UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2019

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 1-10777

AMBAC FINANCIAL GROUP INC

Exact name of Registrant as specified in its charter)

Delaware	**13-3621676**
(State of incorporation)	**(I.R.S. employer identification no.)**
One State Street Plaza New York NY	**10004**
(Address of principal executive offices)	**(Zip code)**

(212) 658-7470

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common stock par value $0.01 per share	AMBC	NASDAQ

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act): (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☒ No ☐

As of August 5, 2019, 45,551,260 shares of common stock, par value $0.01 per share, of the Registrant were outstanding.

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Financial Statements of Ambac Financial Group, Inc. and Subsidiaries

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

(Dollars in thousands, except share data) (June 30, 2019 (Unaudited))	June 30, 2019	December 31, 2018
Assets:		
Investments:		
Fixed income securities, at fair value (amortized cost of $2,465,967 and $3,020,744)	$ 2,604,177	$ 3,115,675
Fixed income securities pledged as collateral, at fair value (amortized cost of $84,418 and $0)	84,418	—
Short-term investments, at fair value (amortized cost of $772,214 and $430,405)	772,299	430,331
Other investments (includes $426,563 and $351,049 at fair value)	469,438	391,217
Total investments	3,930,332	3,937,223
Cash and cash equivalents	17,514	63,089
Restricted cash	—	19,405
Premium receivables	441,526	495,391
Reinsurance recoverable on paid and unpaid losses	27,215	23,133
Deferred ceded premium	56,272	61,134
Subrogation recoverable	1,984,826	1,932,960
Derivative assets	72,376	59,468
Current taxes	14,092	47,040
Insurance intangible asset	454,830	718,931
Other assets	190,566	137,628
Variable interest entity assets:		
Fixed income securities, at fair value	3,138,714	2,737,286
Restricted cash	28,500	999
Loans, at fair value	4,288,572	4,287,664
Derivative assets	62,941	66,302
Other assets	4,790	1,058
Total assets	$ 14,713,066	$ 14,588,711
Liabilities and Stockholders' Equity:		
Liabilities:		
Unearned premiums	$ 556,908	$ 629,971
Loss and loss expense reserves	1,494,106	1,826,078
Ceded premiums payable	30,795	32,913
Deferred taxes	31,716	40,130
Long-term debt	2,946,620	2,928,929
Accrued interest payable	407,096	375,808
Derivative liabilities	88,245	76,699
Other liabilities	137,757	63,792
Variable interest entity liabilities:		
Accrued interest payable	529	556
Long-term debt (includes $5,308,724 and $5,268,596 at fair value)	5,648,083	5,268,596
Derivative liabilities	1,818,273	1,712,062
Other liabilities	22	30
Total liabilities	13,160,150	12,955,564
Commitments and contingencies (See Note 12)		
Stockholders' equity:		
Preferred stock, par value $0.01 per share; 20,000,000 shares authorized shares; issued and outstanding shares—none	—	—
Common stock, par value $0.01 per share; 130,000,000 shares authorized; issued shares: 45,571,743 and 45,365,170	456	454
Additional paid-in capital	226,794	219,429
Accumulated other comprehensive income (loss)	19,088	(48,715)
Retained earnings	1,246,990	1,421,302
Treasury stock, shares at cost: 22,558 and 28,892	(380)	(473)
Total Ambac Financial Group, Inc. stockholders' equity	1,492,948	1,591,997
Noncontrolling interest	59,968	41,150

Total stockholders' equity		**1,552,916**		1,633,147
Total liabilities and stockholders' equity	**$**	**14,713,066**	**$**	**14,588,711**

See accompanying Notes to Unaudited Consolidated Financial Statements

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES

Consolidated Statements of Total Comprehensive Income (Loss) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except share data)	**2019**	**2018**	**2019**	**2018**
Revenues:				
Net premiums earned	$ 7,833	$ 25,836	$ 35,591	56,719
Net investment income	86,459	66,662	141,301	176,902
Other-than-temporary impairment losses:				
Total other-than-temporary impairment losses	—	(1,010)	(29)	(1,351)
Portion of other-than-temporary impairment recognized in other comprehensive income	—	(4)	—	38
Net other-than-temporary impairment losses recognized in earnings	—	(1,014)	(29)	(1,313)
Net realized investment gains (losses)	35,860	47,148	53,093	52,010
Net gains (losses) on derivative contracts	(35,412)	8,932	(51,571)	34,123
Net realized gains (losses) on extinguishment of debt	—	6	—	3,121
Other income (expense)	(8,908)	2,491	(8,106)	1,982
Income (loss) on variable interest entities	3,294	577	19,215	1,151
Total revenues	89,126	150,638	189,494	324,695
Expenses:				
Losses and loss expenses (benefit)	(133,480)	32,579	(121,073)	(214,816)
Insurance intangible amortization	226,242	23,242	262,520	51,878
Operating expenses	29,090	26,063	54,005	62,497
Interest expense	67,381	62,446	135,359	110,519
Total expenses	189,233	144,330	330,811	10,078
Pre-tax income (loss)	(100,107)	6,308	(141,317)	314,617
Provision for income taxes	28,322	1,995	30,313	4,600
Net income (loss) attributable to common stockholders	**$ (128,429)**	**$ 4,313**	**$ (171,630)**	**$ 310,017**
Other comprehensive income (loss), after tax:				
Net income (loss)	$ (128,429)	$ 4,313	$ (171,630)	$ 310,017
Unrealized gains (losses) on securities, net of income tax provision (benefit) of $(7,005), $1,122, $(7,603) and $(586)	15,238	575	71,401	122,879
Gains (losses) on foreign currency translation, net of income tax provision (benefit) of $0, $0, $0 and $0	(18,533)	(52,989)	(3,962)	(20,933)
Credit risk changes of fair value option liabilities, net of income tax provision (benefit) of $33, $(188), $65 and $42	163	(906)	319	208
Changes to postretirement benefit, net of income tax provision (benefit) of $0, $0, $0 and $0	(322)	(302)	45	(1,161)
Total other comprehensive income, net of income tax	(3,454)	(53,622)	67,803	100,993
Total comprehensive income (loss) attributable to common stockholders	**$ (131,883)**	**$ (49,309)**	**$ (103,827)**	**$ 411,010**
Net income (loss) per share attributable to common stockholders:				
Basic	$ (2.79)	$ 0.09	$ (3.74)	$ 6.80
Diluted	$ (2.79)	$ 0.09	$ (3.74)	$ 6.73
Weighted average number of common shares outstanding:				
Basic	45,986,043	45,683,058	45,909,595	45,577,656
Diluted	45,986,043	46,472,375	45,909,595	46,097,647

See accompanying Notes to Unaudited Consolidated Financial Statements

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity (Unaudited)

		Ambac Financial Group, Inc.						
(Dollars in thousands)	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Preferred Stock	Common Stock	Additional Paid-in Capital	Common Stock Held in Treasury, at Cost	Noncontrolling Interest
Balance at March 31, 2019	$ 1,665,888	$ 1,376,244	$ 22,542	$ —	$ 456	$ 223,545	$ (813)	$ 43,914
Total comprehensive income	(131,883)	(128,429)	(3,454)	—	—	—	—	—
Stock-based compensation	3,249	—	—	—	—	3,249	—	—
Cost of shares (acquired) issued under equity plan	(392)	(825)	—	—	—	—	433	—
Re-issuance of Ambac Assurance auction market preferred shares	16,054	—	—	—	—	—	—	16,054
Balance at June 30, 2019	$ 1,552,916	$ 1,246,990	$ 19,088	$ —	$ 456	$ 226,794	$ (380)	$ 59,968
Balance at March 31, 2018	$ 2,109,165	$ 1,541,464	$ 99,476	$ —	$ 454	$ 204,172	$ (511)	$ 264,110
Total comprehensive income	(49,309)	4,313	(53,622)	—	—	—	—	—
Stock-based compensation	4,153	—	—	—	—	4,153	—	—
Cost of shares (acquired) issued under equity plan	(91)	(75)	—	—	—	—	(16)	—
Warrants exercised	3	—	—	—	—	3	—	—
Balance at June 30, 2018	$ 2,063,921	$ 1,545,702	$ 45,854	$ —	$ 454	$ 208,328	$ (527)	$ 264,110

		Ambac Financial Group, Inc.						
(Dollars in thousands)	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Preferred Stock	Common Stock	Additional Paid-in Capital	Common Stock Held in Treasury, at Cost	Noncontrolling Interest
Balance at January 1, 2019	$ 1,633,147	$ 1,421,302	$ (48,715)	$ —	$ 454	$ 219,429	$ (473)	$ 41,150
Total comprehensive income	(103,827)	(171,630)	67,803	—	—	—	—	—
Stock-based compensation	7,365	—	—	—	—	7,365	—	—
Cost of shares (acquired) issued under equity plan	(2,589)	(2,682)	—	—	—	—	93	—
Issuance of common stock	2	—	—	—	2	—	—	—
Re-issuance of Ambac Assurance auction market preferred shares	18,818	—	—	—	—	—	—	18,818
Balance at June 30, 2019	$ 1,552,916	$ 1,246,990	$ 19,088	$ —	$ 456	$ 226,794	$ (380)	$ 59,968
Balance at January 1, 2018	$ 1,645,258	$ 1,233,845	$ (52,239)	$ —	$ 453	$ 199,560	$ (471)	$ 264,110
Total comprehensive income	411,010	310,017	100,993	—	—	—	—	—
Adjustment to initially apply ASU 2016-01	—	2,900	(2,900)	—	—	—	—	—
Stock-based compensation	8,765	—	—	—	—	8,765	—	—
Cost of shares (acquired) issued under equity plan	(1,116)	(1,060)	—	—	—	—	(56)	—
Issuance of common stock	1	—	—	—	1	—	—	—
Warrants exercised	3	—	—	—	—	3	—	—
Balance at June 30, 2018	$ 2,063,921	$ 1,545,702	$ 45,854	$ —	$ 454	$ 208,328	$ (527)	$ 264,110

See accompanying Notes to Unaudited Consolidated Financial Statements

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)	Six Months Ended June 30, 2019	2018
Cash flows from operating activities:		
Net income (loss)	$ (171,630)	$ 310,017
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	286	363
Amortization of bond premium and discount	(55,095)	(102,602)
Share-based compensation	7,365	8,765
Deferred income taxes	(809)	(880)
Current income taxes	33,000	(23,564)
Unearned premiums, net	(68,222)	(57,310)
Losses and loss expenses, net	(388,314)	(1,435,042)
Ceded premiums payable	(2,118)	(2,282)
Premium receivables	53,910	32,432
Accrued interest payable	42,396	(89,633)
Amortization of insurance intangible assets	262,520	51,878
Net mark-to-market (gains) losses	(598)	760
Net realized investment gains	(53,093)	(52,010)
Other-than-temporary impairment charges	29	1,313
(Gain) loss on extinguishment of debt	—	(3,121)
Variable interest entity activities	(19,215)	(1,151)
Derivative assets and liabilities	(764)	(120)
Other, net	95,491	50,599
Net cash used in operating activities	(264,861)	**(1,311,588)**
Cash flows from investing activities:		
Proceeds from sales of bonds	689,226	623,495
Proceeds from matured bonds	274,259	214,066
Purchases of bonds	(426,727)	(163,917)
Proceeds from sales of other invested assets	48,475	51,402
Purchases of other invested assets	(117,386)	(18,862)
Change in short-term investments	(342,091)	164,860
Change in cash collateral receivable	64,955	781
Proceeds from paydowns of consolidated VIE assets	122,085	137,983
Other, net	(221)	5,543
Net cash provided by investing activities	312,575	**1,015,351**
Cash flows from financing activities:		
Net proceeds from issuance of Tier 2 notes	—	240,000
Proceeds from issuance of Ambac UK debt	12,180	—
Proceeds from issuance of surplus notes	—	4,571
Paydowns of Ambac note	(21,914)	(113,457)
Paydowns of a secured borrowing	—	(73,993)
Payments for extinguishment of surplus notes	—	(191,258)
Payments for debt issuance costs	—	(9,221)
Issuance of auction market preferred shares of Ambac Assurance	18,818	—
Tax payments related to shares withheld for share-based compensation plans	(2,198)	(1,116)
Proceeds from warrant exercises	—	3
Payments of consolidated VIE liabilities	(92,042)	(137,984)
Net cash used in financing activities	(85,156)	**(282,455)**
Effect of foreign exchange on cash, cash equivalents and restricted cash	(37)	(539)
Net cash flow	(37,479)	(579,231)
Cash, cash equivalents, and restricted cash at beginning of period	83,493	624,681
Cash, cash equivalents, and restricted cash at end of period	$ 46,014	**$ 45,450**

See accompanying Notes to Unaudited Consolidated Financial Statements

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Dollar Amounts in Thousands, Except Share Amounts)

1. BACKGROUND AND BUSINESS DESCRIPTION

The following description provides an update of *Note 1. Background and Business Description* in the Notes to Consolidated Financial Statements included Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 2018, and should be read in conjunction with the complete descriptions provided in the Form 10-K. Capitalized terms used but not defined herein and in the other footnotes to the Consolidated Financial Statements included in this Quarterly Report on Form 10-Q shall have the meanings ascribed thereto in the Company's Annual Report on Form 10-K for the year ended December 2018.

Ambac Financial Group, Inc. ("Ambac" or the "Company"), headquartered in New York City, is a financial services holding company incorporated in the state of Delaware on April 29, 1991.

Ambac's subsidiary, Ambac Assurance Corporation ("Ambac Assurance" or "AAC") and its subsidiary, Ambac Assurance UK Limited ("Ambac UK"), are both financial guarantee insurance companies in run-off. Insurance policies issued by Ambac Assurance and Ambac UK generally guarantee payment when due of the principal and interest on the obligations guaranteed. Ambac Assurance also has another wholly-owned subsidiary, Everspan Insurance Company, which has been in runoff since its acquisition in 1997. Management reviews financial information, allocates resources and measures financial performance on a consolidated basis. As a result, the Company has a single reportable segment.

Strategies to Enhance Shareholder Value

Ambac's primary goal is to maximize shareholder value through executing the following key strategies:

- Active runoff of Ambac Assurance and its subsidiaries through transaction terminations, policy commutations, reinsurance, settlements and restructurings, with a focus on our watch list credits and known and potential future adversely classified credits, that we believe will improve our risk profile, and maximizing the risk-adjusted return on invested assets;
- Ongoing rationalization of Ambac's and its subsidiaries' capital and liability structures;
- Loss recovery through active litigation management and exercise of contractual and legal rights;
- Ongoing review of the effectiveness and efficiency of Ambac's operating platform; and
- Evaluation of opportunities in certain business sectors that meet acceptable criteria that will generate long-term stockholder value with attractive risk-adjusted returns.

