk, public finance (including Puerto Rico), commercial mortgage, and corporate loan bond sectors. The extent and duration of any deterioration of the credit markets is unknown, as is the effect, if any, on: (i) potential claim payments and the ultimate amount of losses the Company may incur on obligations it has guaranteed and (ii) potential losses the Company may incur on its invested assets.
- The Company's ability to pay dividends on its preferred and common shares is subject to risks and uncertainties, including, without limitation, prior regulatory approval by the NYDFS and compliance with certain contractual restrictions. No assurance can be given as to whether or when SGI may be able to pay any dividends on its preferred and/or common shares. As discussed in Note 18, SGI's ability to pay dividends is subject to regulatory constraints.
- Establishment of case basis reserves for unpaid losses and loss adjustment expenses on the Company's in-force business requires the use and exercise of significant judgment and is based on certain assumptions by management, including estimates regarding the likelihood of occurrence, timing and amount of a loss on a guaranteed obligation. Changes in such assumptions could materially adversely affect such reserve estimates, including the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company, these exposures may result in significant increases in claims beyond those assumed in the Company's reserve estimate (that may or may not result in an increase in such loss reserves) in the near to medium term. A material portion of the Company's case basis reserves reflects certain assumptions that affect reimbursements in the remainder of its insured and reinsured portfolio. Actual experience may, and likely will, differ from those estimates and such difference may be material due to the fact that the ultimate dispositions of claims are subject to the outcome of events that have not yet occurred and, in certain cases, will occur over many years in the future. Examples of these events include changes in the level of interest rates, credit deterioration of guaranteed obligations, recoveries in bankruptcy proceedings, changes in the value of specific assets supporting guaranteed obligations and changes in the level of investment yield. Both qualitative and quantitative factors are used in making such estimates. From time to time the Company reevaluates all such estimates, which may be material. Any estimate of future costs is subject to the inherent limitation on management's ability to predict the aggregate course of future events. It should, therefore, be expected that the actual emergence of losses and claims will vary, perhaps materially, from any estimate. The risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed.
- SGI's non-insurance subsidiary, American Roads LLC, is exposed to certain risks and uncertainties related to its toll road facilities, operations and toll collections. The carrying value of American Roads LLC's assets includes long-lived tangible and intangible assets whose recovery is predicated on toll collections. Any impairment of such assets could have a material adverse effect on SGI's financial position. See Note 21 for further discussion.
- SGI has sought, and may in the future seek, the NYDFS's approval of permitted accounting practices and other regulatory relief which have, and if granted may have, a material effect on SGI's statutory policyholders' surplus. Once granted, these permitted accounting practices have been subject to an annual approval or confirmation. No assurance can be given that the NYDFS will continue to grant approval of SGI's past or any future permitted accounting practices or requested regulatory relief. Failure to obtain continuing approval of the past or future permitted accounting practices or requested regulatory relief could have a material adverse effect on SGI's statutory policyholders' surplus.
- Should the Company experience an "ownership change" for purposes of Section 382 of the Internal Revenue Code, the Company's ability to utilize its net operating loss carryforwards could be subject to an annual limitation in the future, which would be expected to result in a material increase in the Company's U.S. federal income tax liability, reduce reimbursements

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

from profitable affiliates under its tax sharing agreement and therefore materially adversely affect the Company's equity and liquidity position. While the Syncora Holdings Ltd. bye-laws contain restrictions intended to reduce the likelihood of such an "ownership change," it remains possible that an "ownership change" could nonetheless occur. These limitations may prevent Syncora Holdings Ltd. from taking certain strategic actions or may make it more difficult for Syncora Holdings Ltd. to attract additional capital. See Note 15 for more information. In addition, although the Company has not taken any uncertain tax positions, the IRS may nonetheless disagree with the Company's interpretation of this and other tax related matters.

- Notwithstanding the amendments to the 2009 MTA obtained by the Company on August 24, 2015, as discussed in Note 3, and the restructuring transactions completed on August 12, 2016 as discussed in Note 1, the Company remains subject to certain contractual and regulatory restrictions that limit its financial and operating flexibility and may materially and adversely impair its ability to execute on its strategic plan. See below Description of the Company's On-Going Strategic Plan and associated risks.
- The Company relies upon information technology and systems, including those of third parties, to support a variety of its business processes and activities. In addition, the Company has collected and stored confidential information. The Company's data systems and those of third parties on which it relies may be vulnerable to security breaches from external and internal factors. Problems in, or security breaches of, these systems could result in, among other things, reputational harm, the disclosure or misuse of confidential or proprietary information, inaccurate loss projections, legal costs and regulatory penalties. As the Company's business operations rely on the continuous availability of its computer systems, as well as those of certain third parties, a failure to maintain business continuity in the wake of disruptive events could prevent the timely completion of critical processes across its operations, including, for example, claims processing and investment operations. These failures could result in additional costs, fines and litigation.
- Syncora Holdings' business could be negatively affected as a result of actions of activist stockholders, and such activism could affect the trading value of its securities. Responding to actions by activist stockholders can be costly and time-consuming, disrupting operations and diverting the attention of management and employees. Such activities could interfere with 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.
- Due to the installment nature of a significant percentage of its premium income, the Company has an embedded future revenue stream. The amount of installment premiums actually realized by the Company could be materially reduced in the future due to factors such as early termination of insurance contracts, accelerated prepayments of underlying obligations, commutation of existing financial guarantee insurance policies or non-payment. Such reductions could result in materially lower revenues and liquidity.
- The Company's success substantially depends upon its ability to retain qualified employees and upon the ability of its senior management and other key employees to implement its strategic plan. The Company relies substantially upon the services of its executive team and other key employees. The loss of the services of any of these individuals or other key members of the Company's management team or the inability to hire talented personnel could adversely affect the implementation of its strategic plan or ability to operate the business.
- The Company may be unable to execute any or all of the elements of its On-Going Strategic Plan on a timely basis or at all, as described below.

Description of the Company's On-Going Strategic Plan

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

These initiatives include (i) closing of the agreement with Assured Guaranty Corp. ("Assured Guaranty") in respect of a 100% quota share reinsurance transaction of a high percentage of net par outstanding of the Company's insured portfolio (See Note 22 for further discussion), (ii) continuing to make payments on the surplus notes issued by the Company, (iii) continuing to focus on remediating insured exposures (through their purchase on the open market or otherwise, commutation, defeasance or other restructuring) to minimize potential claim payments, maximize recoveries and mitigate potential losses, (iv) completing the sale of American Roads, (v) further reducing operating expenses and improving operational efficiencies, and (vi) seeking to realize the maximum value of its assets, and various legal proceedings described in Note 17 and from any other rights and remedies the Company

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

may have, whether through litigation, settlement, sale or other monetization. In addition, management is considering 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.

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

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

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

The 2009 MTA consisted of the following primary components:

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

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

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

During the years ended December 31, 2017 and 2016, the Company purchased additional RMBS and other securities with an aggregate principal exposure of approximately \$2.0 million and \$121.0 million, respectively, for consideration of approximately \$1.8 million and \$78.4 million, respectively (excluding VIE activity).

The following table illustrates the components of the net receivable on insurance cash flow certificates on the accompanying consolidated balance sheets at December 31, 2017 and December 31, 2016:

(U.S. dollars in thousands)

	<u>2017</u>	<u>2016</u>
Receivables on insurance cash flow certificates	\$ 226,284	\$ 281,534
Deferred gain	<u>(116,415)</u>	<u>(77,770)</u>
Receivables on insurance cash flow certificates, net	<u>\$ 109,869</u>	<u>\$ 203,764</u>

4. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may, and likely will, differ from those estimates and such differences may be material. Accounting policies requiring significant estimates primarily consist of those relating to the Company's reserves for losses and loss adjustment expenses, CDS contracts, variable interest entities' ("VIEs") assets and liabilities, deferred acquisition costs, and investments, as discussed in this note.

Assets and Liabilities Held-For-Sale and Discontinued Operations

On August 8, 2017, management, with Board of Directors approval, committed to a formal plan to sell American Roads LLC. 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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Since the accounting criteria for held-for-sale and discontinued operations were met on August 8, 2017, the Company has reflected these classifications in the accompanying consolidated financial statements. The consolidated balance sheets as of December 31, 2017 and 2016 present the total assets and total liabilities of American Roads LLC in the line items “assets of entity held-for-sale” and “liabilities of entity held-for-sale”, respectively. The consolidated statements of operations and comprehensive income for the years ended December 31, 2017 and 2016 present the total revenues and total expenses of American Roads LLC in the line item “Income from discontinued operations”. The consolidated statements of cash flows for the years ended December 31, 2017 and 2016 present the cash flows of American Roads LLC in the line items “net cash provided by (used in) operating and investing activities from discontinued operations”, respectively.

The significant accounting policies specific to American Roads LLC are presented in Note 21.

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.

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 carried 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. The net unrealized gains or losses on certain investments, net of deferred income taxes, is included in accumulated other comprehensive income. Any unrealized loss in value considered by management to be other-than-temporary is charged to income in the period that such determination is made. See Note 5 for the criteria used by management in assessing whether an other-than-temporary impairment has occurred.

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

Cash and Cash Equivalents

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

Restricted Cash and Cash Equivalents

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

Unearned Premium Revenue and Receivable for Future Premiums

The Company recognizes a liability for unearned premium revenue at the inception of financial guarantee insurance and reinsurance contracts on a contract-by-contract basis. Unearned premium revenue recognized at inception of a contract is measured at the present value of the premium due or expected to be collected. For certain financial guarantee insurance contracts, the Company receives the entire premium due at the inception of the contract, and recognizes unearned premium revenue liability at that time. For other financial guarantee contracts, the Company receives premiums in installments over the term of the contract at stipulated due dates. Unearned premium revenue and a receivable for future premiums are recognized at the inception of an installment contract, and measured at the present value of premiums expected to be collected over the contract period or expected period using a risk-free discount rate. 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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

timing of prepayments are reasonably estimable, and (d) a homogenous pool of assets is the underlying collateral for the insured obligation. The Company has determined that substantially all of its installment contracts are required to be measured based on the contract period. The receivable for future premiums is reduced as installment premiums are collected. The Company reports the accretion of the discount on installment premiums receivable as premium revenue. The Company assesses the receivable for future premiums for collectability each reporting period, adjusts the receivable for uncollectible amounts and recognizes any write-off as an operating expense.

Premium Revenue Recognition

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

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

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

Fees and Other Income

In connection with certain of its insured transactions, the Company may collect waiver, consent, termination and other fees. Depending upon the type of fee received, the fee is either earned when services are rendered and the fee is due, or deferred and earned over a stipulated period or the life of the related transaction.

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, foreign currency exchange losses and other general and administrative expenses.

Interest Expense

Interest expense is recognized on the accrual basis using the effective interest rate method.

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 (see Note 10).

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

The present value of net cash outflows is determined based on a risk free rate of interest commensurate with the expected duration of the related contract. For this purpose, the Company uses the rate on U.S. Treasury obligations with a duration consistent with the duration of the underlying insured obligation for U.S. dollar denominated insured obligations or the comparable risk free rate on foreign government obligations relating to insured obligations denominated in foreign currencies. The weighted average risk free

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

rate at December 31, 2017 and December 31, 2016 was 2.3% and 1.9%, respectively. A claim liability is subsequently remeasured each reporting period for increases or decreases due to changes in the magnitude and likelihood of default and potential recoveries, as well as changes in the risk free rate of interest. Subsequent changes to the measurement of claim liability are recognized as loss expense in the period of change. Measurement and recognition of loss liability is reported gross of any reinsurance. The Company estimates the likelihood of possible claims payments and possible recoveries using probability-weighted expected cash flows based on available information, including market information. Accretion of the discount on a claim liability, as well as any changes in the risk free rate of interest, are included in loss expense.

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

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

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

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

Deferred Acquisition Costs and Deferred Ceding Commission

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

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

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

Salvage and Subrogation Recoverable

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

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 earnings on credit default and other swap contracts" on the consolidated statements of operations. Realized gains (losses) and other settlements on credit default swap contracts include credit default swap derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, contractual claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions expense or income and realized gains or losses related to their early termination. Net unrealized gains (losses) on credit default swaps contracts represent the adjustments for changes in fair value in excess of realized gains and other settlements that are recorded in each reporting period. Fair value of credit default swap contracts is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 8 for a discussion on the fair value methodology for credit default swap contracts.

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.

Foreign Currency Translation

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

Earnings Per Share

Basic earnings per share amounts are calculated by dividing earnings attributable to common shareholders by the weighted average number of common shares outstanding during the period, excluding the effect of dilutive securities. Diluted earnings per share amounts are calculated by dividing earnings attributable to common shareholders by the sum of the weighted average number of common shares outstanding during the period plus additional shares potentially issued from all dilutive securities. There were no dilutive securities outstanding at December 31, 2017 and 2016, respectively.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In August of 2014, the FASB issued "Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern", which provides guidance on determining when and how to disclose going concern uncertainties in the consolidated

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

financial statements. Under the new guidance, management would be required to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. Certain disclosures must be provided if "conditions or events raise substantial doubt about an entity's ability to continue as a going concern." This new standard was effective for annual reporting periods ending after December 15, 2016. The Company adopted this standard for the year ending December 31, 2016 and for subsequent interim periods. As the Company concluded that there is no substantial doubt about the Company's ability to continue as a going concern, this standard did not have a material effect on the Company's consolidated financial statements.

In May of 2015, the FASB issued "Financial Services – Insurance – Disclosures about Short-Duration Contracts." The primary objective of this standard is to improve disclosures for insurance entities which issue short-duration contracts. This standard made significant amendments to the Short-Duration Contract disclosure section and limited amendments affecting the General disclosures. The Company, as a provider of financial guarantee contracts, is subject to the General sections but not the Short-Duration Contract sections. As such, the limited amendments made to the General disclosure section did not have a material effect on the Company's financial statement disclosures. This standard was effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.

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

Accounting Pronouncements Pending Adoption

In January 2016, the FASB issued "Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities". This standard amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This guidance includes requirements for certain equity investments with readily determinable fair values to be measured at fair value with changes recognized in net income and for financial liabilities where the fair value option has been elected, requiring the portion of the fair value change related to instrument-specific credit risk (which includes a Company's own credit risk) to be separately reported in other comprehensive income. This standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company adopted this standard as of January 1, 2018. The Company's credit risk included in the VIE liabilities for which the fair value option was elected was immaterial. As of January 1, 2018, the Company plans to reclassify the accumulated net unrealized gains relating to equity securities in its investment portfolio at December 31, 2017 (approximately \$8.0 million) from accumulated other comprehensive income to retained earnings as a cumulative-effect adjustment, net of tax.

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 public business enterprises that are Securities and Exchange Commission ("SEC") filers and after December 15, 2020 for public business enterprises that are non-SEC filers. The Company is evaluating the effect of adopting this standard, however, since the Company recognizes an other-than-temporary impairment loss in the consolidated statements of operations for a debt security in an unrealized loss position because it either 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, this standard it is not expected to have a material effect on the Company's consolidated financial statements.

In August 2016, the FASB issued "Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments". This standard addresses eight specific cash flow issues, with the objective of reducing the existing diversity in practice in how these transactions are classified in the statement of cash flows. This standard was effective for fiscal years beginning after December 15, 2017, including interim periods within those years, with early adoption permitted provided that all of the amendments are adopted in the same period. The standard requires application using a retrospective transition method to each period presented. The Company will

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

adopt this standard as of January 1, 2018. The Company is finalizing its analysis and the adoption of this standard is not expected to have a material effect on the Company's consolidated financial statements.

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

5. Investments

The amortized cost and fair value of investments as of December 31, 2017 and December 31, 2016 are as follows:

(U.S. dollars in thousands)	Cost or		Gross Unrealized		Gross Unrealized		Fair Value	
	Amortized Cost		Gains ⁽³⁾		Losses ⁽³⁾			
	2017	2016	2017	2016	2017	2016	2017	2016
Debt securities								
Mortgage-backed securities:								
RMBS ⁽¹⁾	\$ 78,468	\$ 123,660	\$ 2,495	\$ 1,808	\$ -	\$ -	\$ 80,963	\$ 125,468
CMBS.....	26,618	75,451	256	450	-	-	26,874	75,901
Asset-backed securities.....	57,640	67,779	53	304	-	-	57,693	68,083
U.S. Government and government agencies.....	154,408	191,556	248	408	(6)	(8)	154,650	191,956
Corporate and Other.....	545,399	648,092	9,902	7,992	(18)	(15)	555,283	656,069
U.S. states and political subdivisions of the states...	48,325	151,132	4,256	4,032	-	-	52,581	155,164
Total debt securities.....	<u>\$910,858</u>	<u>\$1,257,670</u>	<u>\$17,210</u>	<u>\$14,994</u>	<u>\$ (24)</u>	<u>\$ (23)</u>	<u>\$928,044</u>	<u>\$1,272,641</u>
Total other invested assets ⁽²⁾	<u>\$ 94,232</u>	<u>\$ 79,284</u>	<u>\$23,101</u>	<u>\$14,637</u>	<u>\$ (223)</u>	<u>\$ (33)</u>	<u>\$117,110</u>	<u>\$ 93,888</u>

⁽¹⁾ At December 31, 2017, residential mortgage-backed securities include \$2.2 million of fair value and \$0.9 million of amortized cost related to UCFs. At December 31, 2016, residential mortgage-backed securities include \$1.8 million of fair value and \$1.2 million of amortized cost related to UCFs.

⁽²⁾ At December 31, 2017 and 2016, other invested assets include \$14.3 million and \$7.3 million, respectively, of net unrealized gains that were recorded through net income on the consolidated statement of operations on investments in which the Company has elected the fair value option.

⁽³⁾ As of December 31, 2017 and 2016, gross unrealized gains of \$4.7 million and \$17.5 million, respectively, related to foreign currency exchange are not included in the table above.

The change in net unrealized gains consists of changes in the valuation and holdings of debt securities of \$2.2 million and \$2.3 million for the years ended December 31, 2017 and 2016, respectively.

Proceeds from sales of debt securities, net of receivables, for the years ended December 31, 2017 and 2016 were \$490.9 million and \$894.9 million, respectively.

The gross realized gains and gross realized (losses), excluding other-than-temporary impairment losses, for the years ended December 31, 2017 and 2016 were \$24.2 million and \$21.4 million and \$(0.5) million and \$(1.2) 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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amortized cost and fair value of bonds at December 31, 2017 and 2016 by contractual maturity are shown below. Actual maturity may differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are generally more likely to be prepaid than other fixed-maturity securities. As the stated maturities of such securities may not be indicative of actual maturities, the totals for mortgage-backed securities are shown separately.

(U.S. dollars in thousands)	2017		2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$ 81,851	\$ 82,107	\$ 127,795	\$ 128,274
Due after one through five years	498,812	501,665	610,278	613,980
Due after five through ten years	148,878	157,311	151,257	154,408
Due after ten years	18,591	21,431	101,451	106,527
Subtotal	748,132	762,514	990,781	1,003,189
Mortgage- and asset-backed securities	162,726	165,530	266,889	269,452
Total	\$ 910,858	\$ 928,044	\$ 1,257,670	\$ 1,272,641

Net investment income for the years ended December 31, 2017 and 2016 is derived from the following sources:

(U.S. dollars in thousands)	2017	2016
Debt securities and cash and cash equivalents	\$ 41,089	\$ 46,652
Equity securities	4,929	3,135
Other invested assets	777	624
Less: Investment expenses	(1,482)	(1,568)
Net investment income	\$ 45,313	\$ 48,843

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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company also has a formal review process for all equity securities in the Company's investment portfolio, including a review for impairment losses. Factors considered when assessing impairment include; the length of the time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value. Management considers all available evidence to evaluate the realizable value of its investment in equity securities classified as available-for-sale.

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

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

For the years ended December 31, 2017 and 2016, the Company recorded other-than-temporary impairment charges of \$41.5 million and \$39.8 million, respectively, on its debt and equity securities. The other-than-temporary impairment charges recorded by the Company during the year ended December 31, 2017 were primarily due to foreign currency exchange losses on certain debt securities and the Company's conclusion, resulting from its near term anticipated cash needs, that it was more-likely-than not that the Company would be required to sell certain debt securities (including its UCFs) before recovering their cost. The other-than-temporary impairment charges recorded by the Company during the year ended December 31, 2016 were primarily due to the Company's conclusion, resulting from its near-term anticipated cash needs, that it was more-likely-than not that the Company would be required to sell certain debt securities (including its UCFs) before recovering their cost.

The following table presents securities in an aggregate gross unrealized loss position for less than 12 months and fair value by investment category at December 31, 2017 and December 31, 2016, respectively. As of December 31, 2016, there were gross unrealized losses of \$17.5 million related to foreign currency exchange that were in an unrealized loss position for 12 months or more. There were no securities in an aggregate gross unrealized loss position for more than 12 months at December 31, 2017 and 2016.

(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>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
US Government and government agency..	\$ (6)	\$ (8)	\$ 5,539	\$ 10,069	8	6
Corporate and other.....	(18)	(15)	10,174	4,606	8	4
Total debt securities.....	<u>\$ (24)</u>	<u>\$ (23)</u>	<u>\$ 15,713</u>	<u>\$ 14,675</u>	<u>16</u>	<u>10</u>
Total other invested assets.....	<u>\$ (223)</u>	<u>\$ (33)</u>	<u>\$ 1,764</u>	<u>\$ 739</u>	<u>3</u>	<u>2</u>

6. Credit Default and Other Swap Contracts

Prior to suspending writing substantially all new business, the Company issued CDS contracts and entered into arrangements with other issuers of CDS contracts to assume, all or a portion, of the risks in the CDS contracts they issued ("back-to-back arrangements") and, in certain cases, the Company purchased back-to-back credit protection on all or a portion of the risk from the CDS contracts it issued or assumed. Such back-to-back arrangements were generally structured on a proportional basis.

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's policy has been to hold its CDS contracts to maturity and not to manage such contracts to realize gains or losses from periodic market fluctuations. However, in certain circumstances, the Company may enter into an off-setting position or back-to-back arrangement, commute, terminate or restructure a CDS contract prior to maturity for risk management purposes (for example, upon a deterioration in underlying credit quality or for the purposes of managing its capital).

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

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

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

Set forth below is certain information regarding the Company's in-force CDS and other swap contracts as of December 31, 2017 and December 31, 2016, including the aggregate notional amount outstanding, the weighted average life of such contracts, and the ratings of obligations referenced in such contracts.

CDS Contracts

(U.S. dollars in millions)

	<u>2017</u>	<u>2016</u>
Notional Amount Outstanding	\$ 3,214	\$ 3,515
Weighted Average Life (years)	22.6	20.9
Percentage of referenced assets by rating ⁽¹⁾		
AAA	7.5 %	15.1 %
At or above investment grade but below AAA	92.5	84.9
Below investment grade	-	-
Total	<u>100.0 %</u>	<u>100.0 %</u>

⁽¹⁾ 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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table provides the components of net earnings (loss) on credit default and other swap contracts for the years ended December 31, 2017 and 2016:

(U.S. dollars in thousands)	2017	2016
Change in fair value of credit default and other swap contracts:		
Realized gains (losses) and other settlements:		
Net CDS contract premiums received and receivable	\$ 3,335	\$ 4,515
Net CDS contract losses paid and payable.....	—	(15)
Total realized gains and losses and other settlements	3,335	4,500
Unrealized gains (losses):		
Change in fair value of CDS contracts.....	56,351	(60,923)
Net earnings (loss) on credit default and other swap contracts ⁽¹⁾⁽²⁾	\$ 59,686	\$ (56,423)

⁽¹⁾ The change in realized/unrealized gains (losses) relating to the CDS and other swap contracts still held as of December 31, 2017 and 2016 was \$59.7 million and \$(56.4) million, respectively.

⁽²⁾ Includes unrealized gains of \$8.3 million and \$1.5 million for interest rate swap contracts for the years ended December 31, 2017 and 2016, respectively.

7. Consolidation of VIEs

The Company has exposure to VIEs primarily through the issuance of financial guaranty insurance contracts that typically insure the timely payment of principal and interest with respect to debt obligations of the VIEs. As part of the terms of its insurance contracts, at the outset of a contract, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. In addition, the Company has exposure to VIEs through the ownership of UCFs (see Note 3) and other interests.

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

The table below shows the fair value of the consolidated VIE assets and liabilities in the Company's consolidated balance sheets, segregated by the types of assets held by VIEs that collateralize their respective debt obligations as of December 31, 2017 and December 31, 2016. As of December 31, 2017 and December 31, 2016, the Company's qualitative and quantitative analyses have indicated that it does not have a controlling financial interest in any other VIEs.

(U.S. dollars in thousands)	2017		2016	
	Assets	Liabilities	Assets	Liabilities
Subprime (1st lien)	\$ 57,564	\$ 57,564	\$ 80,399	\$ 63,198
Prime (HELOC)	51,229	935	27,616	596
Alt-A (2nd lien)	8,161	2,162	8,765	2,325
Alt-A (1st lien)	1,200	47	7,820	64
Subprime (2nd lien)	-	-	22,257	-
	\$ 118,154	\$ 60,708	\$ 146,857	\$ 66,183

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the revenues and expenses of consolidated VIEs included in the Company's consolidated statements of operations for the years ended December 31, 2017 and 2016:

(U.S. dollars in thousands)	<u>2017</u>	<u>2016</u>
Interest income	\$ 4,828	\$ 4,732
Interest expense	(5,043)	(3,746)
Other expenses	(223)	(247)
Net realized and unrealized gains	<u>38,032</u>	<u>43,789</u>
Net change in variable interest entities	<u>\$ 37,594</u>	<u>\$ 44,528</u>

The Company's maximum exposure to loss provided through its financial guarantees of principal and interest with respect to debt obligations of unconsolidated variable interest entities was \$6.1 billion and \$8.1 billion at December 31, 2017 and 2016, respectively.

8. Financial Instruments and Fair Value Measurements and Disclosures

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

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

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

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

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

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

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

Valuation Techniques — Credit Default Swap Contracts

The principal drivers of the fair value of the Company's CDS contracts include: (i) general market credit spreads for the type(s) of assets referenced in CDS contracts, (ii) the specific quality and performance of the actual assets referenced in the contracts, (iii) the amount of subordination in the transaction before the Company's liability attaches, (iv) other customized structural features of such contracts (e.g., terms, conditions, covenants), (v) supply and demand factors, including the volume of new issuance, and (vi) the

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

market perception of the Company's ability to meet its obligations under its CDS contracts which is factored into the Company's fair value estimates as discussed below.