The execution of Ambac's objective to increase the value of its investment in Ambac Assurance is subject to the rights of the Office of the Commissioner of Insurance for the State of Wisconsin ("OCI") under the Stipulation and Order, which requires OCI to approve certain actions taken by or in respect of Ambac Assurance, as well as restrictions in the Settlement Agreement and in the indenture for the Tier 2 Notes. Opportunities for remediating losses on poorly performing insured transactions also depend on market conditions, including the perception of Ambac Assurance's and its subsidiaries' creditworthiness, the structure of the underlying risk and associated policy as well as other counterparty specific factors. Decisions by OCI could impair Ambac's ability to execute certain of its strategies. Ambac Assurance's ability to commute policies or purchase certain investments may also be limited by available liquidity. Due to these factors, as well as uncertainties relating to the ability of Ambac Assurance to deliver value to Ambac, the value of our securities remains speculative.

With respect to our new business strategy, we have identified certain business sectors adjacent to Ambac's core business in which opportunities are being evaluated. We are actively evaluating strategic opportunities in credit, insurance, asset management and other financial services that we believe are synergistic to Ambac and would leverage our core competencies. We are being measured and disciplined in our approach as we consider and pursue opportunities to deploy our capital with the goal of creating sustainable long-term shareholder value. Although we are exploring new business opportunities for Ambac, no assurance can be given that we will be able to identify or execute a suitable transaction and/or obtain the financial and other resources that may be required to finance the acquisition or development of any new businesses or assets.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The Company has disclosed its significant accounting policies in *Note 2. Basis of Presentation and Significant Accounting Policies* in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018. The following significant accounting policies provide an update to those included in the Company's Annual Report on Form 10-K.

Consolidation:

The consolidated financial statements include the accounts of Ambac and all other entities in which Ambac (directly or through its subsidiaries) has a controlling financial interest, including variable interest entities ("VIEs") for which Ambac or an Ambac subsidiary is deemed the primary beneficiary in accordance with the Consolidation Topic of the Accounting Standards Codification ("ASC"). All significant intercompany balances have been eliminated. The usual condition for a controlling financial interest is ownership of a majority of the voting interests of an entity. However, a controlling financial interest may also exist in entities, such as VIEs, through arrangements that do not involve controlling voting interests. A VIE is an entity: a) that lacks enough equity investment at risk to permit the entity to finance its activities without additional subordinated financial support from other parties; or b) where the group of equity holders does not have: (1) the power, through voting rights or similar rights, to direct the activities of an entity that most significantly impact the entity's economic performance; (2) the obligation to absorb the entity's expected losses; or (3) the right to receive the entity's expected residual returns. The determination of whether a variable interest holder is the primary beneficiary involves performing a qualitative analysis of the VIE that includes, among other factors, its capital structure,

contractual terms including the rights of each variable interest holder, the activities of the VIE, whether the variable interest holder has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance, whether the variable interest holder has the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, related party relationships and the design of the VIE. An entity that is deemed the primary beneficiary of a VIE is required to consolidate the VIE. See *Note 3. Variable Interest Entities*, for a detailed discussion of Ambac's involvement in VIEs, Ambac's methodology for determining whether Ambac is required to consolidate a VIE and the effects of VIEs being consolidated and deconsolidated.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial reporting and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by GAAP for annual periods. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2018. The accompanying consolidated financial statements have not been audited by an independent registered public accounting firm in accordance with the standards of the Public Company Accounting Oversight Board (U.S.), but in the opinion of management such financial statements include all adjustments necessary for the fair presentation of the Company's consolidated financial position and results of operations. The results of operations for the three and six months ended June 30, 2019 may not be indicative of the results that may be expected for the year ending December 31, 2019. The December 31, 2018 consolidated balance sheet was derived from audited financial statements.

The election to use the fair value option is made on an instrument by instrument based under ASC 825-10. At December 31, 2018, all VIE invested assets and long-term debt were reported under the fair value option as disclosed in the notes to the consolidated financial statements included in the Annual Report on Form 10-K. During the six months ended June 30, 2019, Ambac consolidated a new VIE that holds investments in fixed income securities that management has classified as available-for-sale under the Investments - Debt Securities Topic of the ASC. Long-term debt of the newly consolidated VIE is carried at par value less unamortized discount. See *Note 3. Variable Interest Entities*, for further discussion of the accounting elections used and the presentation of VIEs in these unaudited consolidated financial statements.

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

Certain amounts in the condensed consolidated financial statements and associated notes may not add due to rounding.

Noncontrolling Interest:

At June 30, 2019 and December 31, 2018, Ambac Assurance had 5,501 and 4,115 shares of issued and outstanding Auction Market Preferred Shares ("AMPS") with a liquidation preference of $137,525 and $102,875 (reported as noncontrolling interest of $59,968 and $41,150 on Ambac's balance sheet). The increase resulted from the re-issuance of $1,386 shares of Ambac owned AMPS during 2019.

Foreign Currency:

Financial statement accounts expressed in foreign currencies are translated into U.S. dollars in accordance with the Foreign Currency Matters Topic of the ASC. The functional currencies of Ambac's subsidiaries are the local currencies of the country where the respective subsidiaries are based, which are also the primary operating environments in which the subsidiaries operate.

Foreign currency translation: Functional currency assets and liabilities of Ambac's foreign subsidiaries are translated into U.S. dollars using exchange rates in effect at the balance sheet dates and the related translation adjustments, net of deferred taxes, are included as a component of Accumulated Other Comprehensive Income in Stockholders' Equity. Functional currency operating results of foreign subsidiaries are translated using average exchange rates.

Foreign currency transactions: The impact of non-functional currency transactions and the remeasurement of non-functional currency assets and liabilities into the respective subsidiaries' functional currency (collectively "foreign currency transactions gains/(losses)") are $13,108 and $(3,591) for the six months ended June 30, 2019 and 2018, of which $23,155 and $2,011 relate to investments, $(9,783) and $512 relate to premiums receivable and $(774) and $(6,359) relate to the remeasurement of loss reserves, classified in Net realized investment gains (losses), Other income and Losses and loss expenses, respectively. The 2019 foreign currency transactions gains primarily relate to the Ballantyne restructuring and commutation. Foreign currency transactions gains/(losses) are primarily the result of remeasuring Ambac UK's assets and liabilities denominated in currencies other than its functional currency, primarily the U.S. dollar and the Euro.

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
(Dollar Amounts in Thousands, Except Share Amounts)

Supplemental Disclosure of Cash Flow Information	Six Months Ended June 30,	
	2019	2018
Cash paid during the period for:		
Income taxes	$ 852	$ 26,910
Interest on long-term debt	74,426	157,896
Non-cash financing activities:		
Exchange of investments in Puerto Rico COFINA bonds for new bonds issued in the Plan of Adjustment	$ 510,215	$ —
Rehabilitation exit transaction discharge of all Deferred Amounts and cancellation of certain General Account Surplus Notes	—	1,918,561

	June 30,	
	2019	2018
Reconciliation of cash, cash equivalents, and restricted cash reported within the Consolidated Balance Sheets to the Consolidated Statements of Cash Flows:		
Cash and cash equivalents	$ 17,514	$ 44,398
Restricted cash	—	—
Variable Interest Entity Restricted cash	28,500	1,052
Total cash, cash equivalents, and restricted cash shown on the Consolidated Statements of Cash Flows	$ 46,014	$ 45,450

Reclassifications:

Reclassifications have been made to prior years' amounts to conform to the current year's presentation.

Adopted Accounting Standards:

Effective January 1, 2019, Ambac adopted the following accounting standards:

Equity-linked Instruments with Down Round Features

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260) and Derivatives and Hedging (Topic 815) - Accounting for Certain Financial Instruments with Down Round Features*. Equity-linked instruments, such as warrants and convertible instruments may contain down round features that result in the strike price being reduced on the basis of the pricing of future equity offerings. Under the ASU, a down round feature will no longer require a freestanding equity-linked instrument (or embedded conversion option) to be classified as a liability that is remeasured at fair value through the income statement (i.e. marked-to-market). However, other features of the equity-linked instrument (or embedded conversion option) must still be evaluated to determine whether liability or equity classification is appropriate. Equity classified instruments are not marked-to-market. For earnings per share ("EPS") reporting, the ASU requires companies to recognize the effect of the down round feature only when it is triggered by treating it as a dividend and as a reduction of income available to common stockholders in basic EPS. Adoption of this ASU did not impact Ambac's financial statements.

Premium Amortization on Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, *Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities*. The ASU shortens the amortization period for the premium on callable debt securities to the earliest call date. Under previous GAAP, a reporting entity generally amortized the premium as a yield adjustment over the contractual life (i.e. maturity) of the debt security and if that debt security is called, the entity would record a loss equal to the unamortized premium. The ASU does not change the accounting for callable debt securities held at a discount, which will continue to be amortized to maturity. Adoption of this ASU did not have a consequential impact on Ambac's financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU was subsequently amended by ASU 2018-01, *Land Easement Practical Expedient;* ASU 2018-10, *Codification Improvements to Topic 842;* ASU 2018-11, *Targeted Improvements;* ASU 2018-20, *Narrow-Scope Improvements for Lessors;* and ASU 2019-01, *Leases (Topic 842): Codification Improvements* (collectively the "New Lease Standard"). The primary difference between previous U.S. GAAP and the New Lease Standard is the recognition of lease assets and lease liabilities for those leases classified as operating leases with a term longer than 12 months. For those operating leases, a lessee is required to: 1) recognize a right-of-use asset ("ROU") and a lease liability, initially measured at the present value of the lease payments, on the balance sheet, 2) recognize a single lease cost, calculated so that the cost is allocated over the lease term generally on a straight-line basis and 3) classify all cash payments within operating activities in the statement of cash flows. For leases classified as finance leases under the New Lease Standard, the balance sheet presentation and expense recognition pattern is similar to capital leases under previous U.S. GAAP.

Under the transition guidance, a reporting entity must use a modified retrospective approach and may choose to initially apply the New Lease Standard either at (1) the beginning of the earliest comparative period presented, which is January 1, 2017 or (2) its effective date, which is January 1, 2019. If a reporting entity chooses the first option it must recast its comparative period financial statements and provide disclosures for those comparative periods. Ambac chose the second option and initially applied the New Lease Standard on January 1, 2019. Consequently financial information and disclosures were not provided for dates and periods prior to January 1, 2019.

There are a number of optional practical expedients that were elected at transition. We elected the 'package of practical expedients', which permitted us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We also elected the hindsight practical expedient allowing us to use the benefit of hindsight in determining the probability of exercising any lessee options to extend or terminate the lease, or purchase the underlying asset. We did not use the practical expedient pertaining to land easements as it was not applicable to Ambac.

The new new lease standard did not have a material effect on our financial statements. The most significant effects related to (1) the recognition of new ROU assets and lease liabilities on our balance sheet for our office and equipment operating leases of approximately $15,000 at transition and (2) providing significant new disclosures about our leasing activities.

See *Note 11. Leases* for further information.

Future Application of Accounting Standards:

VIE Related Party Guidance

In October 2018, the FASB issued ASU 2018-17, *Consolidation (Topic 810) - Targeted Improvements to Related Party Guidance for Variable Interest Entities*. To determine whether a decision-making fee is a variable interest, under the new guidance a reporting entity must consider indirect interests held through related parties under common control on a proportional basis rather than as a direct interest in its entirety (as currently required in GAAP). These amendments create alignment between determining whether a decision making fee is a variable interest and determining whether a reporting entity within a related party group is the primary beneficiary of a VIE. ASU 2018-17 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Ambac will adopt this ASU on January 1, 2020. The ASU is not expected to have a consequential impact on Ambac's financial statements.

Cloud Computing Arrangement Service Contracts

In August 2018, the FASB issued ASU 2018-15, *Intangibles—Goodwill and Other — Internal-Use Software (Subtopic 350-40) - Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The new guidance requires a customer in a cloud computing arrangement that is a service contract to capitalize certain implementation costs as if the arrangement was an internal-use software project. The internal-use software guidance requires the capitalization of certain costs incurred only during the application development stage (e.g., costs of integration with on-premises software, coding, configuration, customization). That guidance also requires entities to expense costs during the preliminary project and post-implementation stages (e.g., costs of project planning, training, maintenance after implementation, data conversion) as they are incurred. ASU 2018-15 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The ASU may be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. Ambac will adopt this ASU on January 1, 2020. The ASU is not expected to have a consequential impact on Ambac's financial statements.

Defined Benefit and Other Postretirement Plans Disclosures

In August 2018, the FASB issued ASU 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20) - Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*. The ASU modifies various disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Relevant disclosures that will be removed are: i) amounts in accumulated other comprehensive income expected to be recognized as net periodic benefit cost over the next fiscal year and ii) the effects of a one percentage point change in assumed health care cost trend rates on the (a) aggregate of the service and interest cost components of the net periodic pension cost and (b) benefit obligation for postretirement healthcare benefits. Relevant disclosures that will be added are an explanation of the reasons for significant gains and losses related to changes in the benefit obligations for the period. ASU 2018-14 is effective for fiscal years ending after December 15, 2020, with early adoption permitted. The modified disclosures must be applied on a retrospective basis for all periods presented. Ambac has not determined whether it will early adopt this ASU. The ASU is not expected to have a consequential impact on Ambac's financial statements.

Fair Value Measurement Disclosures

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820) - Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. The ASU modifies various disclosure requirements on fair value measurements. Relevant disclosures that will be removed, modified and added are as follows:

- Removals: 1) Amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, 2) Policy for timing of transfers between levels, and 3) Valuation processes for Level 3 fair value measurements.
- Modifications: 1) For investments in certain entities that calculate net asset value, disclosures are only required for the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse, only if the investee has communicated the timing to the reporting entity or publicly announced it and 2) Clarification that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date and not possible future changes.
- Additions: 1) Changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and 2) Range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. Alternatively, an entity may disclose other quantitative information (such as the median or arithmetic average) if it determines that it is a more reasonable and rational method to reflect the distribution of unobservable inputs used.

ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Disclosure amendments related to changes in unrealized gains and losses included in other comprehensive income for Level 3 instruments, the range and weighted average of significant unobservable inputs, and the narrative description of

measurement uncertainty should be applied prospectively only for the most recent interim or annual period presented. All other disclosure amendments should be applied retrospectively to all periods presented. Ambac has not determined whether it will early adopt this ASU. The ASU is not expected to have a consequential impact on Ambac's financial statements.