The fair value of the Company's in-force portfolio of CDS contracts represents the net present value of the difference between the remaining uncollected premiums that the Company originally charged for credit protection and management's best estimate of what a financial guarantor of comparable credit worthiness would hypothetically charge to provide the same protection as of the measurement date. The hypothetical nature of this exit value is representative of the lack of a principal market for the Company's CDS contracts. In the absence of such a principal market, the Company believes other financial guarantors of comparable credit quality to the Company best represent the hypothetical exit market for the Company's CDS contracts. Fair value is defined as the price at which an asset or a liability could be bought or transferred in a current transaction between willing parties. Fair value is determined based on quoted market prices, if available. Quoted market prices are available only on a limited portion of the Company's in-force portfolio of CDS contracts. If quoted market prices are not available, fair value is estimated based on valuation techniques involving management's judgment. In determining the fair value of its CDS contracts, the Company uses various valuation approaches with priority given to observable market prices when they are available. Market prices are generally available for traded securities and market standard CDS contracts but are less available or unavailable for highly-customized CDS contracts. Most of the Company's CDS contracts are highly customized structured credit derivative transactions that are not traded and do not have observable market prices.

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

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

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

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Valuation Techniques — Interest Rate Swap Guarantees

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

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

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

Valuation Techniques — Contingent Consideration

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

Valuation Techniques — VIE Assets and Liabilities

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

Valuation Techniques — Debt Securities Available for Sale

U.S. Government and government agencies

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

Mortgage and asset-backed securities

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

Corporate

The fair value of corporate bonds is determined using recently executed transactions or market price quotations obtained from an independent third-party investment service provider. Corporate bonds are generally categorized in Level 2 of the fair value

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

U.S. State and political subdivisions

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

Valuation Techniques — Cash and Cash Equivalents

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

Valuation Techniques — Other Invested Assets

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

Valuation Techniques — Other Receivable – City of Detroit

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

Valuation Techniques — Interest Rate Derivative Instrument

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

Valuation Techniques — Financial Guarantee Insurance Contracts

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

The fair value of the Company's insurance contracts was \$123.1 million and \$125.6 million at December 31, 2017 and December 31, 2016, respectively. The fair value of the Company's insurance contracts would be categorized into the Level 3 hierarchy since the significant inputs used were unobservable.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 December 31, 2017 and 2016:

(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)		Assets / Liabilities at Fair Value	
	2017	2016	2017	2016	2017	2016	2017	2016
ASSETS								
Debt securities available for sale:								
Mortgage and asset-backed securities								
RMBS.....	\$ -	\$ -	\$ 78,746	\$ 123,649	\$ 2,217	\$ 1,819	\$ 80,963	\$ 125,468
CMBS.....	-	-	26,874	75,901	-	-	26,874	75,901
Asset-backed securities.....	-	-	57,693	68,083	-	-	57,693	68,083
U.S. Government and government agencies.....	139,690	150,093	14,960	41,863	-	-	154,650	191,956
Corporate and other.....	-	2,582	509,839	600,629	45,444	52,858	555,283	656,069
U.S. states and political subdivisions.....	-	-	52,581	100,494	-	54,670	52,581	155,164
Total debt securities available for sale.....	139,690	152,675	740,693	1,010,619	47,661	109,347	928,044	1,272,641
Other invested assets.....	71,398	55,400	5,208	558	40,504	37,930	117,110	93,888
Other assets.....	-	-	-	50	3,007	4,009	3,007	4,059
Cash and cash equivalents.....	311,926	158,095	25	8,993	-	-	311,951	167,088
Restricted cash and cash equivalents.....	2,637	4,704	-	-	-	-	2,637	4,704
Assets of consolidated variable interest entities.....	-	-	-	-	118,154	146,857	118,154	146,857
Total assets.....	\$ 525,651	\$ 370,874	\$ 745,926	\$ 1,020,220	\$ 209,326	\$ 298,143	\$ 1,480,903	\$ 1,689,237
LIABILITIES								
Credit default swap contracts.....	\$ -	\$ -	\$ -	\$ -	\$ 104,094	\$ 160,515	\$ 104,094	\$ 160,515
Contingent consideration.....	-	-	-	-	2,043	3,021	2,043	3,021
Liabilities of consolidated variable interest entities.....	-	-	-	-	60,708	66,183	60,708	66,183
Total liabilities.....	\$ -	\$ -	\$ -	\$ -	\$ 166,845	\$ 229,719	\$ 166,845	\$ 229,719

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 December 31, 2017 and 2016:

(U.S. dollars in thousands)	Debt Securities Available for Sale					
	Mortgage and Asset- Backed Securities		Corporate and Other		U.S. States and Political Subdivisions	
	2017	2016	2017	2016	2017	2016
LEVEL 3 ASSETS						
Balance, beginning of period.....	\$ 1,819	\$ 2,803	\$ 52,858	\$ 16,845	\$ 54,670	\$ 34,066
Deconsolidation of VIEs.....	-	-	-	-	-	-
Realized gains (losses).....	(1,132)	(2,491)	1,319	(1,918)	(14,511)	(14,633)
Unrealized gains (losses) included in earnings.....	-	-	(14,293)	-	-	-
Unrealized gains (losses) included in OCI.....	739	327	24,223	(2,730)	(2)	(485)
Purchases.....	1,650	3,578	1,459	-	-	38,540
Sales.....	(859)	(2,398)	(20,122)	(3,545)	(37,121)	(2,818)
Transfers into (out of) Level 3.....	-	-	-	44,206	(3,036)	-
Balance, end of period.....	\$ 2,217	\$ 1,819	\$ 45,444	\$ 52,858	\$ -	\$ 54,670

(U.S. dollars in thousands)	Assets of Consolidated Variable Interest Entities					
	Other Invested Assets		Other Assets		Assets of Consolidated Variable Interest Entities	
	2017	2016	2017	2016	2017	2016
LEVEL 3 ASSETS						
Balance, beginning of period.....	\$ 37,930	\$ 3,894	\$ 4,009	\$ 5,454	\$ 146,857	\$ 125,608
Deconsolidation of VIEs.....	-	-	-	-	(34,907)	-
Realized gains (losses).....	136	-	(1,002)	(1,445)	(227)	-
Unrealized gains (losses) included in earnings.....	7,046	7,277	-	-	18,452	21,249
Unrealized gains (losses) included in OCI.....	(100)	487	-	-	-	-
Purchases.....	1,100	8,670	-	-	-	-
Sales.....	(608)	(798)	-	-	(12,021)	-
Transfers into (out of) Level 3.....	(5,000)	18,400	-	-	-	-
Balance, end of period.....	\$ 40,504	\$ 37,930	\$ 3,007	\$ 4,009	\$ 118,154	\$ 146,857

For the year ended December 31, 2017, transfers out of Level 3 were \$8.0 million, which related to U.S. states and political subdivisions and other invested assets and were due to the availability of, or corroborated by, observable market inputs other than quoted market prices. For the year ended December 31, 2016, transfers into Level 3 were \$62.6 million, which related to corporate and other and other invested assets and were due to the unavailability of observable market prices.

Level 3 Liabilities

The following table provides a reconciliation for the Company's liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) for the years ended December 31, 2017 and 2016:

(U.S. dollars in thousands)	Credit Default and Other Swap Contracts		Contingent Consideration		Liabilities of Consolidated Variable Interest Entities	
	2017	2016	2017	2016	2017	2016
	LEVEL 3 LIABILITIES					
Balance, beginning of period.....	\$ 160,515	\$ 97,962	\$ 3,021	\$ 3,719	\$ 66,183	\$ 73,726
Deconsolidation of VIEs.....	-	-	-	-	(291)	-
Payment of contingent consideration.....	-	-	(978)	(735)	-	-
Realized (gains) losses.....	(3,335)	(4,500)	-	-	-	-
Unrealized (gains) losses included in earnings.....	(53,086)	67,053	-	37	(5,184)	(7,543)
Balance, end of period.....	\$ 104,094	\$ 160,515	\$ 2,043	\$ 3,021	\$ 60,708	\$ 66,183

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table provides quantitative information regarding the significant unobservable inputs used to measure the fair value of the Company's Level 3 assets and liabilities on a recurring basis as of December 31, 2017 and December 31, 2016:

(U.S. dollars in thousands)

Level 3 Assets / Liabilities	Fair Value		Valuation Techniques	Significant Unobservable Inputs	Range of Inputs	
	2017	2016			2017	2016
Assets						
Mortgage- and asset-backed securities	\$ 2,217	\$ 1,819	Discounted cash flows	Constant prepayment rate	0% - 12.0%	0.9% - 12.0%
				Constant default rate	4.01% - 100%	3.6% - 32.41%
				Loss severity	36.2% - 100%	38.3% - 100%
				Yield	4.55% - 6.55%	5.75% - 7.75%
Corporate and other	45,444	52,858	Discounted cash flows Transaction price	Yield	7.4%	5.7% - 9.7%
U.S. states and political subdivisions	-	54,670	Discounted cash flows Transaction price	Comparable defaulted bonds	-	7.5% - 16.2%
Other invested assets	40,504	37,930	Market approach	Projected revenues	\$14.6 million- \$35.4 million	\$25 million- \$40 million
				Revenue multiples	3.2x - 19.8x	1.9x - 10.2x
				Liquidation preference	\$4.9 million	\$4.9 million
			Net asset value Discounted cash flows	Yield	-	0% - 12.0%
Other assets	3,007	4,009	Selling price scenarios	Credit and illiquidity discount	0% - 50%	0% - 33%
Assets of consolidated VIEs	118,154	146,857	Discounted cash flows	Constant prepayment rate	0.07% - 12.0%	0.21% - 15.89%
				Constant default rate	2.8% - 34.5%	3.5% - 34.7%
				Loss severity	33.7% - 100%	34.8% - 100%
				Yield	4.05% - 6.55%	5.25% - 7.75%
				Non-performance risk	9.1% - 12.6%	3.5% - 9.0%
Liabilities						
Credit default and other swap contracts	\$104,094	160,515	Discounted cash flows	Loss severity	10% - 60%	10% - 60%
				Default rate	0.02% - 5.19%	0.05% - 27.59%
				Market premiums	23 bps - 199 bps	19 bps - 270 bps
				Weighted average life	2.6 yrs - 35.6 yrs	0.3 yrs - 36.6 yrs
				Non-performance risk	9.1% - 10.6%	0.42% to 7.47%
Contingent consideration	2,043	3,021	Discounted cash flows	Discount rate	0% - 2.0%	0% - 2.0%
Liabilities of consolidated VIEs	60,708	66,183	Discounted cash flows	Constant prepayment rate	2.4% - 12.0%	1.72% - 15.89%
				Constant default rate	4.9% - 34.5%	4.6% - 34.67%
				Loss severity	33.7% - 100%	34.67% - 100%
				Yield	4.05% - 6.55%	5.25% - 8.4%
				Non-performance risk	9.1% - 12.6%	3.5% - 9.0%

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

Non-Performance Risk

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

Set forth below is information regarding the Company's in-force CDS and other swap contracts and VIE liabilities as of December 31, 2017 and 2016, 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			
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u> ⁽¹⁾
Fair value, before giving effect to Non-Performance Risk.....	\$ 291.9	\$ 325.0	\$ 60.8	\$ 66.4
Less:				
Non-Performance Risk.....	<u>187.8</u>	<u>164.5</u>	<u>0.1</u>	<u>0.2</u>
Fair value, after giving effect to Non-Performance Risk.....	<u>\$ 104.1</u>	<u>\$ 160.5</u>	<u>\$ 60.7</u>	<u>\$ 66.2</u>

⁽¹⁾ The 2016 non-performance risk on VIE liabilities and fair value of VIE liabilities before non-performance risk as previously reported were misstated, and have been revised by \$10.2 million to reflect the correct non-performance risk disclosed within the fair value calculation of the VIE liabilities. The total fair value disclosed was not affected by this revision.