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments,* subsequently amended by ASU 2018-19*, Codification Improvements to Topic 326, Financial Instruments - Credit Losses;* ASU 2019-04*, Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*; and ASU 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief* (collectively "the ASU").

The ASU significantly affects how reporting entities will measure credit losses for financial assets that are not accounted for at fair value through net income, which include loans, debt securities, premium receivables, net investments in leases, and certain off-balance sheet credit exposures. The ASU does not apply to credit losses on financial guarantee insurance contracts accounted for under ASC 944. For financial assets measured at amortized cost, the ASU replaces the "incurred loss" model, which generally delayed recognition of the full amount of credit losses until the loss was probable of occurring, with an "expected loss" model, which reflects an entity's current estimate of all expected credit losses. Expected credit losses for amortized cost assets will be recorded as a valuation allowance, with subsequent increases or decreases in the allowance reflected in the income statement each period. For available-for-sale debt securities, credit losses under the ASU will be measured similarly to current GAAP. However, under the ASU, credit losses for available-for-sale debt securities will be recorded as a valuation allowance (similar to the amortized cost assets approach described above), rather than as a direct write-down of the security as is required under current GAAP. As a result, improvements to estimated credit losses for available-for-sale debt securities will be recognized immediately in the income statement rather than as interest income over time. The ASU is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted. Ambac will adopt this ASU on January 1, 2020 and we are currently evaluating its impact on Ambac's financial statements. We have preliminarily identified the inventory of financial assets that will be affected by this standard. The remaining significant implementation matters to be addressed include identifying new data requirements and data sources for implementing the expected loss model for those instruments not already using this model and identifying and documenting accounting process changes, including related controls.

3. VARIABLE INTEREST ENTITIES

Ambac, with its subsidiaries, has engaged in transactions with variable interest entities ("VIEs,") in various capacities.

- Ambac provides financial guarantees, including credit derivative contracts, for various debt obligations issued by special purpose entities, including VIEs ("FG VIEs");
- Ambac sponsors special purpose entities that issued notes to investors for various purposes; and
- Ambac is an investor in collateralized debt obligations, mortgage-backed and other asset-backed securities issued by VIEs and its ownership interest is generally insignificant to the VIE and/or Ambac does not have rights that direct the activities that are most significant to such VIE.

FG VIEs:

Ambac's subsidiaries provide financial guarantees in respect of assets held or debt obligations of VIEs. Ambac's primary variable interest exists through this financial guarantee insurance or credit derivative contract. The transaction structures provide certain financial protection to Ambac. Generally, upon deterioration in the performance of a transaction or upon an event of default as specified in the transaction legal documents, Ambac will obtain certain control rights that enable Ambac to remediate losses. These rights may enable Ambac to direct the activities of the entity that most significantly impact the entity's economic performance. Under a 2018 Stipulation and Order, the OCI requires Ambac Assurance to obtain their approval with respect to the exercise of certain significant control rights in connection with policies that had previously been allocated to the Segregated Account. Accordingly, Ambac Assurance does not have the right to direct the most significant activities of those FG VIEs.

- We determined that Ambac's subsidiaries generally have the obligation to absorb a FG VIE's expected losses given that they have issued financial guarantees supporting certain liabilities (and in some cases certain assets). As further described below, Ambac consolidates certain FG VIEs in cases where we also have the power to direct the activities that most significantly impact the VIE's economic performance due to one or more of the following: (i) the transaction experiencing deterioration and breaching performance triggers, giving Ambac the ability to exercise certain control rights, (ii) Ambac being involved in the design of the VIE and receiving control rights from its inception, such as may occur from loss remediation activities, or (iii) the transaction not experiencing deterioration, however due to the passive nature of the VIE, Ambac's contingent control rights upon a future breach of performance triggers is considered to be the power over the most significant activity. FG VIEs which are consolidated may include non-recourse assets or liabilities. FG VIEs' liabilities (and in some cases assets) that are insured by the Company are with recourse, because the Company guarantees the payment of principal and interest. FG VIEs' assets and liabilities that are not insured by the Company are without recourse, because Ambac has not issued a financial guarantee and is under no obligation for the payment of principal and interest of these instruments. The Company's exposure to consolidated FG VIEs is limited to the

financial guarantees issued for recourse assets and liabilities and any additional variable interests held by Ambac.

- A VIE is deconsolidated in the period that Ambac no longer has such control rights, which could occur in connection with the execution of remediation activities on the transaction or amortization of insured exposure, either of which may reduce the degree of Ambac's control over a VIE.
- Assets and liabilities of FG VIEs that are consolidated are reported within Variable interest entity assets or Variable interest entity liabilities on the Consolidated Balance Sheets.
- The election to use the fair value option is made on an instrument by instrument basis. Ambac has elected the fair value option for consolidated FG VIE financial assets and financial liabilities, except in cases where Ambac was involved in the design of the VIE and was granted control rights at its inception.
    - When the fair value option is elected, changes in the fair value of the FG VIE's financial assets and liabilities are reported within Income (loss) on variable interest entities in the Consolidated Statements of Total Comprehensive Income (Loss), except for the portion of the total change in fair value of financial liabilities caused by changes in the instrument-specific credit risk which is presented separately in Other comprehensive income (loss).
    - In cases where the fair value option has not been elected, the FG VIE's invested assets are fixed income securities and are considered available-for-sale as defined by the Investments - Debt Securities Topic of the ASC. These assets are reported in the financial statements at fair value with unrealized gains and losses reflected in Accumulated Other Comprehensive Income in Stockholders' Equity. The financial liabilities of these FG VIEs consist of long term debt obligations and are carried at par less unamortized discount. Income from the FG VIE's available-for-sale securities (including investment income, realized gains and losses and other-than-temporary impairments as applicable) and interest expense on long term debt are reported within Income (loss) on variable interest entities in the Consolidated Statements of Total Comprehensive Income (Loss).
- Upon initial consolidation of a FG VIE, Ambac recognizes a gain or loss in earnings for the difference between: (i) the fair value of the consideration paid, the fair value of any non-controlling interests and the reported amount of any previously held interests and (ii) the net amount, as measured on a fair value basis, of the assets and liabilities consolidated. Upon deconsolidation of a FG VIE, we recognize a gain or loss for the difference between: (i) the fair value of any consideration received, the fair value of any retained non-controlling investment in the VIE and the carrying amount of any non-controlling interest in the VIE and (ii) the carrying amount of the VIE's assets and liabilities. Gains or losses from consolidation and deconsolidation that are reported in earnings are reported within Income (loss) on variable interest entities on the Consolidated Statements of Total Comprehensive Income (Loss).
- The impact of consolidating such FG VIEs on Ambac's balance sheet is the elimination of transactions between the consolidated FG VIEs and Ambac's operating subsidiaries and the inclusion of the FG VIE's third party assets and liabilities. For a financial guarantee insurance policy issued to a consolidated VIE, Ambac does not reflect the financial guarantee insurance policy in accordance with the related insurance accounting rules under the Financial Services – Insurance Topic of the ASC. Consequently, upon consolidation, Ambac eliminates the insurance assets and liabilities associated with the policy from the Consolidated Balance Sheets. Such insurance assets and liabilities may include premium receivables, reinsurance recoverable, deferred ceded premium, subrogation recoverable, unearned premiums, loss and loss expense reserves, ceded premiums payable and insurance intangible assets. For investment securities owned by Ambac that are debt instruments issued by the VIE, the investment securities balance is eliminated upon consolidation.

Ambac is not primarily liable for, and generally does not guarantee all of the debt obligations issued by the VIEs. Ambac would only be required to make payments on the VIE debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due and such obligation is guaranteed by Ambac. Additionally, Ambac's general creditors, other than those specific policy holders which own the VIE debt obligations, do not have rights with regard to the assets of the VIEs. Ambac evaluates the net income effects and earnings per share effects to determine attributions between Ambac and non-controlling interests as a result of consolidating a VIE. Ambac has determined that the net income and earnings per share effect of consolidated FG VIEs are attributable to Ambac's interests through financial guarantee premium and loss payments with the VIE.

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The following table summarizes the carrying values of assets and liabilities, along with other supplemental information related to VIEs that are consolidated as a result of financial guarantees of Ambac UK and Ambac Assurance:

	June 30, 2019			December 31, 2018		
	Ambac UK	Ambac Assurance	Total VIEs	Ambac UK	Ambac Assurance	Total VIEs
Fixed income securities, at fair value:						
Corporate obligations, fair value option	$ 2,881,889	$ —	$ 2,881,889	$ 2,737,286	$ —	$ 2,737,286
Municipal obligations, available-for-sale [1]	—	256,825	256,825	—	—	—
Total FG VIE fixed income securities, at fair value	2,881,889	256,825	3,138,714	2,737,286	—	2,737,286
Restricted cash	983	27,517	28,500	999	—	999
Loans, at fair value [2]	4,288,572	—	4,288,572	4,287,664	—	4,287,664
Derivative assets	62,941	—	62,941	66,302	—	66,302
Other assets	1,052	3,738	4,790	1,058	—	1,058
Total FG VIE assets	$ 7,235,437	$ 288,080	$ 7,523,517	$ 7,093,309	$ —	$ 7,093,309
Accrued interest payable	$ 529	$ —	$ 529	$ 556	$ —	$ 556
Long-term debt:						
Long-term debt, at fair value [3]	5,308,724	—	5,308,724	5,268,596	—	5,268,596
Long-term debt, at par less unamortized discount	—	339,359	339,359	—	—	—
Total long-term debt	5,308,724	339,359	5,648,083	5,268,596	—	5,268,596
Derivative liabilities	1,818,273	—	1,818,273	1,712,062	—	1,712,062
Other liabilities	22	—	22	30	—	30
Total FG VIE liabilities	$ 7,127,548	$ 339,359	$ 7,466,907	$ 6,981,244	$ —	$ 6,981,244
Number of FG VIEs consolidated	7	1	8	7	—	7

(1) Available-for-sale FG VIE fixed income securities consist of municipal obligations with an amortized cost basis of $236,465 and aggregate gross unrealized gains and (losses) of $20,360 at June 30, 2019. All such securities had contractual maturities due after ten years as of June 30, 2019.

(2) The unpaid principal balances of loan assets carried at fair value were $3,342,724 as of June 30, 2019 and $3,418,044 as of December 31, 2018.

(3) The unpaid principal balances of long-term debt carried at fair value were $4,474,815 as of June 30, 2019 and $4,552,643 as of December 31, 2018.

The following schedule details the components of Income (loss) on variable interest entities for the affected periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net change in fair value of VIE assets and liabilities reported under the fair value option	$ 2,924	$ (450)	$ 4,760	$ 1,468
Less: Credit risk changes of fair value option long-term debt reported through other comprehensive income	(223)	1,027	(394)	(317)
Net change in fair value of VIE assets and liabilities reported in earnings	2,701	577	4,366	1,151
Investment income on available-for-sale securities	3,527	—	5,386	—
Net realized investment gains (losses)	1,863	—	1,863	—
Interest expense on long-term debt carried at par less unamortized cost	(4,089)	—	(6,445)	—
Other expenses	(708)	—	(819)	—
Gain (loss) from consolidating FG VIEs	—	—	14,864	—
Income (loss) on Variable Interest Entities	$ 3,294	$ 577	$ 19,215	$ 1,151

On February 12, 2019, in connection with the COFINA POA, the COFINA Class 2 Trust was established. Ambac was required to consolidate the COFINA Class 2 Trust, which resulted in a gain of $14,864. The 2019 balance sheet impact of this additional VIE on the date of consolidation was an increase to total consolidated assets and liabilities by $292,003 and $363,628, respectively. Ambac deconsolidated no VIEs for the six months ended June 30, 2019 and 2018.

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The following table displays the carrying amount of the assets, liabilities and maximum exposure to loss of Ambac's variable interests in non-consolidated VIEs resulting from financial guarantee and derivative contracts by major underlying asset classes, as of June 30, 2019 and December 31, 2018:

		Carrying Value of Assets and Liabilities		
	Maximum Exposure To Loss [1]	Insurance Assets [2]	Insurance Liabilities [3]	Net Derivative Assets (Liabilities) [4]
June 30, 2019:				
Global structured finance:				
Collateralized debt obligations	$ —	$ —	$ —	$ —
Mortgage-backed—residential	6,114,419	1,910,305	507,709	—
Other consumer asset-backed	1,530,894	14,925	230,914	—
Other commercial asset-backed	382,244	6,811	6,627	—
Other	818,606	20,408	17,177	8,237
Total global structured finance	8,846,163	1,952,449	762,427	8,237
Global public finance	23,631,977	310,868	338,416	(861)
Total	$ 32,478,140	$ 2,263,317	$ 1,100,843	$ 7,376
December 31, 2018:				
Global structured finance:				
Collateralized debt obligations	$ 9,787	$ —	$ —	$ (2)
Mortgage-backed—residential	6,713,437	1,859,121	546,682	—
Other consumer asset-backed	1,700,984	15,435	238,234	—
Other commercial asset-backed	873,343	20,735	12,264	—
Other	2,122,648	53,462	301,260	7,170
Total global structured finance	11,420,199	1,948,753	1,098,440	7,168
Global public finance	24,145,956	309,071	335,437	(1,457)
Total	$ 35,566,155	$ 2,257,824	$ 1,433,877	$ 5,711

(1) Maximum exposure to loss represents the maximum future payments of principal and interest on insured obligations and derivative contracts. Ambac's maximum exposure to loss does not include the benefit of any financial instruments (such as reinsurance or hedge contracts) that Ambac may utilize to mitigate the risks associated with these variable interests.

(2) Insurance assets represent the amount included in "Premium receivables" and "Subrogation recoverable" for financial guarantee insurance contracts on Ambac's Consolidated Balance Sheets.

(3) Insurance liabilities represent the amount included in "Loss and loss expense reserves" and "Unearned premiums" for financial guarantee insurance contracts on Ambac's Consolidated Balance Sheets.

(4) Net derivative assets (liabilities) represent the fair value recognized on credit derivative contracts and interest rate swaps on Ambac's Consolidated Balance Sheets.