Financial Instruments Not Carried at Fair Value

At December 31, 2017 and 2016, the carrying value of the Company's notes was \$428.9 million and \$396.8 million, respectively. The interest rate on these notes is 5.0% and 6.0% for each series with the first maturity date on such notes scheduled for December 2011 and in June 2024. The fair value of the Company's notes is difficult and complex to estimate as such notes are not listed on any exchange or publicly traded in any market. Any trading activity is inherently limited, and the prices may vary significantly between trades. Based on limited available market data obtained by management, the Company's short-term notes were found to have a price of approximately 114.0 and 93.5 and the Company's long-term notes were found to have a price of approximately 105.0 and 84.5 as of December 31, 2017 and 2016, respectively. These prices were based on total par and paid-in-kind interest, excluding accrued but unpaid interest. Additionally, as described in Note 2, there are many risks and uncertainties affecting the Company that could affect its financial and liquidity position and consequently, the fair value of these notes is subject to significant volatility.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Notes Payable

As part of the consideration paid in connection with the effective defeasance, or in-substance commutation, of certain of the Company's guarantees of CDS contracts pursuant to the 2009 MTA discussed in Note 3, on July 15, 2009, SGI issued \$150.0 million face amount of short-term and \$475.0 million face amount of long-term surplus notes to the counterparties of such CDS contracts. Subsequent to their issuance, \$142.5 million of paid-in-kind interest has been added to the face amount of the surplus notes. As part of the 2012 settlement of RMBS-related claims and other claims with Bank of America Corp. ("BAC") and affiliates thereof, \$48.4 million face amount of surplus notes (\$21.2 million short-term and \$27.2 million long-term) were received back from the Company which included \$7.7 million of paid-in-kind interest. Furthermore, 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. The total face amount of the surplus notes held by third parties as of December 31, 2017 is \$677.1 million. The short-term surplus notes have a 5.00% interest rate and matured on December 28, 2011, and the long-term surplus notes have a 6.00% interest rate and mature on June 27, 2024. The Company recorded the notes at their estimated fair value of \$141.0 million (\$91.2 million for the short-term notes and \$49.8 million for the long-term notes) at the date of their issuance and accretes the discount from the face amount of the notes over the term of the notes using the interest method. As discussed in Note 1, the reallocated surplus notes were recorded at fair value on August 12, 2016 with the discount also accreting over the term of the notes using the interest method. The estimated yield-to-maturity used for both notes was 31.88% at origination; as a result of the August 12, 2016 restructuring, the estimated yield-to-maturity on the long-term surplus notes is 30.11%. The estimated yield-to-maturity on the reallocated surplus notes (long-term surplus notes only) is 12.64%. Such accretion is recorded as interest expense which is reflected in the accompanying consolidated statements of operations. See table below for the par value, carrying value and accrued interest of these surplus notes as of December 31, 2017 and 2016, and interest expense for the years ended December 31, 2017 and 2016:

(U.S. dollars in millions)	Total		Short-term		Long-term	
	2017	2016	2017	2016	2017	2016
Par value	\$ 677.1	\$ 685.6	\$ 121.7	\$ 130.2	\$ 555.4	\$ 555.4
Carrying value	428.9	396.8	121.7	130.2	307.2	266.6
Accrued interest	127.3	126.0	47.0	41.5	80.3	84.5
Interest expense	88.5	71.8	8.7	0.0	79.8	71.8

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

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

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

In connection with the August 12, 2016 restructuring transactions, \$30.0 million of long-term and short-term surplus notes were transferred from the Company to SGI, and cancelled by SGI. \$23.6 million and \$6.4 million of long-term and short-term notes, respectively (including principal, paid-in-kind interest and accrued interest) of surplus notes were cancelled. In addition, upon closing of the transaction, SGI made a net cash payment of \$55.0 million on its long-term and short-term externally held surplus notes after receiving approval from the NYDFS for such payment. The Company will continue to request NYDFS approval for cash payments to holders of surplus notes each calendar year (to be paid in two equal semi-annual installments during such year), beginning in June

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2017. The Company can provide no assurance about whether the NYDFS will approve any future payments on the short-term or long-term surplus notes.

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

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

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

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

10. Liabilities for Unpaid Losses and Loss Adjustment Expenses

The Company's reserve for unpaid losses and loss adjustment expenses as of December 31, 2017 and 2016 consists of case basis reserves, which represent the probability weighted average of the Company's estimates of the present value, discounted at the risk free rate of interest, of expected losses on insured debt obligations that have defaulted or are expected to default. As of December 31, 2017 and 2016, the range of risk free rates used to discount the Company's liability for losses and loss adjustment expenses was 0.0% to 2.69% and 0.0% to 2.77%, respectively.

Activity in the Company's liability for unpaid losses and loss adjustment expenses for the years ended December 31, 2017 and 2016 are summarized as follows:

(U.S. dollars in thousands)

	<u>2017</u>	<u>2016</u>
Gross unpaid losses and loss adjustment expenses at beginning of period	\$ 742,236	\$ 1,007,186
Salvage and subrogation recoverable.....	(101,207)	(87,829)
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses.....	—	—
Net unpaid losses and loss adjustment expenses at beginning of period.....	<u>641,029</u>	<u>919,357</u>
Economic loss development due to:		
Accretion of discount.....	13,112	15,399
Changes in discount rates	775	(9,081)
Changes in timing and assumptions.....	(211,574)	(185,579)
Current year effect for consolidation of VIEs.....	—	—
Net losses and loss adjustment expenses paid	<u>(191,030)</u>	<u>(99,067)</u>
Net unpaid losses and loss adjustment expenses at end of period	252,312	641,029
Salvage and subrogation recoverable ⁽¹⁾	422,687	101,207
Reinsurance balances recoverable on unpaid losses and loss adjustment expenses.....	—	—
Gross unpaid losses and loss adjustment expenses at end of period	<u>\$ 674,999</u>	<u>\$ 742,236</u>

⁽¹⁾For 2017, balance includes the putback benefit related to the settlement of the GreenPoint litigation. See Note 17 for further discussion.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Case Basis Reserves for Losses and Loss Adjustment Expenses

A summary of case basis reserves for losses and loss adjustment expenses as of December 31, 2017 and 2016 are as follows:

(U.S. dollars in millions)

	<u>Gross</u>		<u>Net of Reinsurance</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
HELOC, CES and Alt-A mortgage loan collateral...	\$ 494.5	\$ 576.5	\$ 494.5	\$ 576.5
Public finance.....	172.8	154.8	172.8	154.8
Structured single risk.....	6.4	9.7	6.4	9.7
CDOs.....	1.3	1.2	1.3	1.2
Total.....	<u>\$ 675.0</u>	<u>\$ 742.2</u>	<u>\$ 675.0</u>	<u>\$ 742.2</u>

Reserves for unpaid losses and loss adjustment expenses on the Company's guarantees of obligations supported by HELOC, CES, and Alt-A mortgage loan collateral, both before and after giving effect to reinsurance, were \$494.5 million and \$576.5 million as of December 31, 2017 and 2016, respectively. The change in reserves from December 31, 2016 to December 31, 2017 is primarily attributable to positive loss development of \$68.8 million.

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

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

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

The Company generally observed peak defaults for the second lien transactions in 2009 and 2010. Default rates at December 31, 2017 are mostly forecasted with steady state default rates. Exceptions to this may include transactions for which there is an excessive build-up of severely delinquent loans for which defaults are anticipated or transactions whose collateral includes loans whose interest-only periods will end, at which point temporary increases to default rates are expected.

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

The Company's default assumptions for the first lien transactions at December 31, 2017 and 2016 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 28% to 61% at December 31, 2017 and from 29% to 62% at December 31, 2016 based upon actual loss severity observances and collateral characteristics to determine the expected loss on the collateral in those transactions.

The change in reserves for the Company's guarantees of public finance transactions from December 31, 2016 to December 31, 2017 is primarily attributable to adverse loss development of \$174.1 million substantially offset by losses paid on prior period reserves.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As shown in the table above, gross and net unpaid losses and loss adjustment expenses on structured single risk transactions decreased by \$3.3 million from December 31, 2016 to December 31, 2017, primarily due to payments for loss adjustment expenses.

Schedule of Insured Financial Obligations with Credit Deterioration

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

The Company's surveillance department focuses its review on monitoring lower rated bond sectors and potentially troubled sectors, which have included certain subsectors within the ABS, CDO, Public Finance and Structured Single Risk portfolios. For the ABS and CDO portfolios, it tracks performance monthly to determine whether or not covenants have been breached. If a covenant is breached, the Company may have the right to put the transaction into rapid amortization so that all cash flow generated from that transaction is used to pay down principal and stay current with interest or take other remedial action. Typically, the surveillance department reviews periodic servicing and trustee reports to track coverage levels, enhancement levels, delinquency levels, loss frequency, loss severity and total losses and compares such performance metrics with the metrics that were made available at the time the transaction was closed. If losses are above projections, the surveillance department will analyze the reasons for the deviation. In some cases, it may be an indication of servicing problems, where loans are delinquent and are not put into foreclosure in time to maximize recovery. Typically once per year, the surveillance department will audit servicers of loans and other assets supporting the Company's insured obligations to better understand their servicing practices and to identify potential servicing problems, if any. For the Public Finance portfolio, the surveillance department uses a Frequency of Review Schedule to prioritize reviews to ensure lower rated and larger exposure credits are being looked at more frequently. In addition, the surveillance department uses screening tools to review the entire Public Finance portfolio based upon news feeds, trade data, material event notices and other third party information. For the Structured Single Risk portfolio, the surveillance department will retain technical consultants as needed to track construction and operational risk and reviews this portfolio based upon reports it receives on a monthly, quarterly or annual basis.

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables set forth certain information in regard to the Company's closely monitored credits as of December 31, 2017 and 2016, 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.

(U.S. dollars in millions)	<u>Total</u>		<u>Loss List</u>		<u>Red Flag List</u>		<u>Yellow Flag List</u>		<u>Special Monitoring List</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Insured contractual payments outstanding:										
Principal	\$ 1,597	\$ 3,087	\$ 529	\$ 685	\$ 22	\$ 817	\$ 616	\$ 1,172	\$ 430	\$ 413
Interest	662	1,195	170	196	12	152	390	615	90	232
Total	<u>\$ 2,259</u>	<u>\$ 4,282</u>	<u>\$ 699</u>	<u>\$ 881</u>	<u>\$ 34</u>	<u>\$ 969</u>	<u>\$ 1,006</u>	<u>\$ 1,787</u>	<u>\$ 520</u>	<u>\$ 645</u>
Number of policies	112	238	88	198	3	6	14	19	7	15
Remaining weighted-average contract period (in years)	<u>12.1</u>	<u>10.3</u>	<u>10.0</u>	<u>8.6</u>	<u>11.1</u>	<u>4.4</u>	<u>15.6</u>	<u>14.3</u>	<u>9.6</u>	<u>13.6</u>
Unpaid loss and loss adjustment expenses:										
Gross amount before reductions	\$ 1,537	\$ 1,172	\$ 1,503	\$ 1,093	\$ 10	\$ 18	\$ 24	\$ 61	\$ -	\$ -
Gross estimated recoveries	(602)	(198)	(593)	(125)	-	(16)	(9)	(57)	-	-
Unearned premium revenue ⁽¹⁾	(16)	(21)	(14)	(16)	-	-	(2)	(5)	-	-
Present value discount	(244)	(211)	(243)	(235)	-	8	(1)	16	-	-
Total	<u>\$ 675</u>	<u>\$ 742</u>	<u>\$ 653</u>	<u>\$ 717</u>	<u>\$ 10</u>	<u>\$ 10</u>	<u>\$ 12</u>	<u>\$ 15</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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Exposures Under Guarantees

While the Company establishes reserves for losses and loss adjustment expenses on obligations it has guaranteed or reinsured, the risk of loss under the Company's guarantees extends to the full amount of unpaid principal and interest on all debt obligations it has guaranteed. Set forth below are tables which reflect certain information regarding the Company's in-force principal and interest exposure at December 31, 2017 and 2016. References in the tables below to "Gross" mean that the amounts are before the effect of ceded reinsurance and references to "Net" mean that the amounts are after the effect of ceded reinsurance.

The following table sets forth the Company's in-force guaranteed principal by bond sector as of December 31, 2017 and 2016, respectively:

Bond Exposure
(U.S. dollars in millions)

	<u>NPO⁽¹⁾</u>	
	<u>2017</u>	<u>2016</u>
Public Finance		
Special Revenue	\$ 3,315	\$ 4,406
General Obligation	1,320	2,756
Utility	938	1,713
Non Ad Valorem	691	1,286
Appropriation	335	641
Other	4	4
Total Public Finance	<u>\$ 6,603</u>	<u>\$ 10,806</u>
Asset-Backed Securities		
RMBS	\$ 367	\$ 445
Total Asset-Backed Securities	<u>\$ 367</u>	<u>\$ 445</u>
Collateralized Debt Obligations		
Cashflow CDO	\$ 27	\$ 54
Synthetic CDO	-	150
Total Collateralized Debt Obligations	<u>\$ 27</u>	<u>\$ 204</u>
Structured Single Risk		
Power & Utilities	\$ 5,067	\$ 5,051
Global Infrastructure	2,512	3,419
Specialized Risk	263	441
Total Structured Single Risk	<u>\$ 7,842</u>	<u>\$ 8,911</u>
Total Outstanding	<u>\$ 14,839</u>	<u>\$ 20,366</u>

⁽¹⁾ NPO represents Net Principal Outstanding.

As of December 31, 2017 and 2016, total Gross Principal Outstanding was \$15,431 million and \$21,024 million, respectively.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth the number of years to maturity of the Company's in-force guaranteed principal and interest exposure at December 31, 2017:

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

	<u>Scheduled Net Debt</u>	<u>NPIO⁽¹⁾</u>
2017 Q4	\$ -	\$ 24,629
2018 Q1	310	24,319
2018 Q2	168	24,151
2018 Q3	286	23,865
2018 Q4	247	23,618
Total 2018	<u>\$ 1,011</u>	
2019	\$ 924	\$ 22,694
2020	1,056	21,638
2021	1,303	20,335
2022	1,039	19,296
Total 2019-2022	<u>\$ 4,322</u>	
2023-2027	\$ 4,571	\$ 14,725
2028-2032	3,153	11,572
2033-2037	2,698	8,874
2038 and thereafter	8,874	-
Total 2023-thereafter	<u>\$ 19,296</u>	
Total	<u>\$ 24,629</u>	

⁽¹⁾ NPIO represents Net Principal and Interest Outstanding.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth the Company's in-force guaranteed principal exposure by geographic concentration at December 31, 2017 and 2016, respectively:

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

	<u>NPO</u>		<u>% NPO</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
United States				
California	\$ 2,198	2,790	14.9 %	13.7 %
New York	1,158	1,289	7.8	6.3
Virginia	609	640	4.1	3.1
District Of Columbia	432	446	2.9	2.2
Texas	296	697	2.0	3.4
Florida	255	559	1.7	2.7
Georgia	247	445	1.7	2.2
Puerto Rico	220	339	1.5	1.7
Washington	214	240	1.4	1.2
New Jersey	210	288	1.4	1.4
Massachusetts	208	231	1.4	1.1
Missouri	178	194	1.2	1.0
Tennessee	168	356	1.1	1.7
Colorado	150	200	1.0	1.0
Other ⁽¹⁾	1,261	3,361	8.5	16.6
Non-PF Multi ⁽²⁾⁽³⁾	375	626	2.5	3.1
Total United States	<u>\$ 8,179</u>	<u>\$ 12,701</u>	<u>55.1 %</u>	<u>62.4 %</u>
International				
United Kingdom	\$ 5,034	\$ 4,885	34.0 %	23.9 %
Chile	370	501	2.5	2.5
New Zealand	323	492	2.2	2.4
Australia	258	1,037	1.7	5.1
France	152	149	1.0	0.7
Other ⁽¹⁾	523	508	3.5	2.5
Non-PF Multi ⁽²⁾⁽⁴⁾	-	93	-	0.5
Total International	<u>\$ 6,660</u>	<u>\$ 7,665</u>	<u>44.9 %</u>	<u>37.6 %</u>
Total Par Outstanding	<u>\$ 14,839</u>	<u>\$ 20,366</u>	<u>100.0 %</u>	<u>100.0 %</u>

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

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

⁽³⁾ Consists of \$27 million and \$204 million of CDO net par in 2017 and 2016, respectively, and \$348 million and \$422 million of ABS net par in 2017 and 2016, respectively.

⁽⁴⁾ Consists of zero and \$93 million of SSR net par in 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the total Gross Principal Outstanding was \$15,431 million and \$21,024 million, respectively.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Exposure to Residential Mortgage Market

The Company is exposed to residential mortgages directly, through its insurance guarantees of RMBS.

As of December 31, 2017 and 2016, the Company's total net direct exposure to RMBS aggregated approximately \$0.4 billion (the amount excludes exposure related to guarantees which were effectively defeased or, in-substance, commuted pursuant to ICFs – see Note 3), representing approximately 2.5% of its total in-force guaranteed net principal outstanding at such date. The RMBS exposure consisted of various collateral types as set forth in the table below. The tables below also set forth the Company's internal ratings, as well as the ratings of certain rating agencies, of the insured transactions at December 31, 2017 (excluding exposure related to guarantees which were effectively defeased or, in-substance, commuted pursuant to ICFs as discussed above).

Exposure to RMBS

The following table presents the net principal outstanding for the Company's insured RMBS portfolio by type of collateral⁽¹⁾ as of December 31, 2017 and 2016, respectively:

RMBS Exposure
(U.S. dollars in millions)

	NPO		% NPO	
	2017	2016	2017	2016
Prime (1st lien)	\$ 18	\$ 23	5.0 %	5.2 %
Prime (2nd lien)	7	12	2.0	2.7
Prime (HELOC)	74	99	20.3	22.3
Alt-A (1st lien)	22	26	6.1	5.8
Alt-A (2nd lien)	2	4	0.7	0.8
Subprime (1st lien)	219	245	59.1	55.0
Subprime (2nd lien)	7	14	1.8	3.2
Subprime (1st lien) - International	18	22	5.0	5.0
Total RMBS Outstanding	<u>\$ 367</u>	<u>\$ 445</u>	<u>100.0 %</u>	<u>100.0 %</u>

⁽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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the net principal outstanding and net reserves for unpaid losses for the Company's insured RMBS portfolio by year of origination (year the guarantee was underwritten and issued) as of December 31, 2017. Net principal outstanding in the table below excludes principal effectively defeased or, in-substance, commuted by the Company in connection with its acquisition of ICFs, whereas net reserves for unpaid losses in the table below are reported on the same basis as reflected in the Company's balance sheet (not adjusted to reflect reserves effectively defeased or, in-substance, commuted pursuant to the Company's acquisition of ICFs).

RMBS Exposure

(U.S. dollars in millions)

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Total</u>
Prime/Alt-A	\$ 60	\$ 30	\$ 30	\$ 3	\$ 123
Subprime	8 ⁽¹⁾	93	-	143	244
Total RMBS Outstanding	<u>\$ 68</u>	<u>\$ 123</u>	<u>\$ 30</u>	<u>\$ 146</u>	<u>\$ 367</u>

(U.S. dollars in millions)

Net case reserves for unpaid losses	<u>\$ 22</u>	<u>\$ 100</u>	<u>\$ (322)</u>	<u>\$ 301</u>	<u>\$ 101</u>
-------------------------------------	--------------	---------------	-----------------	---------------	---------------

⁽¹⁾ Includes \$0.3 million relating to business underwritten and issued in 1999.

The following tables show the Company's current internal and rating agency ratings on all of the Company's direct RMBS exposure by deal, grouped by collateral type as of December 31, 2017. The Company's internal ratings are based on its internal credit assessment of each transaction taking into account the overall credit strengths and weaknesses, transaction structure and the trends in the asset sector. The Company bases its analysis on information received from the trustees or from the issuer, as well as on-site visits to issuers, servicers, collateral managers and project sites. Modeling results are also considered. The Company also takes into consideration the ratings agencies' rationale for their ratings; however, variations may exist between the Company's ratings and the ratings of the ratings agencies. Ratings agencies may change their ratings on obligations on a frequent basis and in some cases ratings issued by ratings agencies may be withdrawn by such ratings agencies. Accordingly, the following tables may not reflect the ratings agencies most current published ratings.

RMBS Ratings

(U.S. dollars in millions)

	<u>Vintage</u>	<u>Internal Rating</u>	<u>S&P Rating⁽¹⁾</u>	<u>Moody's Rating⁽¹⁾</u>	<u>NPO</u>
Prime (1st lien)					
1.	2004	bbb+	NR	Ba1	\$ 10
2.	2004	aa	AA+	NR	5
3.	2004	aa	AA+	Ba1	3
Total					<u>\$ 18</u>
Prime (2nd lien)					
1.	2006	d	NR	C	\$ 7
Total					<u>\$ 7</u>

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Prime (HELOC)						
1.	.....	2004	d	CCC	Caa3	\$ 24
2.	.....	2004	d	CCC	Ca	18
3.	.....	2005	d	NR	Ca	8
4.	.....	2006	d	NR	C	19
5.	.....	2006	d	NR	Ca	3
6.	.....	2006	d	NR	Ca	1
7.	.....	2007	d	NR	Ca	1
Total						\$ 74
Alt-A (1st lien)						
1.	.....	2005	bb	AA+	Baa3	\$ 17
2.	.....	2005	d	NR	Caa2	5
Total						\$ 22
Alt-A (2nd lien)						
1.	.....	2007	d	NR	Caa1	\$ 2
Total						\$ 2
Subprime (1st lien)						
1.	.....	2004	aa	AA+	A1	6
2.	.....	2004	a+	AAA	Aaa	2
3.	.....	2005	d	CCC	-	93
4.	.....	2007	c	CCC	C	118
Total						\$ 219
Subprime (2nd lien)						
1.	.....	2007	d	CC	C	\$ 3
2.	.....	2007	bbb-	BBB+	Baa1	2
3.	.....	2007	c	CC	Ca	2
Total						\$ 7
Subprime (1st lien) - International						
1.	.....	2007	bbb	BBB	Baa2	\$ 18
Total						\$ 18
Total RMBS Outstanding						\$ 367

⁽¹⁾ A "-" rating indicates the deal is not rated by the rating agency.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Exposure to CDOs

The following table presents the net notional exposure of the Company's guaranteed CDOs by type⁽¹⁾ of referenced asset as of December 31, 2017 and 2016, respectively. A CDO is a security that is collateralized by, or synthetically references, a pool of debt obligations such as corporate loans, bonds and ABS:

CDO Exposure

(U.S. dollars in millions)

	NPO		% NPO		# of Credits	
	2017	2016	2017	2016	2017	2016
Cashflow CDO						
TRUPS CDO	\$ 25	\$ 37	91.8 %	18.1 %	2	2
ABS CDO	2	2	8.2	1.1	1	1
US CLO	-	15	-	7.2	-	1
Total Cashflow CDO	\$ 27	\$ 54	100.0 %	26.4 %	3	4
Synthetic CDO						
Corporate Synthetic CDO	\$ -	\$ 150	-	73.6 %	-	1
Total Synthetic CDO	\$ -	\$ 150	-	73.6 %	-	1
Total Collateralized Debt Obligations Outstanding	\$ 27	\$ 204	100.0 %	100.0 %	3	5

⁽¹⁾ Asset type is defined as follows. A Cash flow CDO is a securitized bond that is collateralized by a pool of debt obligations such as corporate loans, bonds and ABS. A US CLO is a CDO with underlying collateral primarily consisting of senior secured bank loans made to corporate entities domiciled in the United States and rated below investment grade at inception (i.e., rated below "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch). A Euro CLO is a CDO with underlying collateral primarily consisting of senior secured bank loans made to corporate entities domiciled in Europe and generally rated below investment grade at inception (i.e., rated below "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch). A Trups CDO is a CDO with underlying collateral primarily consisting of trust preferred securities issued by bank holding companies. A Multi-Sector CDO is a CDO with underlying collateral primarily consisting of ABS securities (including less than 50% RMBS bonds). An ABS CDO is a CDO with underlying collateral primarily consisting of RMBS bonds (greater than 50%) and other ABS securities.

A Synthetic CDO is a CDO that synthetically references a portfolio of debt obligations through the use of credit default swaps. A CMBS CDO is a CDO that synthetically references a portfolio of Commercial Mortgage Backed Securities. A Corporate Synthetic CDO is a CDO that references a pool primarily consisting of senior unsecured corporate credits rated investment grade at inception (i.e., rated at least "BBB-" by S&P, "Baa3" by Moody's and "BBB-" by Fitch or higher).

The following table presents the net notional exposure of the Company's guaranteed CDOs by rating as of December 31, 2017:

CDO Ratings⁽¹⁾

(U.S. dollars in millions)

	NPO	% NPO
AAA	\$ 25	91.8 %
Below Investment Grade	2	8.2
Total Collateralized Debt Obligations Outstanding	\$ 27	100.0 %

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Insurance Premiums

As of December 31, 2017, the Company reported a premium receivable of \$92.8 million primarily related to installment policies for which premiums will be collected over the term of the contracts. Premiums are discounted at a risk-free rate that considers the expected maturity of each contract. The weighted average risk-free rate used to discount future installment premiums was 2.6% and the weighted average collection term of the premium receivable was 12.43 years. For the year ended December 31, 2017, the accretion of the premium receivable was \$2.7 million and is reported in “Premiums earned” on the accompanying consolidated statement of operations. As of December 31, 2017, the Company reported a reinsurance premium payable of \$12.9 million, which represents the portion of the Company’s premium receivable that is due to reinsurers. The reinsurance premium payable will be accreted and paid, as premiums due to the Company are accreted and collected. The following table presents a roll forward of the Company’s premium receivable for the years ended December 31, 2017 and 2016:

(US dollars in thousands)	2017	2016
Premium receivable, beginning of period.....	\$ 117,728	\$ 133,516
Premium payments received.....	(12,093)	(14,121)
Adjustments:		
Changes in expected term of policies	(15,536)	(4,938)
Accretion of premium receivable discount	2,725	3,271
Premium receivable, end of period	<u>\$ 92,824</u>	<u>\$ 117,728</u>

The following table presents the Company’s installment premiums on direct business expected to be collected in the future and the periods in which such collections are expected to occur, the expected unearned premium revenue balance and the expected future premium earnings of the Company’s direct in-force business as of and for the periods presented. In addition to that presented in the table below, the Company had installment premiums receivable of \$18.4 million (on a present value basis) and unearned premium revenue of \$41.7 million relating to assumed reinsurance business at December 31, 2017:

(U.S. dollars in thousands)	Expected Collection of Premiums	Unearned Premium Revenue	Expected Premium Earnings			
			Upfront	Installments	Accretion	Total
Three months ended:						
March 31, 2018	\$ 2,649	\$ 179,651	\$ 2,398	\$ 1,598	\$ 587	\$ 4,583
June 30, 2018	1,403	175,688	2,399	1,564	570	4,533
September 30, 2018	1,133	171,821	2,328	1,539	559	4,426
December 31, 2018	<u>962</u>	<u>168,018</u>	<u>2,274</u>	<u>1,530</u>	<u>547</u>	<u>4,351</u>
Twelve months ended:						
December 31, 2019	6,038	153,262	8,789	5,966	2,068	16,823
December 31, 2020	5,910	139,377	8,255	5,630	1,869	15,754
December 31, 2021	5,251	126,470	7,699	5,209	1,681	14,589
December 31, 2022	<u>4,942</u>	<u>114,721</u>	<u>7,144</u>	<u>4,605</u>	<u>1,520</u>	<u>13,269</u>
Five years ended:						
December 31, 2027	20,857	68,877	27,405	18,439	5,445	51,289
December 31, 2032	14,528	39,234	18,221	11,422	2,795	32,438
December 31, 2037	9,320	18,666	14,092	6,476	893	21,461
December 31, 2042	1,559	10,247	7,264	1,155	111	8,530
December 31, 2047	318	5,963	4,053	231	27	4,311
December 31, 2052	58	2,124	3,797	42	1	3,840
December 31, 2057	-	27	2,097	-	-	2,097
December 31, 2062	<u>-</u>	<u>-</u>	<u>27</u>	<u>-</u>	<u>-</u>	<u>27</u>
Total	<u>\$ 74,928</u>		<u>\$ 118,242</u>	<u>\$ 65,406</u>	<u>\$ 18,673</u>	<u>\$ 202,321</u>

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following sets forth the components of premiums earned for the years ended December 31, 2017 and 2016:

	2017	2016
(U.S. dollars in thousands)		
Gross premiums written	\$ (15,324)	\$ 1,880
Reinsurance premiums assumed.....	(114)	2,887
Total premiums written.....	(15,438)	4,767
Change in direct unearned premium revenue	60,796	71,654
Change in assumed unearned premium revenue	7,136	2,350
Gross premiums earned.....	52,494	78,771
Reinsurance premiums ceded.....	(1,255)	1,402
Change in prepaid reinsurance premiums	(158)	(3,019)
Ceded premiums earned.....	(1,413)	(1,617)
Net premiums earned	\$ 51,081	\$ 77,154

For the years ended December 31, 2017 and 2016, net premiums earned include \$24.8 million and \$43.2 million, respectively, of earned premium relating to Premium Accelerations.