Ambac Sponsored Non-consolidated VIEs:

In 1994, Ambac established a VIE to provide certain financial guarantee clients with funding for their debt obligations. This VIE was established as a separate legal entity, demonstrably distinct from Ambac and that Ambac, its affiliates or its agents could not unilaterally dissolve. The permitted activities of this entity are contractually limited to purchasing assets from Ambac, issuing medium-term notes ("MTNs") to fund such purchases, executing derivative hedges and obtaining financial guarantee policies with respect to indebtedness incurred. Ambac does not consolidate this entity because the exercise of related control rights in such policies remain subject to OCI approval under the Stipulation and Order, as discussed above. Ambac elected to account for its equity interest in this entity at fair value under the fair value option in accordance with the Financial Instruments Topic of the ASC. We believe that the fair value of the investments in this entity provides for greater transparency for recording profit or loss as compared to the equity method under the Investments – Equity Method and Joint Ventures Topic of the ASC. Refer to *Note 7. Fair Value Measurements* for further information on the valuation technique and inputs used to measure the fair value of Ambac's equity interest in this entity. At June 30, 2019 and December 31, 2018 the fair value of this entity was $3,771 and $4,516, respectively, and is reported within Other assets on the Consolidated Balance Sheets.

- Total principal amount of debt outstanding was $391,480 and $393,010 at June 30, 2019 and December 31, 2018, respectively. In each case, Ambac sold assets to this entity, which are composed of utility obligations with a weighted average rating of BBB+ at June 30, 2019 and weighted average life of 1.6 years. The purchase by this entity of financial assets was financed through the issuance of MTNs, which are cross-collateralized by the purchased assets. The MTNs have the

same expected weighted average life as the purchased assets. Derivative contracts (interest rate swaps) are used within the entity for economic hedging purposes only. Derivative positions were established at the time MTNs were issued to purchase financial assets. As of June 30, 2019 Ambac Assurance had financial guarantee insurance policies issued for all assets, MTNs and derivative contracts owned and outstanding by the entity.

- Insurance premiums paid to Ambac Assurance by this entity are earned in a manner consistent with other insurance policies, over the risk period. Additionally, any losses incurred on such insurance policies are included in Ambac's Consolidated Statements of Total Comprehensive Income (Loss). Under the terms of an Administrative Agency Agreement, Ambac provides certain administrative duties, primarily collecting amounts due on the obligations and making interest payments on the MTNs.

On August 28, 2014, Ambac monetized its ownership of the junior surplus note issued to it by the Segregated Account by depositing the junior surplus note into a newly formed VIE trust in exchange for cash and an owner trust certificate, which represents Ambac's right to residual cash flows from the junior surplus note. Ambac does not consolidate the VIE since it does not have a variable interest in the trust. Ambac reports its owner trust certificate as an equity investment within Other investments on the Consolidated Balance Sheets with associated results from operations included within Net investment income: Other investments on the Consolidated Statements of Total Comprehensive Income (Loss). The equity investment had a carrying value of $42,875 and $40,168 as of June 30, 2019 and December 31, 2018, respectively.

On February 12, 2018, Ambac formed a VIE, Ambac LSNI. Ambac LSNI issued Secured Notes in connection with the Rehabilitation Exit Transactions. Ambac does not consolidate the VIE since it does not have a variable interest in the trust. Ambac reports its holdings of Secured Notes within Fixed Income Securities in the Consolidated Balance Sheets. The carrying value of Secured Notes held by Ambac was $575,138 and $656,473 at June 30, 2019 and December 31, 2018, respectively. Ambac's debt obligation to the VIE (the Ambac Note) had a carrying value of $1,918,357 and $1,940,289 at June 30, 2019 and December 31, 2018, respectively, and is reported within Long-term debt on the Consolidated Balance Sheets.

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4. COMPREHENSIVE INCOME

The following tables detail the changes in the balances of each component of accumulated other comprehensive income for the affected periods:

	Unrealized Gains (Losses) on Available for Sale Securities [1]	Amortization of Postretirement Benefit [1]	Gain (Loss) on Foreign Currency Translation [1]	Credit Risk Changes of Fair Value Option Liabilities [1] [2]	Total
Three Months Ended June 30, 2019:					
Beginning Balance	$ 142,066	$ 9,241	$ (126,956)	$ (1,809)	$ 22,542
Other comprehensive income (loss) before reclassifications	51,098	—	(18,533)	—	32,565
Amounts reclassified from accumulated other comprehensive income (loss)	(35,860)	(322)	—	163	(36,019)
Net current period other comprehensive income (loss)	15,238	(322)	(18,533)	163	(3,454)
Balance at June 30, 2019	$ 157,304	$ 8,919	$ (145,489)	$ (1,646)	$ 19,088
Three Months Ended June 30, 2018:					
Beginning Balance	$ 153,059	$ 9,781	$ (61,578)	$ (1,786)	$ 99,476
Other comprehensive income (loss) before reclassifications	46,709	—	(52,989)	—	(6,280)
Amounts reclassified from accumulated other comprehensive income (loss)	(46,134)	(302)	—	(906)	(47,342)
Net current period other comprehensive income (loss)	575	(302)	(52,989)	(906)	(53,622)
Balance at June 30, 2018	$ 153,634	$ 9,479	$ (114,567)	$ (2,692)	$ 45,854
Six Months Ended June 30, 2019:					
Beginning Balance	$ 85,903	$ 8,874	$ (141,527)	$ (1,965)	$ (48,715)
Other comprehensive income (loss) before reclassifications	124,465	689	(3,962)	—	121,192
Amounts reclassified from accumulated other comprehensive income (loss)	(53,064)	(644)	—	319	(53,389)
Net current period other comprehensive income (loss)	71,401	45	(3,962)	319	67,803
Balance at June 30, 2019	$ 157,304	$ 8,919	$ (145,489)	$ (1,646)	$ 19,088
Six Months Ended June 30, 2018:					
Beginning Balance	$ 30,755	$ 10,640	$ (93,634)	$ —	$ (52,239)
Adjustments to opening balance, net of taxes (3)	—	—	—	(2,900)	(2,900)
Adjusted balance, beginning of period	30,755	10,640	(93,634)	(2,900)	(55,139)
Other comprehensive income before reclassifications	173,576	(556)	(20,933)	—	152,087
Amounts reclassified from accumulated other comprehensive income	(50,697)	(605)	—	208	(51,094)
Net current period other comprehensive income	$ 122,879	$ (1,161)	$ (20,933)	$ 208	$ 100,993
Balance at June 30, 2018	$ 153,634	$ 9,479	$ (114,567)	$ (2,692)	$ 45,854

(1) All amounts are net of tax and noncontrolling interest. Amounts in parentheses indicate reductions to Accumulated Other Comprehensive Income.

(2) Represents the changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected.

(3) Beginning in 2018, credit risk changes of fair value option liabilities are reflected as a component of Accumulated Other Comprehensive Income pursuant to the adoption of ASU 2016-01.

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The following table details the significant amounts reclassified from each component of accumulated other comprehensive income, shown in the above rollforward tables, for the affected periods:

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income [1]				Affected Line Item in the Consolidated Statement of Total Comprehensive Income (Loss)
	Three Months Ended June 30,		Six Months Ended June 30,		
	2019	2018	2019	2018	
Unrealized Gains (Losses) on Available-for-Sale Securities					
	$ (40,883)	$ (47,256)	$ (57,576)	$ (50,111)	Net realized investment gains (losses) and other-than-temporary impairment losses
	5,023	1,122	4,512	(586)	Provision for income taxes
	$ (35,860)	$ (46,134)	$ (53,064)	$ (50,697)	Net of tax and noncontrolling interest
Amortization of Postretirement Benefit					
Prior service cost	$ (241)	$ (241)	$ (482)	$ (482)	Other income [2]
Actuarial (losses)	(81)	(61)	(162)	(123)	Other income [2]
	(322)	(302)	(644)	(605)	Total before tax
	—	—	—	—	Provision for income taxes
	$ (322)	$ (302)	$ (644)	$ (605)	Net of tax and noncontrolling interest
Credit risk changes of fair value option liabilities					
	$ 196	$ (1,094)	$ 384	$ 250	Credit Risk Changes of Fair Value Option Liabilities
	(33)	188	(65)	(42)	Provision for income taxes
	$ 163	$ (906)	$ 319	$ 208	Net of tax and noncontrolling interest
Total reclassifications for the period	$ (36,019)	$ (47,342)	$ (53,389)	$ (51,094)	Net of tax and noncontrolling interest

(1) Amounts in parentheses indicate reductions to Accumulated Other Comprehensive Income with corresponding increases to the affected line items in the Consolidated Statement of Total Comprehensive Income.

(2) These accumulated other comprehensive income components are included in the computation of net periodic benefit cost.

5. NET INCOME PER SHARE

As of June 30, 2019, 45,549,185 shares of Ambac's common stock (par value $0.01) and warrants entitling holders to acquire up to 4,877,783 shares of new common stock at an exercise price of $16.67 per share were issued and outstanding. Common shares increased during the six months ended June 30, 2019 due to settlements of employee restricted stock units.

Basic net income per share is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares outstanding and vested restricted stock units. Diluted net income per share is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares used for basic earnings per share plus all potential dilutive common shares outstanding during the period. All potential dilutive common shares outstanding consider common stock deliverable pursuant to warrants, vested and unvested options, unvested restricted stock units and performance stock units granted under employee and director compensation plans.

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The following table provides a reconciliation of the common shares used for basic net income per share to the diluted shares used for diluted net income per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Basic weighted average shares outstanding	**45,986,043**	**45,683,058**	**45,909,595**	**45,577,656**
Effect of potential dilutive shares [1]:				
Stock options	—	—	—	—
Warrants	—	392,772	—	196,386
Restricted stock units	—	70,498	—	54,720
Performance stock units [2]	—	326,047	—	268,885
Diluted weighted average shares outstanding	**45,986,043**	**46,472,375**	**45,909,595**	**46,097,647**
Anti-dilutive shares excluded from the above reconciliation:				
Stock options	**16,667**	126,667	**16,667**	126,667
Warrants	**4,877,783**	—	**4,877,783**	—
Restricted stock units	**263,151**	—	**244,202**	5,362
Performance stock units [2]	**699,038**	—	**651,310**	—

(1) For the three and six months ended June 30, 2019, Ambac had a net loss and accordingly excluded all potentially dilutive securities from the determination of diluted loss per share as their impact was anti-dilutive.

(2) Performance stock units are reflected based on the performance metrics through the balance sheet date. Vesting of these units is contingent upon meeting certain performance metrics. Although a portion of these performance metrics have been achieved as of the respective period end, it is possible that awards may no longer meet the metric at the end of the performance period.

6. FINANCIAL GUARANTEE INSURANCE CONTRACTS

Amounts presented in this Note relate only to Ambac's non-derivative insurance business for insurance policies issued to beneficiaries, including VIEs, for which we do not consolidate the VIE.

Net Premiums Earned:

Gross premiums are received either upfront or in installments. For premiums received upfront, an unearned premium revenue ("UPR") liability is established, which is initially recorded as the cash amount received. For installment premium transactions, a premium receivable asset and offsetting UPR liability is initially established in an amount equal to: (i) the present value of future contractual premiums due (the "contractual" method) or (ii) if the assets underlying the insured obligation are homogenous pools which are contractually prepayable, the present value of premiums to be collected over the expected life of the transaction (the "expected" method). An appropriate risk-free rate corresponding to the weighted average life of each policy and currency is used to discount the future premiums contractually due or expected to be collected. For example, U.S. dollar exposures are discounted using U.S. Treasury rates. The weighted average risk-free rate at June 30, 2019 and December 31, 2018, was 2.5% and 2.7%, respectively, and the weighted average period of future premiums used to estimate the premium receivable at June 30, 2019 and December 31, 2018, was 8.7 years and 8.7 years, respectively.

In evaluating the credit quality of the premium receivables, management evaluates the obligor's ability to pay. For structured finance transactions, this evaluation will include a review of the priority for the payment of financial guarantee premiums to Ambac, as required by bond indentures, in the transaction's waterfall structure. The financial guarantee premium is generally senior in the waterfall. Uncollectable premiums are determined on a policy basis and utilize a combination of historical premium collection data in addition to cash flow analysis to determine if an impairment in the related policy's premium receivables exist. At June 30, 2019 and December 31, 2018, $8,288 and $7,136 respectively, of premium receivables were deemed uncollectable. As of June 30, 2019 and December 31, 2018, approximately 13% and 20% of the premium receivables, net of uncollectable receivables, related to transactions with non-investment grade internal ratings, mainly structured finance transactions. Past due premiums on policies insuring non-investment grade obligations amounted to less than $200 at June 30, 2019.

Below is the gross premium receivable roll-forward for the affected periods:

	Six Months Ended June 30,	
	2019	2018
Beginning premium receivable	$ **495,391**	$ 586,312
Premium receipts	**(25,693)**	(29,822)
Adjustments for changes in expected and contractual cash flows [1]	**(22,310)**	(5,066)
Accretion of premium receivable discount	**6,206**	7,627
Changes to uncollectable premiums	**(1,155)**	(11)
Other adjustments (including foreign exchange)	**(10,913)**	(5,082)
Ending premium receivable [2]	$ **441,526**	$ **553,958**

(1) Adjustments for changes in expected and contractual cash flows primarily due to reductions in insured exposure as a result of early policy terminations and unscheduled principal paydowns.

(2) Premium receivable includes premiums to be received in foreign denominated currencies most notably in British Pounds and Euros. At June 30, 2019 and 2018, premium receivables include British Pounds of $137,137 (£107,974) and $151,316 (£114,729), respectively, and Euros of $28,367 (€24,941) and $33,114 (€28,380), respectively.

When a bond issue insured by Ambac Assurance has been retired early, typically due to an issuer call, any remaining UPR is recognized at that time to the extent the financial guarantee contract is legally extinguished, causing accelerated premium revenue. For installment premium paying transactions, we offset the recognition of any remaining UPR by the reduction of the related premium receivable to zero (as it will not be collected as a result of the retirement), which may cause negative accelerated premium revenue. Ambac's accelerated premium revenue for retired obligations for the three and six months ended June 30, 2019 was $(6,169) and $6,054, respectively, and for the three and six months ended June 30, 2018 was $6,103 and 15,495, respectively.

The effect of reinsurance on premiums written and earned for the respective periods was as follows:

	Three Months Ended June 30,			
	2019		2018	
	Written	Earned	Written	Earned
Direct	$ (20,605)	$ 10,066	$ (611)	$ 27,339
Assumed	—	20	—	19
Ceded	(343)	2,253	(224)	1,522
Net premiums	**$ (20,262)**	**$ 7,833**	**$ (387)**	**$ 25,836**

	Six Months Ended June 30,			
	2019		2018	
	Written	Earned	Written	Earned
Direct	$ (17,259)	$ 39,500	$ 3,650	$ 59,947
Assumed	—	39	—	39
Ceded	(844)	3,948	(1,043)	3,267
Net premiums	$ (16,415)	$ 35,591	$ 4,693	$ 56,719

The following table summarizes net premiums earned by location of risk for the respective periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
United States	$ 5,626	$ 19,752	$ 33,869	$ 44,469
United Kingdom	4,224	4,958	8,415	9,815
Other international	(2,017)	1,126	(6,693)	2,435
Total	**$ 7,833**	**$ 25,836**	**$ 35,591**	**$ 56,719**

The table below summarizes the future gross undiscounted premiums to be collected and future premiums earned, net of reinsurance at June 30, 2019:

	Future Premiums to be Collected [1]	Future Premiums to be Earned Net of Reinsurance [1]
Three months ended:		
September 30, 2019	$ 12,324	$ 11,927
December 31, 2019	11,060	11,541
Twelve months ended:		
December 31, 2020	43,319	45,409
December 31, 2021	37,827	41,186
December 31, 2022	35,997	38,351
December 31, 2023	34,530	35,714
Five years ended:		
December 31, 2028	151,837	146,197
December 31, 2033	113,812	96,407
December 31, 2038	61,127	48,749
December 31, 2043	26,437	16,643
December 31, 2048	11,782	6,885
December 31, 2053	2,252	1,577
December 31, 2058	31	50
Total	**$ 542,335**	**$ 500,636**

(1) Future premiums to be collected are undiscounted and are used to derive the discounted premium receivable asset recorded on Ambac's balance sheet. Future premiums to be earned, net of reinsurance relate to the unearned premiums liability and deferred ceded premium asset recorded on Ambac's balance sheet. The use of contractual lives for many bond types which do not have homogeneous pools of underlying collateral is required in the calculation of the premium receivable, as further described in *Note 2. Basis of Presentation and Significant Accounting Policies* in the Notes to Consolidated Financial Statements included in Ambac's Annual Report on Form 10-K for the year ended December 31, 2018. This results in a different premium receivable balance than if expected lives were considered. If installment paying policies are retired or prepay early, premiums reflected in the premium receivable asset and amounts reported in the above table for such policies may not be collected. Future premiums to be earned also considers the use of contractual lives for many bond types which do not have homogeneous pools of underlying collateral, which may result in different unearned premium than if expected lives were considered. If those bonds types are retired early, premium earnings may be negative in the period of call or refinancing.

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Loss and Loss Expense Reserves:

The loss and loss expense reserve ("loss reserve") policy for financial guarantee insurance relates only to Ambac's non-derivative insurance business for insurance policies issued to beneficiaries, including VIEs, for which we do not consolidate the VIE. Ambac's loss reserves are based on management's on-going review of the financial guarantee credit portfolio. Below are the components of the Loss and loss expense reserves liability and the Subrogation recoverable asset at June 30, 2019 and December 31, 2018:

Balance Sheet Line Item	Present Value of Expected Net Cash Flows: Claims and Loss Expenses	Present Value of Expected Net Cash Flows: Recoveries	Unearned Premium Revenue	Gross Loss and Loss Expense Reserves
June 30, 2019:				
Loss and loss expense reserves	$ 1,828,116	$ (273,597)	$ (60,413)	$ 1,494,106
Subrogation recoverable	157,307	(2,142,133)	—	(1,984,826)
Totals	$ 1,985,423	$ (2,415,730)	$ (60,413)	$ (490,720)
December 31, 2018:				
Loss and loss expense reserves	$ 2,246,335	$ (313,595)	$ (106,662)	$ 1,826,078
Subrogation recoverable	175,694	(2,108,654)	—	(1,932,960)
Totals	$ 2,422,029	$ (2,422,249)	$ (106,662)	$ (106,882)

Below is the loss and loss expense reserve roll-forward, net of subrogation recoverable and reinsurance, for the affected periods:

	Six Months Ended June 30, 2019	Six Months Ended June 30, 2018
Beginning gross loss and loss expense reserves	$ (106,882)	$ 4,113,802
Reinsurance recoverable	22,623	40,658
Beginning balance of net loss and loss expense reserves	(129,505)	4,073,144
Losses and loss expenses (benefit):		
Current year	806	996
Prior years	(121,879)	(215,812)
Total [1][2][3]	(121,073)	(214,816)
Loss and loss expenses paid (recovered):		
Current year	40	105
Prior years [3]	194,106	3,708,992
Total	194,146	3,709,097
Foreign exchange effect	(799)	(6,378)
Ending net loss and loss expense reserves	(445,523)	142,853
Impact of VIE consolidation	(72,159)	—
Reinsurance recoverable [4]	26,962	38,293
Ending gross loss and loss expense reserves	$ (490,720)	$ 181,146

(1) Total losses and loss expenses (benefit) includes $(6,067) and $870 for the six months ended June 30, 2019 and 2018, respectively, related to ceded reinsurance.

(2) Ambac records the impact of estimated recoveries related to securitized loans in RMBS transactions that breached certain representations and warranties ("R&W"s) by transaction sponsors within losses and loss expenses (benefit). The losses and loss expense (benefit) incurred associated with changes in estimated R&Ws for the six months ended June 30, 2019 and 2018 was $8,188 and $17,602, respectively.

(3) On February 12, 2018, Deferred Amounts and Interest Accrued on Deferred Amounts in the amount of $3,000,158 and $856,834, respectively were settled in connection with the Rehabilitation Exit Transactions. 2018 includes a $288,204 loss and loss expense benefit on these settled Deferred Amounts.

(4) Represents reinsurance recoverable on future loss and loss expenses. Additionally, the Balance Sheet line "Reinsurance recoverable on paid and unpaid losses" includes reinsurance recoverables (payables) of $253 and $778 as of June 30, 2019 and 2018, respectively, related to previously presented loss and loss expenses and subrogation.

For 2019, the positive development in prior years was primarily a result of the Ballantyne and Puerto Rico COFINA commutations and positive development in the RMBS portfolio, partially offset by deterioration in other Public Finance credits, primarily Puerto Rico credits other than COFINA.

For 2018, the net positive development in prior years was primarily a result of the discount recorded on the Rehabilitation Exit Transactions partially offset by negative development in the Public Finance and RMBS portfolios and interest accrued on Deferred Amounts prior to the Rehabilitation Exit Transactions.

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The tables below summarize information related to policies currently included in Ambac's loss and loss expense reserves or subrogation recoverable at June 30, 2019 and December 31, 2018. Gross par exposures include capital appreciation bonds which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bond. The weighted average risk-free rate used to discount loss reserves at June 30, 2019 and December 31, 2018 was 2.1% and 2.8%, respectively.

Surveillance Categories as of June 30, 2019

	I	IA	II	III	IV	V	Total
Number of policies	36	23	14	16	141	3	233
Remaining weighted-average contract period (in years) [1]	8	18	8	18	14	3	14
Gross insured contractual payments outstanding:							
Principal	$ 993,210	$ 659,974	$ 201,537	$ 884,385	$ 4,179,704	$ 37,962	$ 6,956,772
Interest	489,600	590,727	101,507	422,528	1,789,609	12,413	3,406,384
Total	$ 1,482,810	$ 1,250,701	$ 303,044	$ 1,306,913	$ 5,969,313	$ 50,375	$ 10,363,156
Gross undiscounted claim liability	$ 6,295	$ 53,913	$ 27,057	$ 558,922	$ 1,778,465	$ 50,343	$ 2,474,995
Discount, gross claim liability	(492)	(5,850)	(1,627)	(169,017)	(392,990)	(2,524)	(572,500)
Gross claim liability before all subrogation and before reinsurance	5,803	48,063	25,430	389,905	1,385,475	47,819	1,902,495
Less:							
Gross RMBS subrogation [2]	—	—	—	—	(1,792,616)	—	(1,792,616)
Discount, RMBS subrogation	—	—	—	—	30,399	—	30,399
Discounted RMBS subrogation, before reinsurance	—	—	—	—	(1,762,217)	—	(1,762,217)
Less:							
Gross other subrogation [3]	—	—	—	(43,231)	(649,071)	(12,758)	(705,060)
Discount, other subrogation	—	—	—	4,586	43,997	2,964	51,547
Discounted other subrogation, before reinsurance	—	—	—	(38,645)	(605,074)	(9,794)	(653,513)
Gross claim liability, net of all subrogation and discounts, before reinsurance	5,803	48,063	25,430	351,260	(981,816)	38,025	(513,235)
Less: Unearned premium revenue	(3,695)	(9,463)	(1,870)	(7,201)	(38,005)	(179)	(60,413)
Plus: Loss expense reserves	1,140	3,809	374	1,361	76,244	—	82,928
Gross loss and loss expense reserves	$ 3,248	$ 42,409	$ 23,934	$ 345,420	$ (943,577)	$ 37,846	$ (490,720)
Reinsurance recoverable reported on Balance Sheet [4]	$ 186	$ 9,225	$ 3,673	$ 26,601	$ (12,470)	$ —	$ 27,215

(1) Remaining weighted-average contract period is weighted based on projected gross claims over the lives of the respective policies.

(2) RMBS subrogation represents Ambac's estimate of subrogation recoveries from RMBS transaction sponsors for R&W breaches.

(3) Other subrogation represents subrogation related to excess spread and other contractual cash flows on public finance and structured finance transactions, including RMBS.

(4) Reinsurance recoverable reported on the Balance Sheet includes reinsurance recoverables of $26,962 related to future loss and loss expenses and $253 related to presented loss and loss expenses and subrogation.

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Surveillance Categories as of December 31, 2018

	I	IA	II	III	IV	V	Total
Number of policies	**21**	**28**	**18**	**16**	**145**	**3**	**231**
Remaining weighted-average contract period (in years) [1]	**9**	**19**	**9**	**22**	**14**	**3**	**16**
Gross insured contractual payments outstanding:							
Principal	$ 916,530	$ 708,249	$ 622,820	$ 1,705,464	$ 5,407,202	$ 43,140	$ 9,403,405
Interest	487,702	631,708	293,293	6,979,130	2,177,539	13,401	10,582,773
Total	$ 1,404,232	$ 1,339,957	$ 916,113	$ 8,684,594	$ 7,584,741	$ 56,541	$ 19,986,178
Gross undiscounted claim liability	$ 4,019	$ 63,712	$ 36,000	$ 992,019	$ 2,295,968	$ 56,510	$ 3,448,228
Discount, gross claim liability	(481)	(13,008)	(3,069)	(433,709)	(637,548)	(4,143)	(1,091,958)
Gross claim liability before all subrogation and before reinsurance	**3,538**	**50,704**	**32,931**	**558,310**	**1,658,420**	**52,367**	**2,356,270**
Less:							
Gross RMBS subrogation [2]	—	—	—	—	(1,809,937)	—	(1,809,937)
Discount, RMBS subrogation	—	—	—	—	39,391	—	39,391
Discounted RMBS subrogation, before reinsurance	**—**	**—**	**—**	**—**	**(1,770,546)**	**—**	**(1,770,546)**
Less:							
Gross other subrogation [3]	—	(10,816)	—	(136,541)	(624,654)	(12,880)	(784,891)
Discount, other subrogation	—	7,318	—	67,008	55,088	3,774	133,188
Discounted other subrogation, before reinsurance	**—**	**(3,498)**	**—**	**(69,533)**	**(569,566)**	**(9,106)**	**(651,703)**
Gross claim liability, net of all subrogation and discounts, before reinsurance	**3,538**	**47,206**	**32,931**	**488,777**	**(681,692)**	**43,261**	**(65,979)**
Less: Unearned premium revenue	(943)	(10,073)	(5,085)	(36,365)	(53,987)	(209)	(106,662)
Plus: Loss expense reserves	1,369	4,253	2,564	(5,926)	63,499	—	65,759
Gross loss and loss expense reserves	**$ 3,964**	**$ 41,386**	**$ 30,410**	**$ 446,486**	**$ (672,180)**	**$ 43,052**	**$ (106,882)**
Reinsurance recoverable reported on Balance Sheet [4]	**$ 367**	**$ 7,285**	**$ 4,223**	**$ 26,096**	**$ (14,838)**	**$ —**	**$ 23,133**

(1) Remaining weighted-average contract period is weighted based on projected gross claims over the lives of the respective policies.

(2) RMBS subrogation represents Ambac's estimate of subrogation recoveries from RMBS transaction sponsors for R&W breaches.

(3) Other subrogation represents subrogation related to excess spread and other contractual cash flows on public finance and structured finance transactions, including RMBS.

(4) Reinsurance recoverable reported on Balance Sheet includes reinsurance recoverables of $22,623 related to future loss and loss expenses and $510 related to presented loss and loss expenses and subrogation.

Puerto Rico:

Ambac has exposure to the Commonwealth of Puerto Rico (the "Commonwealth") and its instrumentalities across several different issuing entities. Each has its own credit risk profile attributable to discrete revenue sources, direct general obligation pledges or general obligation guarantees. The Commonwealth of Puerto Rico and certain of its instrumentalities have defaulted and may continue to default on debt service payments, including payments owed on bonds insured by Ambac Assurance. Ambac Assurance may be required to make significant amounts of policy payments over the next several years, the recoverability of which is subject to great uncertainty, which may lead to a material increase in permanent losses causing a material adverse impact on our results of operations and financial condition. Our exposure to Puerto Rico is impacted by the amount of monies available for debt service, which is in turn affected by a number of factors including demographic trends, economic growth, tax policy and revenues, impact of reforms, fiscal plans, government actions, political instability, budgetary performance and flexibility, weather events, litigation outcomes, as well as federal funding of Commonwealth needs. In the near term, the financial and economic outlook for Puerto Rico is dependent upon a still fragile infrastructure, heightening its vulnerability to additional weather events. The longer term recovery of the Commonwealth economy and its essential infrastructure will likely be dependent on, amongst other factors, the management, usage and efficacy of federal resources.

Also important to Puerto Rico's economic growth, government reform and creditor outcomes is the revised Fiscal Plan for the Commonwealth of Puerto Rico, certified by the Financial Oversight and Management Board for Puerto Rico ("Oversight Board") on May 9, 2019. The Commonwealth Fiscal Plan outlines a series of reforms, projects the fiscal and economic impact of those reforms, and provides forecasts of resulting budgetary surpluses over a fiscal year series. However, as was the case with prior Commonwealth Fiscal Plans, the Commonwealth Fiscal Plan certified on May 9,

2019 lacks a high degree of transparency regarding the underlying data, assumptions and rationales supporting those assumptions, making reconciliation and due diligence difficult. As a result, it is difficult to predict the long-term capacity and willingness of the Puerto Rico government and its instrumentalities to pay debt service on bonded debt and how their debt burden and financial flexibility might affect Ambac Assurance's claim potential, risk profile and long-term financial strength.