13. Deferred Acquisition Costs and Deferred Ceding Commissions

Deferred acquisition costs, net of deferred ceding commission revenue, as well as related amortization, as of and for the years ended December 31, 2017 and 2016 are as follows:

	2017	2016
(U.S. dollars in thousands)		
Deferred acquisition costs, net—beginning of period	\$ 42,614	\$ 54,243
Acquisition costs and ceding commission revenue amortized:		
Acquisition costs amortized	(7,717)	(11,679)
Ceding commission revenue amortized	33	50
Amortization of deferred acquisition costs	(7,684)	(11,629)
Deferred acquisition costs, net—end of period	\$ 34,930	\$ 42,614

Accelerated amortization of deferred acquisition costs due to Premium Accelerations was \$3.8 million and \$6.8 million for the years ended December 31, 2017 and 2016, respectively.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Accumulated Other Comprehensive Income

Changes in accumulated other comprehensive income for the years ended December 31, 2017 and 2016 by component are as follows:

(U.S. dollars in thousands)	2017	2016
Available-for-sale securities		
Balance, Beginning.....	\$ 3,951	\$ (237)
Other comprehensive income before reclassifications	18,608	1,292
Amounts reclassified from accumulated other comprehensive income:		
Realized gains on sale of securities.....	(7,157)	(3,298)
Foreign currency impairment losses.....	14,303	-
Other-than-temporary impairments.....	958	6,194
Current period other comprehensive income, net.....	26,712	4,188
Balance, Ending.....	\$ 30,663	\$ 3,951
Unrecognized pension and post retirement benefit costs		
Balance, Beginning.....	\$ (154)	\$ 643
Other comprehensive income (loss) before reclassifications	(300)	(799)
Amounts reclassified from accumulated other comprehensive income:		
Reclassify amortization and effect of terminations and curtailments of pension and other post-retirement benefit amounts to net income.....	806	2
Current period other comprehensive (loss), net.....	506	(797)
Balance, Ending.....	\$ 352	\$ (154)
Total.....	\$ 31,015	\$ 3,797

15. 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. net operating losses (“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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company’s income tax (benefit) provision for the years ended December 31, 2017 and 2016 was \$(4.8) million and \$4.8 million, respectively.

The (benefit) provision for income taxes incurred is different from that which would be obtained by applying the U.S. Federal income tax rate to income before income tax expense. The difference between the expected and actual tax benefit or expense for the years ended December 31, 2017 and 2016 is primarily attributable to the following items discussed below:

(U.S. dollars in thousands)

	<u>2017</u>	<u>2016</u>
Theoretical Federal income tax expense at U.S. statutory rate of 35%	\$ 45,191	\$ 13,313
Change in valuation allowance ⁽¹⁾	(518,158)	(30,084)
LLC outside basis	68,799	-
Tax-exempt interest income	(10)	(2,349)
Enactment of new tax reform	411,283	-
Non-deductible restructuring costs	-	3,636
Cancellation of debt income	-	16,925
Other ⁽¹⁾	(11,898)	3,314
Consolidated income tax (benefit) expense	<u>\$ (4,793)</u>	<u>\$ 4,755</u>

⁽¹⁾ In 2016, the change in valuation allowance disclosed in the reconciliation includes the effect of the revisions made to the deferred income tax inventory, which decreased the valuation allowance by \$30.1 million from \$1,174.7 million in 2015 to \$1,144.6 million in 2016. The change in valuation allowance was therefore revised from \$33.7 million (previously disclosed) to \$30.1 million. The Other line item of \$7.0 million (previously disclosed) in the reconciliation was revised to \$3.3 million. The total pre-tax income and tax amounts in the reconciliation remained unchanged.

As of December 31, 2017 and 2016, 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 years ended December 31, 2017 and 2016. Tax years 2014 through 2017 are subject to examination by U.S. federal authorities. There are currently no state or local tax audits underway for the Company as of December 31, 2017. However, there is a U.S. federal tax audit underway for tax year 2016.

At December 31, 2017, the Company had net operating loss carryforwards expiring from 2027 through 2037 of \$2.6 billion.

At December 31, 2017, the Company had capital loss carryforwards of \$178.3 million expiring from 2018 through 2022.

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Syncora Holdings' and Syncora Guarantee's net deferred tax assets and liabilities as of December 31, 2017 and 2016 consist of the following:

(U.S. dollars in thousands)	<u>2017</u>	<u>2016</u>
Deferred Tax Assets:		
Loss reserves and loss adjustment expenses	\$ 96,275	\$ 328,012
Credit default swaps at fair value	21,860	56,144
NOL and capital loss carryforwards	584,845	974,244
Other	11,973	2,413
Total gross deferred tax assets	<u>714,953</u>	<u>1,360,813</u>
Valuation allowance	<u>(616,986)</u>	<u>(1,144,670)</u>
Total net deferred tax assets	<u>97,967</u>	<u>216,143</u>
Deferred Tax Liabilities:		
Deferred acquisition costs	7,335	14,915
Insurance cash flow certificates	23,072	71,318
Installment premiums receivable ⁽¹⁾	15,494	34,640
Surplus notes original issue discount	52,128	101,079
Total deferred tax liabilities	<u>98,029</u>	<u>221,952</u>
Net deferred tax assets/(liabilities)	<u>\$ (62)</u>	<u>\$ (5,809)</u>

⁽¹⁾ The 2016 deferred tax assets and liabilities as previously reported were misstated and have been revised by \$42.3 million primarily as a result of including a new \$34.6 million deferred tax liability related to a temporary difference arising from future installment premiums. The effects of including this deferred tax liability and the other adjustments recorded are fully offset by a reduction to valuation allowance.

The most significant items giving rise to deferred tax assets as of December 31, 2017 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 December 31, 2017 and 2016. The valuation allowance was calculated in accordance with the provisions of the accounting pronouncements for income taxes, which place primary importance on operating results in recent periods when assessing the need for a valuation allowance. The Company intends to maintain a full valuation allowance for its net U.S. deferred tax assets until sufficient positive evidence exists to support reversal of all or a portion of the valuation allowance.

As of December 31, 2017 and December 31, 2016, the Company recorded net deferred tax liabilities of \$0.1 million and \$5.8 million, respectively, and are included in "Other liabilities" on the Company's consolidated balance sheet.

At December 31, 2017, 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 December 31, 2017 expires from 2027 through 2037. Approximately \$161.3 million of the Company's NOLs are subject to limitation under Section 382 of the Internal Revenue Code ("Section 382") as a result of an ownership change, as defined under that code section that occurred on August 5, 2008. An ownership change, as defined under Section 382 generally occurs if the percentage stock ownership of shareholders owning (or deemed under Section 382 to own) 5% or more of Syncora Holdings' common shares increases by more than 50 percentage points over the lowest percentage of Syncora Holdings' common shares owned by such shareholders during a defined period of time. To avoid an ownership change in the future and further limitation on the use of the Company's NOLs, on October 21, 2008, Syncora Holdings' Board of Directors approved changes to Syncora Holdings' Bye-laws which were subsequently approved by the shareholders on February 9, 2009 to limit the transfer of shares prior to the expiration of certain time periods specified in such bye-laws.

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

The Company's significant NOLs are expected to reduce future U.S. tax liability that otherwise would be payable by the Company. The ability to utilize these NOLs would be limited in certain events, including if an "ownership change" under Section 382 were to occur. Section 382 limits the ability of a corporation that experiences an ownership change to utilize its NOLs and certain

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

16. Preferred and Common Shares

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

On February 11, 2008, Syncora Guarantee Re Ltd., a former affiliate of SGI issued 2,000 shares of non-cumulative perpetual Series B preferred shares (the "Series B Preferred Shares") for consideration aggregating \$200 million pursuant to the exercise of a put option under its capital facility. The put option fair value was \$180.0 million at date of exercise. Upon the exercise of the put option, the Company reduced the amount of the Series B Preferred Shares by such amount. Accordingly, the original carrying value of the Series B Preferred Shares of \$20.0 million represented the net proceeds received upon the issuance less the reversal of the fair value of the put option on the date of exercise. After the merger of Syncora Guarantee Re 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 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.

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 years ended December 31, 2017 and 2016. In connection with the BAC settlement, SGI holds 655 shares of its non-cumulative perpetual Series B preferred shares, which were transferred by BAC.

Series A Perpetual Non-Cumulative Preferred Shares

On April 5, 2007, Syncora Holdings consummated a private placement sale of \$250.0 million of its Series A Preferred Shares. Net proceeds from the offering were \$246.6 million after offering costs of \$3.4 million. The Series A Preferred Shares were perpetual securities with no fixed maturity date and, if declared by the Board of Syncora Holdings, pay a fixed dividend, on a semi-annual basis during the first and third quarters of each fiscal year, at the annualized rate of 6.88% until December 31, 2017. After such date, the Series A Preferred Shares, if declared by the Board of Syncora Holdings, were to pay dividends, on a quarterly basis, at a floating rate based on three-month LIBOR plus 2.715%. Dividends on the Syncora Holdings Series A Preferred Shares were non-cumulative. The Syncora Holdings Series A Preferred Shares have a liquidation preference of \$1,000 per preferred share. There were 250,000 Syncora Holdings Series A preferred shares outstanding. In February 2015, the Company's subsidiary, SGI, was transferred 84,584 preferred shares of the Company from BAC in connection with the Company's previously reported 2012 settlement of RMBS-related claims and other claims with BAC and affiliates thereof. Such preferred shares were held as treasury shares. As a result of this transfer and based on accounting guidance for extinguishment of preferred shares, Syncora Holdings recorded a reduction to the carrying value of its Series A preferred shares with a corresponding reduction to accumulated deficit. For purposes of earnings per share to common shareholders, this transfer was reflected as a gain which increased the net income available to common shareholders.

In connection with the completed restructuring transaction as discussed in Note 1, all of the Syncora Holdings Series A Preferred Shares were cancelled, including the shares held as treasury and no Syncora Holdings Series A Preferred Shares remain outstanding. As a result of the restructuring transaction related to the conversion of the Syncora Holdings Series A Preferred Shares, based on accounting guidance for extinguishment of preferred shares, Syncora Holdings recorded a reduction to the carrying value of its Series A preferred shares with a corresponding reduction to accumulated deficit. For purposes of earnings per share to common shareholders, this conversion resulted in a gain, which increased the net income available to common shareholders.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 18 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.

17. Commitments and Contingencies

a. Legal Matters

In the ordinary course of business, the Company is directly or indirectly subject to litigation or other legal proceedings. The Company intends to vigorously defend itself and its interests, and the Company does not expect the outcome of these matters to have a material adverse effect on the Company's financial position, results of operations or liquidity. The Company can provide no assurance that the ultimate outcome of these actions will not cause a loss nor have a material adverse effect on the Company's financial position, results of operations or liquidity.

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

US Bank v. GreenPoint Mortgage

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

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

ARPA Litigation

The Arkansas River Power Authority ("ARPA") is a six member joint action agency in Colorado formed to provide electricity to its constituent municipalities. ARPA's members are contractually obligated to purchase their electricity requirements from ARPA. ARPA attempted to convert an existing natural gas-fired generator in Lamar, Colorado to a coal-fired facility and to raise funds for this project, ARPA issued several series of bonds guaranteed by the Company. The Lamar plant is not currently operating.

In 2014, Lamar, Colorado (one of the six ARPA member municipalities) and others, filed a series of suits against ARPA and Syncora Guarantee alleging that ARPA mismanaged the project and seeking, among other things, to terminate its membership in ARPA. Syncora Guarantee is no longer named as a party in these litigations.

The parties settled this litigation and it was dismissed in November 2017.