Substantial uncertainty exists with respect to the ultimate outcome for creditors in Puerto Rico, such as Ambac Assurance, due to, amongst other matters, legislation enacted by the Commonwealth and the federal government, including PROMESA, actions taken pursuant to such laws, including Title III filings, as well as political uncertainty and leadership turnover, including the resignation of Governor Ricardo Rosselló, many of his cabinet members and other public officials. Ambac Assurance is involved in multiple litigations relating to such actions and other issues and may not be successful in pursuing claims or protecting its interests. As a result of litigation or other aspects of the restructuring processes, the difference among the credits insured by Ambac Assurance may not be respected.

Ambac Assurance has and may continue to participate in mediation processes related to potential debt restructurings. Mediation may not be productive or may not resolve Ambac Assurance's claims in a manner that avoids significant losses. No assurances can be given that negotiations will be successfully concluded, that Commonwealth, Oversight Board and creditor parties will reach definitive agreements on additional debt restructurings, that any additional negotiated transaction debt restructuring, definitive agreement or Plan of Adjustment will be approved by the court and completed, or that any transaction or Plan of Adjustment will not have an adverse impact on Ambac's financial conditions or results. It is possible that certain restructuring process solutions, together with associated legislation, budgetary, and/or public policy proposals could be adopted and could further impair our exposures, causing losses that could have a material adverse impact on our results of operations and financial condition.

While our reserving scenarios reflect a wide range of possible outcomes, reflecting the significant uncertainty regarding future developments and outcomes, given our exposure to Puerto Rico and the economic, fiscal, legal and political uncertainties associated therewith as well as the uncertainties emanating from the damage caused by hurricanes Maria and Irma, our loss reserves may ultimately prove to be insufficient to cover our losses, potentially by a material amount, and may be subject to material volatility.

Ambac has considered these developments and other factors in evaluating its Puerto Rico loss reserves. During the six months ended June 30, 2019, Ambac had incurred losses associated with its Domestic Public Finance insured portfolio of $119,560, which was primarily impacted by the continued uncertainty and volatility of the situation in Puerto Rico. While management believes its reserves are adequate to cover losses in its Public Finance insured portfolio, there can be no assurance that Ambac may not incur additional losses in the future, particularly given the developing economic, political, and legal circumstances in Puerto Rico. Such additional losses may have a material adverse effect on Ambac's results of operations and financial condition. For public finance credits, including Puerto Rico, as well as other issuers, for which Ambac has an estimate of expected loss at June 30, 2019, the possible increase in loss reserves under stress or other adverse conditions and circumstances was estimated to be approximately $1,100,000. This possible increase in loss reserves under stress or other adverse conditions is significant and if we were to experience such incremental losses, our stockholders' equity as of June 30, 2019 would decrease from $1,552,916 to $452,916. However, there can be no assurance that losses may not exceed such amount.

COFINA Debt Restructuring

On January 16-17, 2019, the hearings for the confirmation of the COFINA Plan of Adjustment ("POA") and the Commonwealth 9019 motion were held. On February 4, 2019, the COFINA POA was confirmed and the Commonwealth 9019 motion was approved by the U.S. District Court for the District of Puerto Rico. On February 12, 2019, the COFINA POA went effective. Pursuant to the POA, all existing COFINA senior and subordinate bonds were discharged and exchanged for cash and new COFINA current interest and capital appreciation bonds ("new COFINA bonds"). The cash and new COFINA bonds allocated to COFINA senior bondholders equaled approximately 93% (considering the new COFINA bonds at par) of such senior bondholders' allowed claim, in the amount of the COFINA senior bond accreted value, as of, but not including, May 5, 2017 (the COFINA Title III Petition Date).

Pursuant to the POA, each holder of Ambac Assurance-insured senior COFINA bonds had the option to elect by January 11, 2019 to either (i) commute their rights in respect of the Ambac Assurance insurance policy associated with the existing senior COFINA bonds, which bonds would be discharged and Ambac Assurance policy obligations with respect thereto would be released, in exchange for new COFINA bonds, cash amounts to be paid by COFINA plus additional cash consideration provided by Ambac Assurance equal to 5.25% of the accreted value of the Ambac Assurance-insured senior COFINA bonds as of the COFINA Petition Date or (ii) agree to deposit their Ambac Assurance-insured senior COFINA bonds into a trust in exchange for units issued by the trust (the "COFINA Class 2 Trust"), which trust would receive the new COFINA bonds and the cash amounts to be paid by COFINA that such bondholders would have otherwise received to the extent they had elected the recovery under clause (i) above (thereby entitling the COFINA Class 2 Trust to receive debt service payments from COFINA with respect to the new COFINA bonds deposited into the trust) plus any accelerated policy payments (made solely at Ambac Assurance's own discretion) or claim payments due under the existing Ambac Assurance insurance policy for the deficiency relating to the existing senior COFINA bonds at the relevant scheduled payment dates (2047 through 2054). Any claims payable under the existing Ambac Assurance policy for the Ambac Assurance-insured senior COFINA bonds held in the trust will be reduced by all amounts distributed or deemed distributed from the trust to the holders of the trust units from the new COFINA bonds and cash as well as accelerated policy payments made by Ambac Assurance at its own discretion. Ambac makes no representation and can give no assurances that the new COFINA bonds or COFINA Class 2 Trust units, both of which are not insured by Ambac Assurance, will trade at par or any other price. Under the COFINA POA, Ambac Assurance-insured bondholders who did not affirmatively elect the trust option in clause (ii) above were deemed to have elected the commutation option described in clause (i) above. Approximately 75% of Ambac Assurance-insured

senior COFINA bondholders, by measure of insured par, elected the commutation option or did not affirmatively elect to exchange their bonds for units of the COFINA Class 2 Trust.

As a result of the POA, commutations, amendments, and subsequent redemptions of obligations of the COFINA Class 2 Trust, Ambac Assurance's net par outstanding was reduced to $177,605 as of June 30, 2019. Ambac Assurance's remaining policy obligation of $177,605 net par is an asset of the COFINA Class 2 Trust, which holds a ratable distribution of new COFINA bonds, the interest and principal from which can be used to partially offset Ambac's remaining insurance liability. As further discussed in *Note 3. Variable Interest Entities*, Ambac Assurance consolidated the COFINA Class 2 Trust.

At this time, it is unclear what impact the COFINA restructuring will have on the prospective recoveries of Ambac Assurance's other insured Puerto Rico instrumentalities.

Representation and Warranty Recoveries:

Ambac records estimated subrogation recoveries for breaches of R&Ws by sponsors of certain RMBS transactions. For a discussion of the approach utilized to estimate R&W subrogation recoveries, see *Note 2. Basis of Presentation and Significant Accounting Policies* in the Notes to Consolidated Financial Statements included Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

Ambac has recorded R&W subrogation recoveries of $1,762,217 ($1,736,055 net of reinsurance) and $1,770,546 ($1,744,243 net of reinsurance) at June 30, 2019 and December 31, 2018, respectively. R&W recovery proceeds up to the first $1,400,000 and above $1,600,000 have been pledged as security on certain of Ambac's long-term debt obligations as described further in *Note 1. Background and Business Description* in the Notes to Consolidated Financial Statements included Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

Below is the rollforward of R&W subrogation for the affected periods:

	Six Months Ended June 30,	
	2019	**2018**
Discounted R&W subrogation (gross of reinsurance) at beginning of period	$ 1,770,546	$ 1,834,387
Changes recognized during the period:		
Impact of sponsor actions [1]	—	—
All other changes [2]	(8,329)	(18,002)
Discounted R&W subrogation (gross of reinsurance) at end of period	**$ 1,762,217**	**$ 1,816,385**

(1) Sponsor actions include loan repurchases, direct payments to Ambac and other contributions from sponsors.

(2) All other changes which may impact RMBS R&W subrogation recoveries include changes in actual or projected collateral performance, changes in the creditworthiness of a sponsor and/or the projected timing of recoveries.

Our ability to realize R&W subrogation recoveries is subject to significant uncertainty, including risks inherent in litigation, collectability of such amounts from counterparties (and/or their respective parents and affiliates), timing of receipt of any such recoveries, intervention by OCI, which could impede our ability to take actions required to realize such recoveries, and uncertainty inherent in the assumptions used in estimating such recoveries. Failure to realize R&W subrogation recoveries for any reason or the realization of R&W subrogation recoveries materially below the amount recorded on Ambac's consolidated balance sheet would have a material adverse effect on our results of operations and financial condition and may result in adverse consequences such as impairing the ability of Ambac Assurance to honor its financial obligations; the initiation of rehabilitation proceedings against Ambac Assurance; decreased likelihood of Ambac Assurance delivering value to Ambac, through dividends or otherwise; and a significant drop in the value of securities issued or insured by Ambac or Ambac Assurance.

Insurance intangible asset:

The insurance intangible amortization expense is included in insurance intangible amortization on the Consolidated Statements of Total Comprehensive Income (Loss). For the three and six months ended June 30, 2019, the insurance intangible amortization expense was $226,242 and $262,520, respectively, and for the three and six months ended June 30, 2018, the insurance intangible amortization expense was $23,242 and $51,878, respectively. As of June 30, 2019 and December 31, 2018, the gross carrying value of the insurance intangible asset was $1,265,052 and $1,551,576, respectively. Accumulated amortization of the insurance intangible asset was $810,222 and $832,645, as of June 30, 2019 and December 31, 2018, respectively, resulting in a net insurance intangible asset of $454,830 and $718,931, respectively.

The estimated future amortization expense for the net insurance intangible asset is as follows:

Amortization expense [1]	
2019 (six months)	**$ 24,591**
2020	**45,139**
2021	**39,777**
2022	**36,194**
2023	**33,016**
Thereafter	**276,113**

(1) Future amortization considers the use of contractual lives for many bond types which do not have homogeneous pools of underlying collateral. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay certain obligations. If those bonds types are retired early, amortization expense may differ in the period of call or refinancing.

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7. FAIR VALUE MEASUREMENTS

The Fair Value Measurement Topic of the ASC establishes a framework for measuring fair value and disclosures about fair value measurements.

Fair Value Hierarchy:

The Fair Value Measurement Topic of the ASC specifies a fair value hierarchy based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company-based assumptions. The fair value hierarchy prioritizes model inputs into three broad levels as follows:

- Level 1: Quoted prices for identical instruments in active markets. Assets and liabilities classified as Level 1 include US Treasury and other foreign government obligations traded in highly liquid and transparent markets, exchange traded futures contracts, variable rate demand obligations and money market funds.
- Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. Assets and liabilities classified as Level 2 generally include investments in fixed income securities representing municipal, asset-backed and corporate obligations, certain interest rate swap contracts and most long-term debt of variable interest entities consolidated under the Consolidation Topic of the ASC.
- Level 3: Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. This hierarchy requires the use of observable market data when available. Assets and liabilities classified as Level 3 include credit derivative contracts, certain uncollateralized interest rate swap contracts, equity interests in Ambac sponsored special purpose entities and certain investments in fixed income securities. Additionally, Level 3 assets and liabilities generally include loan receivables, and certain long-term debt of variable interest entities consolidated under the Consolidation Topic of the ASC.

The Fair Value Measurement Topic of the ASC permits, as a practical expedient, the estimation of fair value of certain investments in funds using the net asset value per share of the investment or its equivalent ("NAV"). Investments in funds valued using NAV are not categorized as Level 1, 2 or 3 under the fair value hierarchy. The following table sets forth the carrying amount and fair value of Ambac's financial assets and liabilities as of June 30, 2019 and December 31, 2018, including the level within the fair value hierarchy at which fair value measurements are categorized. As required by the Fair Value Measurement Topic of the ASC, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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June 30, 2019:	Carrying Amount	Total Fair Value	Fair Value Measurements Categorized as: Level 1	Level 2	Level 3
Financial assets:					
Fixed income securities:					
Municipal obligations	$ 342,673	$ 342,673	$ —	$ 342,673	$ —
Corporate obligations	1,400,659	1,400,659	—	1,400,659	—
Foreign obligations	30,743	30,743	30,324	419	—
U.S. government obligations	96,806	96,806	96,806	—	—
Residential mortgage-backed securities	252,260	252,260	—	252,260	—
Collateralized debt obligations	136,153	136,153	—	136,153	—
Other asset-backed securities	344,883	344,883	—	270,565	74,318
Fixed income securities, pledged as collateral:					
U.S. government obligations	84,418	84,418	84,418	—	—
Short term investments	772,299	772,299	739,762	32,537	—
Other investments [1]	469,438	443,791	129,689	—	17,228
Cash, cash equivalents and restricted cash	17,514	17,514	12,028	5,486	—
Derivative assets:					
Interest rate swaps—asset position	72,156	72,156	—	9,025	63,131
Futures contracts	220	220	220	—	—
Other assets - equity in sponsored VIE	3,771	3,771	—	—	3,771
Other assets-Loans	9,760	12,233	—	—	12,233
Variable interest entity assets:					
Fixed income securities: Corporate obligations	2,881,889	2,881,889	—	—	2,881,889
Fixed income securities: Municipal obligations	256,825	256,825	—	256,825	—
Restricted cash	28,500	28,500	28,500	—	—
Loans	4,288,572	4,288,572	—	—	4,288,572
Derivative assets: Currency swaps-asset position	62,941	62,941	—	62,941	—
Total financial assets	$ 11,552,480	$ 11,529,306	$ 1,121,747	$ 2,769,543	$ 7,341,142
Financial liabilities:					
Long term debt, including accrued interest	$ 3,353,716	$ 3,348,262	$ —	$ 2,960,079	$ 388,183
Derivative liabilities:					
Credit derivatives	861	861	—	—	861
Interest rate swaps—asset position	(239)	(239)	—	(239)	—
Interest rate swaps—liability position	87,623	87,623	—	87,623	—
Liabilities for net financial guarantees written [2]	(861,263)	319,384	—	—	319,384
Variable interest entity liabilities:					
Long-term debt (includes $5,308,724 carried at fair value)	5,648,083	5,702,129	—	5,471,514	230,615
Derivative liabilities: Interest rate swaps—liability position	1,818,273	1,818,273	—	1,818,273	—
Total financial liabilities	$ 10,047,054	$ 11,276,293	$ —	$ 10,337,250	$ 939,043