Macquarie Litigation

On April 18, 2012, Syncora Guarantee initiated an action in the Supreme Court of the State of New York against Macquarie Capital (USA) Inc. ("Macquarie"), among others. The case remains pending only against Macquarie, with Syncora Guarantee having entered into a stipulation dismissing the other defendants from the lawsuit. Syncora Guarantee alleges that Macquarie made misrepresentations and omissions in obtaining insurance in connection with a bond offering by American Roads LLC. Macquarie's initial motion to dismiss the claims was denied in its entirety and decided in Syncora Guarantee's favor. On September 28, 2015,

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Syncora Guarantee filed a motion to amend its complaint to include additional allegations against Macquarie. In May 2016, Macquarie filed a motion to dismiss Syncora Guarantee's amended complaint and, in the alternative, to narrow any claims and damages. On February 15, 2017, the court ruled on Macquarie's motion to dismiss. The court sustained Syncora Guarantee's fraud and negligent misrepresentation claims for compensatory damages but dismissed Syncora Guarantee's claims for "rescissory" damages and punitive damages. The court also rejected Macquarie's request to strike the amended complaint's reference to Section 3105. On January 17, 2018, Macquarie appealed the trial court's ruling in respect of Syncora Guarantee's compensatory damages.

Pretrial discovery concluded on February 1, 2018. The court has set July 11, 2018 as the trial date.

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, the District Court for the District of Puerto Rico entered an order denying the motion. On September 28, 2017, Syncora and the other creditors appealed the decision to the United States Court of Appeals for the First Circuit.

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

Fir Tree Managed Trusts v. Syncora Guarantee

On April 24, 2017, certain RMBS recovery trusts managed by Fir Tree Partners, Inc. sued Syncora Guarantee in New York State Court seeking a portion of Syncora Guarantee's \$400 million 2014 settlement with JPMorgan as well as certain additional amounts that Syncora Guarantee has received and may receive as reimbursements. As of December 31, 2017, Syncora Guarantee has resolved this litigation.

Reliance Rail Litigation

In 2006, Reliance Rail was granted the concession from the New South Wales Government to design, construct, deliver, and maintain 78 commuter trains for the public rail service in Sydney, Australia. Reliance Rail raised debt for the project through its finance subsidiary, which was completed on December 7, 2006. Syncora Guarantee provided certain financial guarantee insurance policies in connection with the bonds and swaps issued by Reliance Rail. Reliance Rail is now seeking to refinance its current debt obligations.

On June 21, 2017, Reliance Rail brought suit in the Supreme Court of New South Wales against the trustees for the bondholders seeking a declaration from the court that Reliance Rail is entitled to redeem the bonds prior to their stated maturity dates at the outstanding par amounts without payment of any premium amounts.

On July 27, 2017, the plaintiffs filed an amended summons joining Syncora Guarantee and FGIC UK Limited, among others, as defendants to the proceedings. The amended summons sought further declarations from the court that Syncora Guarantee and FGIC UK Limited are authorized to approve certain changes in the underlying documentation proposed by Reliance Rail related to indemnities given to lenders including the bondholders.

In November 2017, the litigation was resolved and Reliance Rail successfully completed a refinancing of its debt. With the refinancing complete Syncora Guarantee removed this credit from its insured exposure.

b. Lease and Other Commitments

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

In June 2016, the Company entered into an amended two year agreement with International Business Machines Corporation for information technology outsourcing services, effective January 1, 2017. Fees associated with the agreement are expected to be approximately \$1.3 million in 2018.

Net minimum aggregate lease commitments are \$1.0 million, \$0, \$0, \$0 and \$0 for the years ended December 31, 2018 through December 31, 2022.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Net rent expense was \$1.2 million and \$1.1 million for the years ended December 31, 2017 and 2016, respectively.

18. Dividend Restrictions and Insurance Regulatory Requirements

Syncora Holdings

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

SGI

The ability of SGI to declare and pay a dividend to shareholders is governed by applicable New York law, including the NYIL. Under Section 4105 of the NYIL, SGI is permitted to pay dividends to shareholders in any 12-month period, without the prior approval of the NYDFS in an amount equal to the lesser of 10% of its policyholders' surplus as of last financial statement filed with the NYDFS (annual or quarterly) or their adjusted net investment income for the 12-month period, as determined in accordance with Statutory Accounting Practices prescribed or permitted by the NYDFS. The NYIL also provides that SGI may distribute dividends to shareholders in excess of the aforementioned amount only upon approval thereof by the NYDFS. Even if these tests are satisfied, NYIL provides a further test in that SGI may not declare or distribute any dividends to shareholders except out of "earned surplus" (an amount equal to "unassigned funds (surplus)" as shown on SGI's statutory balance sheet, which as of December 31, 2017 and 2016 was \$554.1 million and \$417.1 million, less its "unrealized appreciation of assets"). As of December 31, 2017, SGI's unrealized appreciation of assets was \$6.2 million. The NYDFS may disapprove such dividends to shareholders if it finds that SGI will retain insufficient surplus to support its obligations and writings.

As discussed in Note 1, 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 a result of this permitted practice, SGI reclassified its gross paid in and contributed surplus balance of \$2.0 billion to earned surplus at September 30, 2016.

Pursuant to the terms of the 2009 MTA, SGI is not permitted to pay dividends or repurchase, redeem, exchange or convert any equity securities until such time as all notes issued by SGI (see Note 9) are paid in full.

Among other requirements, Article 69 of the NYIL provides that financial guarantee insurance companies maintain minimum policyholders' surplus of \$66 million. In accordance with accounting practices prescribed or permitted by the NYDFS, as of December 31, 2017 and 2016, SGI reported policyholders' surplus of \$1,317.6 million and \$1,188.3 million, respectively. For the years ended December 31, 2017 and 2016, SGI reported net income of \$70.5 million and \$45.3 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.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 years ended December 31, 2017 and 2016 and as of December 31, 2017 and 2016. As a result of the merger with SCAI, all prior year 2016 financial statement information was restated to include SCAI's financial information as if it was merged as of the beginning of the prior year.

SGI

(U.S. Dollars in thousands)

Description	Net Income		Capital and Surplus	
	Year Ended December 31,		December 31,	
	2017	2016	2017	2016
NAIC SAP Basis	\$ 169,225	\$ 269,937	\$ 182,000	\$ 2,911
Effect of NY prescribed practices				
(a)	-	-	-	-
Effect of NY permitted practices				
(b)	-	-	878,669	816,529
(c)	(98,688)	(222,448)	207,791	306,479
(d)	-	-	-	-
(e)	-	(2,233)	49,164	62,365
(f)	-	-	-	-
NY Basis	\$ 70,537	\$ 45,256	\$ 1,317,624	\$ 1,188,284

Permitted or Prescribed Practices

- (a) Pursuant to certain prescribed accounting practices under Articles 14 and 69 of the NYIL that differ with those found in NAIC SAP, the admissible carrying value of a share of an insurer is limited to a stipulated percentage of policyholders' surplus, and investments in certain securities (including the Uninsured Cash Flow Certificates) are also subject to limitations. In connection with the 2009 MTA, the NYDFS permitted the Company to admit these assets notwithstanding the otherwise applicable limitations, which resulted in no difference between NAIC SAP and NY basis.
- (b) Pursuant to approval granted by the NYDFS in accordance with section 6903 of the NYIL, as of December 31, 2017 and December 31, 2016, SGI has de-recognized \$878.7 million and \$816.5 million, respectively, in the aggregate, of contingency reserves on terminated policies, and policies on which the Company has established case reserves, whereas under NAIC SAP the Company would still be required to carry such reserves. The Company applied the permitted practice described above to release contingency reserves on an obligation by obligation basis under policies insuring multiple obligations rather than on a policy by policy basis. In addition to the foregoing, the Company released contingency reserves based on a methodology pursuant to a permitted practice granted by the NYDFS.
- (c) The NYDFS granted the SGI a permitted practice to de-recognize reserves for unpaid losses, unearned premium reserve and contingency reserves relating to, and expense payments (which are reflected in "Net losses and loss adjustment expenses" on the Statements of Operations and Changes in Capital and Surplus ("Statements of Operations")) made to effect, certain transactions executed in connection with its continued remediation efforts which effectively defeased or, in-substance, commuted, in whole or in part, the policies relating thereto, whereas under NAIC SAP such reserves would continue to be carried until such time the underlying contracts were legally extinguished and the payments made to effect the transactions would have resulted in the recording of an asset, as such payments were made in exchange for the assignment to the Company or an affiliate of the Company of all rights under the aforementioned policies. As of December 31, 2017, such de-recognized reserves for unpaid losses, unearned premium reserve and contingency reserves (as of the date of the effective defeasance or, in-substance commutations) aggregated \$6.2 billion, \$17.4 million and \$4.9 million, respectively. As of December 31, 2016, such de-recognized reserves for unpaid losses, unearned premium reserve and contingency reserves (as of the date of the effective defeasance or, in-substance commutations) aggregated \$6.2 billion, \$17.4 million and \$4.9 million, respectively. As of December 31, 2015, the Company no longer sought approval for the de-recognition of unpaid losses, unearned premium reserves and contingency reserves relating to, and expense payments made which effectively defeased or, in-substance, commuted certain CDS contracts executed in connection with the consummation of the 2009 MTA and that were previously disclosed on an aggregate basis. As such CDS contracts were legally extinguished as of December 31, 2015, the associated reserves were released under NAIC SAP resulting in no difference between NAIC SAP and NY basis, and therefore the permitted practice is no longer required.
- (d) The NYDFS granted the Company a permitted practice to value the surplus notes issued by the Company in settlement of certain policy obligations in connection with the 2009 MTA at original face value of \$625.0 million in the aggregate, as compared to the estimated fair value thereof, that the Company would otherwise have been required to reflect such surplus notes in accordance with NAIC SAP. Any adjustment to the carrying value of surplus notes would result in an equal and offsetting adjustment to unassigned funds. As both surplus notes and unassigned funds are elements of policyholders' surplus, a change in the value of the surplus notes would not affect policyholders' surplus.
- (e) The NYDFS granted the Company a permitted practice to account for its ownership of the common stock of American Roads LLC entities as salvage recoverable using a discounted cash flow model, which is deducted from the liability for unpaid claims or losses, whereas under NAIC SAP, the Company would be required to record its 100% equity ownership of the American Roads LLC entities using GAAP equity value.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (f) In connection with the Restructuring Transactions (as defined in Note 1) completed on August 12, 2016, the NYDFS granted the Company permission to increase its earned surplus to the greatest extent possible given its current gross paid in and contributed surplus by allocating the entire balance of that account to earned surplus. As both earned surplus and gross paid in and contributed surplus are elements of policyholders' surplus, this permitted practice has no effect on total policyholders' surplus.

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

As of December 31, 2017 and 2016, the Company had, in the aggregate, approximately \$41.2 million and \$78.2 million, respectively, on deposit to collateralize its contractual obligations under certain agreements, including reinsurance, lease and letter of credit agreements. Of such deposits, \$2.6 million and \$4.9 million, \$10.4 million and \$15.5 million and \$28.2 million and \$57.8 million are recorded on the accompanying consolidated balance sheet in "Restricted cash and cash equivalents", "Other assets" and "Debt securities, available for sale, at fair value", respectively. In addition, debt securities with an amortized cost and fair value of \$6.3 million and \$6.5 million at December 31, 2017 and \$6.2 million and \$6.4 million at December 31, 2016, respectively, were on deposit with various regulatory authorities as required by insurance laws.

20. 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 December 31, 2017 and 2016 and for the years ended December 31, 2017 and 2016 are set forth below:

(U.S. dollars in thousands)	<u>2017</u>	<u>2016</u>
Assets		
Debt securities available for sale, at fair value (amortized cost: \$5,333 and \$1,970)	\$ 5,442	\$ 2,090
Cash and cash equivalents	1,312	512
Accrued investment income.....	23	7
Investment in subsidiaries on an equity basis:		
Syncora Guarantee Inc.....	659,149	496,653
Other subsidiaries	19,878	19,575
Other assets.....	155	5,824
Total assets.....	<u>\$ 685,959</u>	<u>\$ 524,661</u>
Liabilities and Shareholders' Equity		
Liabilities— accounts payable, accrued expenses, and other liabilities	<u>\$ —</u>	<u>\$ —</u>
Shareholders' equity		
Common shares and additional paid-in capital.....	2,716,798	2,716,220
Accumulated deficit	(2,061,854)	(2,195,356)
Accumulated other comprehensive income.....	31,015	3,797
Total shareholders' equity.....	<u>685,959</u>	<u>524,661</u>
Total liabilities and shareholders' equity.....	<u>\$ 685,959</u>	<u>\$ 524,661</u>

**SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

	2017	2016
Revenues		
Net investment income.....	\$ 60	\$ 36
Total revenues.....	60	36
Operating expenses	2,544	2,657
Loss before equity in net income of subsidiaries	(2,484)	(2,621)
Equity in net income of Syncora Guarantee Inc.	135,271	35,239
Equity in net income of other subsidiaries.....	715	32
Equity in net income of subsidiaries	135,986	35,271
Net income attributable to Syncora Holdings Ltd.	133,502	32,650
Other comprehensive income:		
Net unrealized (losses) gains on investments	(7)	13
Equity in other comprehensive income of Syncora Guarantee Inc.	27,225	3,378
Total other comprehensive income	27,218	3,391
Total comprehensive income	160,720	36,041
Effect of restructuring transactions.....	—	(47,952)
Change in common shares and additional paid-in-capital	578	37,874
Change in shareholders' equity	161,298	25,963
Total shareholders' equity- beginning of period	524,661	498,698
Total shareholders' equity- end of period	\$ 685,959	\$ 524,661
	2017	2016
Cash flows from operating activities:		
Operating expenses paid	\$ (2,811)	\$ (2,382)
Investment income collected.....	42	44
Other cash receipts (disbursements)	6,480	(281)
Net cash provided by (used in) operating activities	3,711	(2,619)
Cash flows from investing activities:		
Proceeds from sale of debt securities.....	500	100
Proceeds from maturity of debt securities.....	930	2,212
Purchases of debt securities	(4,341)	(402)
Net cash (used in) provided by investing activities	(2,911)	1,910
Increase (decrease) in cash and cash equivalents.....	800	(709)
Cash and cash equivalents—beginning of period	512	1,221
Cash and cash equivalents—end of period.....	\$ 1,312	\$ 512

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21. Assets and Liabilities Held-for-Sale and Discontinued Operations of American Roads LLC

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

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

The following table summarizes the components of assets and liabilities held-for-sale of American Roads LLC on the consolidated balance sheets as of December 31, 2017 and December 31, 2016.