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December 31, 2018:	Carrying Amount	Total Fair Value	Fair Value Measurements Categorized as: Level 1	Level 2	Level 3
Financial assets:					
Fixed income securities:					
Municipal obligations	$ 879,919	$ 879,919	$ —	$ 879,919	$ —
Corporate obligations	1,278,122	1,278,122	—	1,278,122	—
Foreign obligations	30,834	30,834	29,922	912	—
U.S. government obligations	94,394	94,394	94,394	—	—
Residential mortgage-backed securities	258,607	258,607	—	258,607	—
Collateralized debt obligations	131,356	131,356	—	131,356	—
Other asset-backed securities	442,443	442,443	—	370,372	72,071
Short term investments	430,331	430,331	304,880	125,451	—
Other investments (1)	391,217	367,315	71,108	—	16,266
Cash and cash equivalents	82,494	82,494	52,661	29,833	—
Derivative assets:					
Interest rate swaps—asset position	59,468	59,468	—	12,008	47,460
Other assets - equity in sponsored VIE	4,516	4,516	—	—	4,516
Other assets-loans	9,913	11,620	—	—	11,620
Variable interest entity assets:					
Fixed income securities: Corporate obligations	2,737,286	2,737,286	—	—	2,737,286
Restricted cash	999	999	999	—	—
Loans	4,287,664	4,287,664	—	—	4,287,664
Derivative assets: Currency swaps—asset position	66,302	66,302	—	66,302	—
Total financial assets	**$ 11,185,865**	**$ 11,163,670**	**$ 553,964**	**$ 3,152,882**	**$ 7,176,883**
Financial liabilities:					
Long term debt, including accrued interest	$ 3,304,737	$ 3,259,966	$ —	$ 2,909,272	$ 350,694
Derivative liabilities:					
Credit derivatives	1,459	1,459	—	—	1,459
Interest rate swaps—liability position	71,861	71,861	—	71,861	—
Futures contracts	3,379	3,379	3,379	—	
Liabilities for net financial guarantees written (2)	(718,388)	558,824	—	—	558,824
Variable interest entity liabilities:					
Long-term debt	5,268,596	5,268,596	—	5,051,504	217,092
Derivative liabilities: Interest rate swaps—liability position	1,712,062	1,712,062	—	1,712,062	—
Total financial liabilities	**$ 9,643,706**	**$ 10,876,147**	**$ 3,379**	**$ 9,744,699**	**$ 1,128,069**

(1) Excluded from the fair value measurement categories in the table above are investment funds of $296,874 and $279,941 as of June 30, 2019 and December 31, 2018, respectively, which are measured using NAV as a practical expedient.

(2) The carrying value of net financial guarantees written includes the following balance sheet items: Premium receivables; Reinsurance recoverable on paid and unpaid losses; Deferred ceded premium; Subrogation recoverable; Insurance intangible asset; Unearned premiums; Loss and loss expense reserves; Ceded premiums payable, premiums taxes payable and other deferred fees recorded in Other liabilities.

Determination of Fair Value:

When available, Ambac uses quoted active market prices specific to the financial instrument to determine fair value, and classifies such items within Level 1. The determination of fair value for financial instruments categorized in Level 2 or 3 involves judgment due to the complexity of factors contributing to the valuation. Third-party sources from which we obtain independent market quotes also use assumptions, judgments and estimates in determining financial instrument values and different third parties may use different methodologies or provide different values for financial instruments. In addition, the use of internal valuation models may require assumptions about hypothetical or inactive markets. As a result of these factors, the actual trade value of a financial instrument in the market, or exit value of a financial instrument position by Ambac, may be significantly different from its recorded fair value.

Ambac's financial instruments carried at fair value are mainly comprised of investments in fixed income securities, equity interests in pooled investment funds, derivative instruments, certain variable interest entity assets and liabilities and interests in Ambac sponsored special purpose entities. Valuation of financial instruments is performed by Ambac's finance group using methods approved by senior financial management with consultation from risk

management and portfolio managers as appropriate. Preliminary valuation results are discussed with portfolio managers quarterly to assess consistency with market transactions and trends as applicable. Market transactions such as trades or negotiated settlements of similar positions, if any, are reviewed to validate fair value model results. However, many of the financial instruments valued using significant unobservable inputs have very little or no observable market activity. Methods and significant inputs and assumptions used to determine fair values across portfolios are reviewed quarterly by senior financial management. Other valuation control procedures specific to particular portfolios are described further below.

We reflect Ambac's own creditworthiness in the fair value of financial liabilities by including a credit valuation adjustment ("CVA") in the determination of fair value. A decline (increase) in Ambac's creditworthiness as perceived by market participants will generally result in a higher (lower) CVA, thereby lowering (increasing) the fair value of Ambac's financial liabilities as reported.

Fixed Income Securities:

The fair values of fixed income investment securities are based primarily on market prices received from quotes or alternative pricing sources. Because many fixed income securities do not trade on a daily basis, pricing sources apply available market information through processes such as matrix pricing to calculate fair value. Such prices generally consider a variety of factors, including recent trades of the same and similar securities. In those cases, the items are classified within Level 2. For those fixed income investments where quotes were not available or cannot be reasonably corroborated, fair values are based on internal valuation models. Key inputs to the internal valuation models generally include maturity date, coupon and yield curves for asset-type and credit rating characteristics that closely match those characteristics of the specific investment securities being valued. Items valued using valuation models are classified according to the lowest level input or value driver that is significant to the valuation. Thus, an item may be classified in Level 3 even though there may be significant inputs that are readily observable. Longer (shorter) expected maturities or higher (lower) yields used in the valuation model will, in isolation, result in decreases (increases) in fair value. Generally, lower credit ratings or longer expected maturities will be accompanied by higher yields used to value a security. At June 30, 2019, approximately 4%, 94% and 2% of the fixed income investment portfolio (excluding variable interest entity investments) was valued using broker quotes, alternative pricing sources and internal valuation models, respectively. At December 31, 2018, approximately 8%, 90% and 2% of the fixed income investment portfolio (excluding variable interest entity investments) was valued using broker quotes, alternative pricing sources and internal valuation models, respectively.

Ambac performs various review and validation procedures to quoted and modeled prices for fixed income securities, including price variance analyses, missing and static price reviews, overall valuation analysis by portfolio managers and finance managers and reviews associated with our ongoing impairment analysis. Unusual prices identified through these procedures will be evaluated further against alternative third party quotes (if available) and/or internally modeled prices, and the pricing source values will be challenged as necessary. Price challenges generally result in the use of the pricing source's quote as originally provided or as revised by the source following their internal diligence process. A price challenge may result in a determination by either the pricing source or Ambac management that the pricing source cannot provide a reasonable value for a security or cannot adequately support a quote, in which case Ambac would resort to using either other quotes or internal models. Results of price challenges are reviewed by portfolio managers and finance managers.

Information about the valuation inputs for fixed income securities classified as Level 3 is included below:

Other asset-backed securities: These securities are a subordinated tranche of a resecuritization collateralized by Ambac-insured military housing bonds. The fair value of such securities classified as Level 3 was $74,318 and $72,071 at June 30, 2019 and December 31, 2018, respectively. Fair value was calculated using a discounted cash flow approach with expected future cash flows discounted using a yield consistent with the security type and rating. Significant inputs for the valuation at June 30, 2019 and December 31, 2018 include the following weighted averages:

June 30, 2019:	
a. Coupon rate:	**5.98%**
b. Average Life:	**15.93 years**
c. Yield:	**11.50%**
December 31, 2018:	
a. Coupon rate:	5.97%
b. Maturity:	16.29 years
c. Yield:	12.00%

Other Investments:

Other investments primarily relate to investments in pooled investment funds. The fair value of pooled investment funds is determined using dealer quotes or alternative pricing sources when such investments have readily determinable fair values. When fair value is not readily determinable, pooled investment funds are valued using NAV as a practical expedient as permitted under the Fair Value Measurement Topic of the ASC. Refer to *Note 8. Investments* for additional information about such investments in pooled funds that are reported at fair value using NAV as a practical expedient.

Other investments also includes Ambac's equity interest in a non-consolidated VIE which is carried under the equity method. Fair value for the non-consolidated VIE equity interest is internally calculated using a discounted cash flow approach and is classified as Level 3.

Derivative Instruments:

Ambac's derivative instruments primarily comprise interest rate swaps, credit default swaps and exchange traded futures contracts. Fair value is determined based upon market quotes from independent sources, when available. When independent quotes are

not available, fair value is determined using valuation models. These valuation models require market-driven inputs, including contractual terms, credit spreads and ratings on underlying referenced obligations, yield curves and tax-exempt interest ratios. The valuation of certain interest rate as well as all credit derivative contracts also require the use of data inputs and assumptions that are determined by management and are not readily observable in the market. Under the Fair Value Measurement Topic of the ASC, Ambac is required to consider its own credit risk when measuring the fair value of derivatives and other liabilities. Factors considered in estimating the amount of any Ambac CVA on such contracts include collateral posting provisions, right of set-off with the counterparty, the period of time remaining on the derivative and the pricing of recent terminations. The fair value of credit derivative liabilities was reduced by $75 and $138 at June 30, 2019 and December 31, 2018, respectively, as a result of incorporating an Ambac CVA into the valuation model for these contracts. Interest rate swap liabilities are collateralized and are not adjusted with an Ambac CVA at June 30, 2019 and December 31, 2018.

Interest rate swaps that are not centrally cleared are valued using vendor-developed models that incorporate interest rates and yield curves that are observable and regularly quoted. These models provide the net present value of the derivatives based on contractual terms and observable market data. Generally, the need for counterparty (or Ambac) CVAs on interest rate derivatives is mitigated by the existence of collateral posting agreements under which adequate collateral has been posted. Certain of these derivative contracts entered into with financial guarantee customers are not subject to collateral posting agreements. Counterparty credit risk related to such customer derivative assets is included in our determination of their fair value.

Ambac's remaining credit derivatives ("CDS") are valued using an internal model that uses traditional financial guarantee CDS pricing to calculate the fair value of the derivative contract based on the reference obligation's current pricing, remaining life and credit rating and Ambac's own credit risk. The model calculates the difference between the present value of the projected fees receivable under the CDS and our estimate of the fees a financial guarantor of comparable credit quality would charge to provide the same protection at the balance sheet date. Unobservable inputs used include Ambac's internal reference obligation credit ratings and expected life, estimates of fees that would be charged to assume the credit derivative obligation and Ambac's CVA. Ambac is party to only one remaining credit derivative with internal credit rating of AA at June 30, 2019. Ambac has not made any significant changes to its modeling techniques or related model inputs for the periods presented.

Financial Guarantees:

Fair value of net financial guarantees written represents our estimate of the cost to Ambac to completely transfer its insurance obligation to another market participant of comparable credit worthiness. In theory, this amount should be the same amount that another market participant of comparable credit worthiness would hypothetically charge in the market place, on a present value basis, to provide the same protection as of the balance sheet date. This fair value estimate of financial guarantees is presented on a net basis and includes direct and assumed contracts written, net of ceded reinsurance contracts.

The fair value estimate of financial guarantees is computed by utilizing cash flows calculated at the policy level. For direct and assumed contracts, net cash flows for each policy includes future: (i) installment premium receipts, (ii) gross claim payments, and (iii) subrogation receipts. For ceded reinsurance contracts, net cash flows for each policy includes future: (i) installment ceded premium payments, (ii) ceding commission receipts, (iii) ceded claim receipts, and (iv) ceded subrogation payments. For each assumed or ceded reinsurance contract, the respective undiscounted cash flow components are aggregated to determine if we are in a net asset or net liability position. U.S. GAAP requires that the nonperformance risk of a financial liability be included in the estimation of fair value, which includes considering Ambac Assurance's own credit risk. Accordingly, for each contract in a net liability position, we estimate the fair value using internally developed discount rates and market pricing that incorporate Ambac's own credit risk and subsequently apply a profit margin. This profit margin represents what another market participant would require to assume the financial guarantee contracts. A profit margin was developed based on discussions with the third-party institutions with valuation expertise and discussions with industry participants. The discount rates used for contracts in a net liability position are derived from the rates implicit in the fair value of Ambac guaranteed securities with future cash flows that are highly dependent upon Ambac financial guarantee payments. For each contract in a net asset position, we estimate the fair value using a discount rate that is commensurate with a hypothetical buyer's cost of capital.

This methodology is based on management's expectations of how a market participant would estimate net cash flows. Since no financial guarantor with Ambac Assurance's credit quality is writing or otherwise obtaining financial guarantee business (e.g. reinsurance or novation of policies from other insurers) we do not have access to observable pricing data points and therefore fair or exit value may differ, perhaps materially.

Long-term Debt:

Long-term debt includes Ambac Assurance surplus notes and junior surplus notes, the Ambac Note and Tier 2 Notes issued in connection with the Rehabilitation Exit Transactions and the Ambac UK debt issued in connection with the Ballantyne commutation. The fair values of surplus notes, the Ambac Note and Tier 2 Notes are classified as Level 2. The fair value of junior surplus notes and Ambac UK debt are classified as Level 3.

Other Financial Assets and Liabilities:

The fair values of Loans and Ambac's equity interest in Ambac sponsored VIEs are estimated based upon internal valuation models and are classified as Level 3.

Variable Interest Entity Assets and Liabilities:

The financial assets and liabilities of VIEs consolidated under the Consolidation Topic of the ASC consist primarily of fixed income securities, loans, derivative and debt instruments and are generally carried at fair value. These consolidated VIEs are securitization entities which have liabilities and/or assets guaranteed by Ambac Assurance or Ambac UK. The fair values of VIE debt instruments are determined using the same methodologies used to value Ambac's fixed income securities in its investment portfolio as described above. VIE debt fair value is based on market prices received from

independent market sources. Such quotes are considered Level 2 and generally consider a variety of factors, including recent trades of the same and similar securities. For those VIE debt instruments where quotes were not available, the debt instrument fair values are considered Level 3 and are based on internal discounted cash flow models. Comparable to the sensitivities of investments in fixed income securities described above, longer (shorter) expected maturities or higher (lower) yields used in the valuation model will, in isolation, result in decreases (increases) in fair value liability measurement for VIE debt. VIE debt instruments considered Level 3 include fixed rate notes secured by various asset types, primarily European ABS. Information about the valuation inputs for the various VIE debt categories classified as Level 3 is as follows:

European ABS transactions: The fair value of such obligations classified as Level 3 was $230,615 and $217,092 at June 30, 2019 and December 31, 2018, respectively. Fair values were calculated by using a discounted cash flow approach. The discount rates used were based on the rates implied from the third party quoted values for comparable notes from the same securitization entity. Significant inputs for the valuation at June 30, 2019 and December 31, 2018 include the following weighted averages:

June 30, 2019:	
a. Coupon rate:	**2.20%**
b. Maturity:	**18.44 years**
c. Yield:	**2.80%**
December 31, 2018:	
a. Coupon rate:	2.20%
b. Maturity:	18.93 years
c. Yield:	3.18%

VIE derivative asset and liability fair values are determined using valuation models. When specific derivative contractual terms are available and may be valued primarily by reference to interest rates, foreign exchange rates and yield curves that are observable and regularly quoted, the derivatives are valued using vendor-developed models. Other derivatives within the VIEs that include significant unobservable valuation inputs are valued using internally developed models. VIE derivative liability fair value balances at June 30, 2019 and December 31, 2018 were developed using vendor-developed models and do not use significant unobservable inputs.