(U.S. dollars in thousands)	2017	2016
ASSETS		
Debt securities, available-for-sale, at fair value.....	\$ 2,810	\$ 2,802
Cash and cash equivalents	36,652	21,533
Total cash and invested assets	39,462	24,335
Restricted cash and bank time deposits	194	2,105
Property and equipment, net.....	51,655	48,802
Leasehold rights and other definite-lived intangible assets, net.....	6,451	7,713
Toll rights and other indefinite-lived intangible assets	94,492	94,492
Other assets.....	3,286	2,310
Total assets of entity held-for-sale.....	\$ 195,540	\$ 179,757
LIABILITIES		
Accounts payable, accrued expenses and other liabilities.....	8,635	6,409
Pension and other postretirement liabilities	11,793	11,475
Total liabilities of entity held-for-sale	\$ 20,428	\$ 17,884

The following table summarizes the components of Income from discontinued operations for American Roads LLC for the years ended December 31, 2017 and 2016.

(U.S. dollars in thousands)	2017	2016
Revenues		
Toll revenue.....	\$ 27,341	\$ 27,769
Net investment income	135	421
Fees and other income	4,105	4,189
Total revenues	31,581	32,379
Expenses		
Foreign currency exchange gain	(142)	(3)
Operating expenses	19,201	19,334
Total expenses	19,059	19,331
Income from discontinued operations	12,522	13,048
Other comprehensive income (loss) from discontinued operations	511	(797)
Comprehensive income from discontinued operations	\$ 13,033	\$ 12,251

The income from discontinued operations does not include any income taxes since American Roads LLC is not a tax paying entity and is part of a consolidated U.S. federal tax return with Syncora Holdings U.S. Inc. See Note 15 for further discussion.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the components of cash flow information for American Roads LLC for the years ended December 31, 2017 and 2016.

(U.S. dollars in thousands)	2017	2016
Cash flows from operating activities:		
Tolls collected	\$ 27,842	\$ 27,380
Management fees received.....	702	527
Other operating cash receipts.....	3,475	3,667
Cash paid for operating expenses.....	(15,307)	(13,000)
Interest and dividend income collected.....	134	321
Net cash provided by operating activities of discontinued operations.....	16,846	18,895
Cash flows from investing activities:		
Proceeds from sale of investments.....	807	21,660
Purchases of investments.....	(841)	(5,239)
Purchases of property and equipment	(3,604)	(918)
Net cash (used in) provided by investing activities of discontinued operations	(3,638)	15,503
Cash flows from financing activities:		
Distribution to parent company.....	—	(32,412)
Net cash used in financing activities of discontinued operations.....	—	(32,412)
Increase in cash and cash equivalents and restricted cash and bank time deposits	13,208	1,986
Cash and cash equivalents and restricted cash and bank time deposits- beginning of period.....	23,638	21,652
Cash and cash equivalents and restricted cash and bank time deposits- end of period.....	\$ 36,846	\$ 23,638
Summary of cash and cash equivalents and restricted cash and bank time deposits- end of period:		
Cash and cash equivalents.....	\$ 36,652	\$ 21,533
Restricted cash and bank time deposits.....	194	2,105
Cash and cash equivalents and restricted cash and bank time deposits- end of period.....	\$ 36,846	\$ 23,638

Summary of Significant Accounting Policies specific to American Roads LLC

Toll Revenue

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

Property and Equipment

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

Property and equipment are tested for impairment whenever events or changes in circumstances suggest that an asset or asset group's carrying value may not be fully recoverable. An impairment, calculated as the difference between the estimated fair value and the carrying value of an asset or asset group, is recognized if the sum of the expected undiscounted cash flows relating to the asset or asset group is less than the corresponding carrying value. There was no impairment of property and equipment at December 31, 2017 and December 31, 2016. Property and equipment related to American Roads LLC have been included in assets of entity held-for-sale on the consolidated balance sheets and included in the measurement of the disposal group at lower of cost or fair value, less cost of sale.

Intangible Assets

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

down to fair value. There was no impairment of definite-lived intangibles at December 31, 2017 and December 31, 2016. Definite-lived intangible assets related to American Roads LLC have been included in assets of entity held-for-sale on the consolidated balance sheets and included in the measurement of the disposal group at lower of cost or fair value, less cost of sale.

Indefinite-lived intangible assets include toll rights and goodwill. Management performs its annual impairment test as of August 31, or more frequently if facts and circumstances indicate that an impairment has occurred. In accordance with applicable guidance, American Roads LLC uses fair value techniques to evaluate indefinite-lived intangible assets for possible impairment. Management evaluates events and circumstances to determine if it is more likely than not that the fair value of indefinite-lived intangible assets is less than its carrying amount. If the fair value of the indefinite-lived intangible asset is less than the carrying amount, an impairment is recognized in an amount equal to the difference. The fair value of the indefinite-lived intangible is generally established using discounted cash flows. In accordance with the policy as described above, an impairment test was performed as of August 31, 2017. For the years ended December 31, 2017 and 2016, management's assessment determined that indefinite-lived assets were not impaired. Indefinite-lived intangible assets related to American Roads LLC have been included in assets of entity held-for-sale on the consolidated balance sheets.

Goodwill reflects the excess of the reorganization value of American Roads LLC over the fair value of tangible and identifiable intangible assets, net of liabilities, from the adoption of fresh start reporting. American Roads LLC recorded goodwill upon emergence from bankruptcy and does not amortize goodwill; however, management performs its annual impairment test as of August 31, or more frequently if facts and circumstances indicate that an impairment has occurred. This impairment test is calculated at the reporting unit level, which was determined to be each toll road facility. The goodwill impairment test has three steps. The first step evaluates events and circumstances to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If the qualitative assessment concludes that the fair value of the reporting units exceeds the carrying amount, goodwill is not impaired and the additional steps are not necessary. The second step identifies potential impairments by comparing the fair value of a reporting unit with its book value, including goodwill. If the fair value of the reporting units exceeds the carrying amount, goodwill is not impaired and the third step is not necessary. If the carrying value exceeds the fair value, the third step calculates the possible impairment by comparing the implied fair value of goodwill with the carrying amount. If the implied goodwill is less than the carrying amount, a write-down is recorded. To derive the fair value of the reporting units, American Roads LLC utilizes the income approach, given the lack of comparable publicly-traded information. Under the income approach, fair value was determined based on estimated future cash flows discounted at an appropriate risk-adjusted discount rate which represents the rate of return an outside investor would expect to earn. Although the cash flow forecasts are based on assumptions that are considered reasonable by management and consistent with the plans and estimates used to manage the underlying business, there is significant judgment in determining the expected future cash flows attributable to these reporting units. Management believes the fair values estimated are reasonable, however actual performance in the short-term and long-term could be materially different from forecasts, which could impact future estimates of fair value of the reporting units and may result in impairment of goodwill. In accordance with the policy as described above, an impairment test was performed as of August 31, 2017. For the years ended December 31, 2017 and 2016, management's test determined that goodwill was not impaired. Goodwill related to American Roads LLC has been included in assets of entity held-for-sale on the consolidated balance sheets.

Retirement and Other Post Retirement Benefits

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accounting Pronouncements Pending Adoption

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

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

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

Property and Equipment

Property and equipment consist of the following at December 31, 2017 and 2016:

(U.S. dollars in thousands)		Gross		Net	
Asset Class	Depreciation Life	2017	2016	2017	2016
Land	-	\$ 2,137	\$ 2,137	\$ 2,137	\$ 2,137
Leasehold improvements	Shorter of life of lease or asset	12,263	12,259	5,767	6,790
Roadways	15 years	3,460	2,594	2,831	2,069
Bridges and facilities	75 years	37,587	37,557	35,105	35,458
Buildings and toll plazas	3-20 years	1,715	1,613	928	915
Furniture, computers and equipment	3-5 years	1,395	1,160	609	493
Construction in progress	-	4,278	940	4,278	940
Total		62,835	58,260	<u>\$ 51,655</u>	<u>\$ 48,802</u>
Less accumulated depreciation and amortization		<u>(11,180)</u>	<u>(9,458)</u>		
Property and equipment, net		<u>\$ 51,655</u>	<u>\$ 48,802</u>		

Depreciation and amortization expense on property and equipment in 2017 and 2016 amounted to \$1.7 million and \$2.9 million, respectively. Depreciation ceased on August 8, 2017, the date the sale was approved and the assets were held-for-sale.

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Intangible Assets

Definite-lived intangible assets subject to amortization consist of the following at December 31, 2017 and 2016:

(U.S. dollars in thousands)

Asset Class	Amortization Life	Gross		Net	
		2017	2016	2017	2016
Lease rights	7 years	\$ 13,954	\$ 13,954	\$ 6,357	\$ 7,480
Software	3-5 years	1,516	1,516	94	233
Total		15,470	15,470	\$ 6,451	\$ 7,713
Less accumulated amortization		(9,019)	(7,757)		
Definitive-lived intangible assets, net		<u>\$ 6,451</u>	<u>\$ 7,713</u>		

Amortization expense in 2017 and 2016 amounted to \$1.3 million and \$2.3 million, respectively. Amortization ceased on August 8, 2017, the date the sale was approved and the assets were held-for-sale.

Indefinite-lived intangible assets not subject to amortization consist of the following at December 31, 2017 and 2016:

(U.S. dollars in thousands)

	Gross		Net	
	2017	2016	2017	2016
Toll rights	\$ 66,307	\$ 66,307	\$ 66,307	\$ 66,307
Goodwill	28,185	28,185	28,185	28,185
Total	<u>\$ 94,492</u>	<u>\$ 94,492</u>	<u>\$ 94,492</u>	<u>\$ 94,492</u>

Commitments and Contingencies

Detroit Lease Agreement

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

Joint Operating Agreement

The Canadian portion of the tunnel was operated by DWT pursuant to the Joint Operating Agreement with the City of Windsor, which expired October 31, 2007. Under the agreement, the contract automatically continued until one party provided ninety days notice to the other party to terminate the agreement. During 2017, the agreement was amended to provide either party only thirty days notice to terminate the agreement. The Joint Operating Agreement governed the distribution of costs related to the operating, maintaining and repairing of the tunnel. Under the Joint Operating Agreement, generally the City of Windsor reimbursed DWT for 50% of the direct operating expenses of the tunnel and reimburses DWT for certain overhead expenses in the form of a management fee. Management fee revenue was approximately \$0.7 million in 2017 and 2016, respectively.

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

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

SYNCORA HOLDINGS LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DWT and the City of Windsor are also negotiating a Shared Services Agreement, which will govern the use and provide for the operation, management, repair, replacement and improvement of the tunnel. DWT and the City of Windsor are expected to execute the Transition and Termination Agreement and the Shared Services Agreement during April 2018.

Other Contingencies

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

22. Subsequent Events

On February 2, 2018, SGI, entered into an agreement, the closing of which is subject to regulatory and other approvals as further described below, with Assured Guaranty pursuant to which Assured Guaranty agreed to provide reinsurance, generally on a 100% quota share basis, to SGI of approximately \$13.5 billion of net par outstanding of SGI-insured financial guaranty insurance policies, representing approximately 91% of SGI's outstanding insured exposure. As consideration for the transaction, which also involves a commutation of a small book of business ceded to SGI by an Assured Guaranty affiliate which is included in the par outstanding numbers above, SGI would pay approximately \$360 million (which amount includes ceded reserves) and assign over future installment premium for the reinsured policies. In addition, in connection with the reinsurance, SGI has also entered into an administrative services agreement with Assured Guaranty pursuant to which Assured Guaranty would provide certain administrative services with respect to the reinsured policies. Subsequent to the execution of this reinsurance agreement, SGI's remaining insured portfolio would be approximately \$1.29 billion of net par outstanding. In addition, SGI has the option to cede certain debt service reserve fund surety and interest rate swap policies for an immaterial additional premium payment.

Closing of the reinsurance transaction is subject to the receipt of required regulatory approvals, consents from certain third parties and other closing conditions, including NYDFS approval of a payment of principal and accrued interest of at least \$400 million on SGI's surplus notes. The parties would expect to close the transaction no later than the end of the second quarter of 2018.

There can be no assurance that SGI will receive the required approvals or consents for the reinsurance or that the reinsurance transaction will close on the expected timeline or at all; neither can assurance be given as to the timing or the amount, if any, of payment on SGI's surplus notes that the NYDFS may approve.

The Company has evaluated all subsequent events through March 27, 2018, the date the consolidated financial statements were available to be issued.