The fair value of VIE assets are obtained from market quotes when available. Typically VIE asset fair values are not readily available from market quotes and are estimated internally. The consolidated VIEs are securitization entities in which net cash flows from assets and derivatives (after adjusting for financial guarantor cash flows and other expenses) will be paid out to note holders or equity interests. Internal valuations of VIE assets (fixed income securities or loans), therefore, are generally derived from the fair value of notes and derivatives, as described above, adjusted for the fair value of cash flows from Ambac's financial guarantee. The fair value of financial guarantee cash flows include: (i) estimated future premiums discounted at a rate consistent with that implicit in the fair value of the VIE's liabilities and (ii) internal estimates of future loss payments by Ambac discounted at a rate that includes Ambac's own credit risk. Estimated future premium payments to be paid by the VIEs were discounted at a weighted average rate of 2.8% and 3.1% at June 30, 2019 and December 31, 2018, respectively. The value of future loss payments to be paid by Ambac to the VIEs was adjusted to include an Ambac CVA appropriate for the term of expected Ambac claim payments.

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Additional Fair Value Information for Financial Assets and Liabilities Accounted for at Fair Value:

The following tables present the changes in the Level 3 fair value category for the periods presented in 2019 and 2018. Ambac classifies financial instruments in Level 3 of the fair value hierarchy when there is reliance on at least one significant unobservable input to the valuation model. In addition to these unobservable inputs, the valuation models for Level 3 financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Thus, the gains and losses presented below include changes in the fair value related to both observable and unobservable inputs.

Level 3 - Financial Assets and Liabilities Accounted for at Fair Value

				VIE Assets and Liabilities			
	Investments	Other Assets[1]	Derivatives	Investments	Loans	Long-term Debt	Total
Three Months Ended June 30, 2019:							
Balance, beginning of period	$ 71,855	$4,148	$ 53,034	$2,858,404	$ 4,375,761	$ (224,447)	$ 7,138,755
Total gains/(losses) realized and unrealized:							
Included in earnings	388	(377)	10,366	108,556	85,681	(11,550)	193,064
Included in other comprehensive income	2,385	—	—	(67,887)	(102,465)	5,382	(162,585)
Purchases	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Settlements	(310)	—	(1,130)	(17,184)	(70,405)	—	(89,029)
Balance, end of period	$ 74,318	$3,771	$ 62,270	$2,881,889	$ 4,288,572	$ (230,615)	$ 7,080,205
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ (377)	$ 10,270	$ 108,556	$ 85,681	$ (11,550)	$ 192,580

Three Months Ended June 30, 2018:							
Balance, beginning of period	$ 77,630	$5,621	$ 49,908	$2,955,763	$11,558,331	$(2,696,516)	$11,950,737
Total gains/(losses) realized and unrealized:							
Included in earnings	282	(366)	(2,682)	(4,137)	27,466	17,228	37,791
Included in other comprehensive income	(3,514)	—	—	(177,107)	(672,595)	161,650	(691,566)
Purchases	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Settlements	(287)	—	(1,613)	(17,595)	(162,003)	—	(181,498)
Transfers into Level 3	(5,309)	—	—	—	—	—	(5,309)
Balance, end of period	$ 68,802	$5,255	$ 45,613	$2,756,924	$10,751,199	$(2,517,638)	$11,110,155

The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ (366)	$ (2,773)	$ (4,137)	$ 27,466	$ 17,228	$ 37,418

(1) Other assets carried at fair value and classified as Level 3 relate to an equity interest in an Ambac sponsored VIE.

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Level 3 - Financial Assets and Liabilities Accounted for at Fair Value

				VIE Assets and Liabilities			
	Investments	Other Assets	Derivatives	Investments	Loans	Long-term Debt	Total
Six Months Ended June 30, 2019:							
Balance, beginning of period	$ 72,071	$ 4,516	$ 46,001	$ 2,737,286	$ 4,287,664	$ (217,092)	$ 6,930,446
Total gains/(losses) realized and unrealized:							
Included in earnings	771	(745)	18,553	175,475	173,962	(14,603)	353,413
Included in other comprehensive income	2,114	—	—	(13,688)	(17,404)	1,080	(27,898)
Purchases	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Settlements	(638)	—	(2,284)	(17,184)	(155,650)	—	(175,756)
Balance, end of period	$ 74,318	$ 3,771	$ 62,270	$ 2,881,889	$ 4,288,572	$ (230,615)	$ 7,080,205
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ (745)	$ 18,366	$ 175,475	$ 173,962	$ (14,603)	$ 352,455
Six Months Ended June 30, 2018:							
Balance, beginning of period	$ 808,557	$ 5,979	$ 60,808	$ 2,914,145	$ 11,529,384	$ (2,757,688)	$ 12,561,185
Total gains/(losses) realized and unrealized:							
Included in earnings	35,466	(724)	(12,057)	(73,163)	(175,122)	177,213	(48,387)
Included in other comprehensive income	(56,022)	—	—	(66,463)	(248,703)	57,773	(313,415)
Purchases	—	—	—	—	—	—	—
Issuances	—	—	—	—	—	—	—
Sales	—	—	—	—	—	—	—
Settlements	(713,890)	—	(3,138)	(17,595)	(354,360)	5,064	(1,083,919)
Transfers into Level 3	(5,309)	—	—	—	—	—	(5,309)
Balance, end of period	$ 68,802	$ 5,255	$ 45,613	$ 2,756,924	$ 10,751,199	$ (2,517,638)	$ 11,110,155
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ (724)	$ (12,254)	$ (73,163)	$ (175,122)	$ 177,213	$ (84,050)

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The tables below provide roll-forward information by class of investments and derivatives measured using significant unobservable inputs.

Level 3 - Investments by Class:

	Three Months Ended June 30, 2019			Three Months Ended June 30, 2018		
	Other Asset Backed Securities	Non-Agency RMBS	Total Investments	Other Asset Backed Securities	Non-Agency RMBS	Total Investments
Balance, beginning of period	$ 71,855	$ —	$ 71,855	$ 72,321	$ 5,309	$ 77,630
Total gains/(losses) realized and unrealized:						
Included in earnings	388	—	388	282	—	282
Included in other comprehensive income	2,385	—	2,385	(3,514)	—	(3,514)
Purchases	—	—	—	—	—	—
Issuances	—	—	—	—	—	—
Sales	—	—	—	—	—	—
Settlements	(310)	—	(310)	(287)	—	(287)
Transfers into Level 3	—	—	—	—	(5,309)	(5,309)
Balance, end of period	$ 74,318	$ —	$ 74,318	$ 68,802	$ —	$ 68,802
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ —	$ —	$ —	$ —	$ —

Level 3 - Investments by Class:

	Six Months Ended June 30, 2019			Six Months Ended June 30, 2018		
	Other Asset Backed Securities	Non-Agency RMBS	Total Investments	Other Asset Backed Securities	Non-Agency RMBS	Total Investments
Balance, beginning of period	$ 72,071	$ —	$ 72,071	$ 72,540	$ 736,017	$ 808,557
Total gains/(losses) realized and unrealized:						
Included in earnings	771	—	771	739	34,727	35,466
Included in other comprehensive income	2,114	—	2,114	(3,884)	(52,138)	(56,022)
Purchases	—	—	—	—	—	—
Issuances	—	—	—	—	—	—
Sales	—	—	—	—	—	—
Settlements	(638)	—	(638)	(593)	(713,297)	(713,890)
Transfers out of Level 3	—	—	—	—	(5,309)	(5,309)
Balance, end of period	$ 74,318	$ —	$ 74,318	$ 68,802	$ —	$ 68,802
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ —	$ —	$ —	$ —	$ —	$ —

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Level 3 - Derivatives by Class:

	Three Months Ended June 30, 2019			Three Months Ended June 30, 2018		
	Interest Rate Swaps	Credit Derivatives	Total Derivatives	Interest Rate Swaps	Credit Derivatives	Total Derivatives
Balance, beginning of period	$ 54,111	$ (1,077)	$ 53,034	$ 50,926	$ (1,018)	$ 49,908
Total gains/(losses) realized and unrealized:						
Included in earnings	10,056	310	10,366	(2,465)	(217)	(2,682)
Included in other comprehensive income	—	—	—	—	—	—
Purchases	—	—	—	—	—	—
Issuances	—	—	—	—	—	—
Sales	—	—	—	—	—	—
Settlements	(1,036)	(94)	(1,130)	(1,522)	(91)	(1,613)
Balance, end of period	**$ 63,131**	**$ (861)**	**$ 62,270**	**$ 46,939**	**$ (1,326)**	**$ 45,613**
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ 10,056	$ 214	$ 10,270	$ (2,465)	$ (308)	$ (2,773)

Level 3 - Derivatives by Class:

	Six Months Ended June 30, 2019			Six Months Ended June 30, 2018		
	Interest Rate Swaps	Credit Derivatives	Total Derivatives	Interest Rate Swaps	Credit Derivatives	Total Derivatives
Balance, beginning of period	$ 47,460	$ (1,459)	$ 46,001	$ 61,374	$ (566)	$ 60,808
Total gains/(losses) realized and unrealized:						
Included in earnings	17,770	783	18,553	(11,494)	(563)	(12,057)
Included in other comprehensive income	—	—	—	—	—	—
Purchases	—	—	—	—	—	—
Issuances	—	—	—	—	—	—
Sales	—	—	—	—	—	—
Settlements	(2,099)	(185)	(2,284)	(2,941)	(197)	(3,138)
Balance, end of period	**$ 63,131**	**$ (861)**	**$ 62,270**	**$ 46,939**	**$ (1,326)**	**$ 45,613**
The amount of total gains/(losses) included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held at the reporting date	$ 17,770	$ 596	$ 18,366	$ (11,494)	$ (760)	$ (12,254)

Invested assets and VIE long-term debt are transferred into Level 3 when internal valuation models that include significant unobservable inputs are used to estimate fair value. All such securities that have internally modeled fair values have been classified as Level 3. Non-agency RMBS securities transferred out of Level 3 into Level 2 in 2018 consist of an Ambac-insured re-REMIC collateralized by distressed mortgage-backed securities.

Derivative instruments are transferred into Level 3 when the use of unobservable inputs becomes significant to the overall valuation. There were no transfers of derivative instruments into or out of Level 3 in the periods disclosed.

There were no transfers between Level 1 and Level 2 for the periods presented. All transfers between fair value hierarchy Levels 1, 2 and 3 are recognized at the beginning of each accounting period.

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Gains and losses (realized and unrealized) relating to Level 3 assets and liabilities included in earnings for the affected periods are reported as follows:

	Net Investment Income	Net Gains (Losses) on Derivative Contracts	Income (Loss) on Variable Interest Entities	Other Income or (Loss)
Three Months Ended June 30, 2019:				
Total gains or losses included in earnings for the period	**$ 388**	**$ 10,366**	**$ 182,687**	**$ (377)**
Changes in unrealized gains or losses relating to the assets and liabilities still held at the reporting date	**—**	**10,270**	**182,687**	**(377)**
Three Months Ended June 30, 2018:				
Total gains or losses included in earnings for the period	$ 282	$ (2,682)	$ 40,557	$ (366)
Changes in unrealized gains or losses relating to the assets and liabilities still held at the reporting date	—	(2,773)	40,557	(366)
Six Months Ended June 30, 2019:				
Total gains or losses included in earnings for the period	**$ 771**	**$ 18,553**	**$ 334,834**	**$ (745)**
Changes in unrealized gains or losses relating to the assets and liabilities still held at the reporting date	**—**	**18,366**	**334,834**	**(745)**
Six Months Ended June 30, 2018:				
Total gains or losses included in earnings for the period	$ 35,466	$ (12,057)	$ (71,072)	$ (724)
Changes in unrealized gains or losses relating to the assets and liabilities still held at the reporting date	—	(12,254)	(71,072)	(724)

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8. INVESTMENTS

Ambac's non-VIE invested assets are primarily comprised of fixed income securities classified as available-for-sale and interests in pooled investment funds which are reported within Other investments on the Consolidated Balance Sheets. Interests in pooled investment funds in the form of common stock or in-substance common stock are classified as trading securities, while limited partner interests in such funds are reported using the equity method. Other investments also include Ambac's equity interest in an unconsolidated trust created in connection with its sale of Segregated Account junior surplus notes on August 28, 2014.

Fixed Income Securities:

The amortized cost and estimated fair value of available-for-sale investments, excluding VIE investments, at June 30, 2019 and December 31, 2018 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Non-credit Other-than temporary Impairments [1]
June 30, 2019:					
Fixed income securities:					
Municipal obligations	$ 312,476	$ 31,106	$ 909	$ 342,673	$ —
Corporate obligations [2]	1,365,426	35,670	437	1,400,659	—
Foreign obligations	30,149	608	14	30,743	—
U.S. government obligations	94,211	2,634	39	96,806	—
Residential mortgage-backed securities	211,081	41,241	62	252,260	62
Collateralized debt obligations	136,547	47	441	136,153	—
Other asset-backed securities	316,077	28,861	55	344,883	—
	2,465,967	140,167	1,957	2,604,177	62
Short-term	772,214	87	2	772,299	—
	3,238,181	140,254	1,959	3,376,476	62
Fixed income securities pledged as collateral:					
U.S. government obligations	84,418	—	—	84,418	—
Total fixed income securities pledged as collateral	84,418	—	—	84,418	—
Total available-for-sale investments	$ 3,322,599	$ 140,254	$ 1,959	$ 3,460,894	$ 62
December 31, 2018:					
Fixed income securities:					
Municipal obligations	$ 882,631	$ 14,364	$ 17,076	$ 879,919	$ 5
Corporate obligations [2]	1,288,882	6,444	17,204	1,278,122	—
Foreign obligations	30,496	399	61	30,834	—
U.S. government obligations	93,636	1,371	613	94,394	—
Residential mortgage-backed securities	221,825	37,575	793	258,607	27
Collateralized debt obligations	133,075	8	1,727	131,356	—
Other asset-backed securities	370,199	72,868	624	442,443	—
	3,020,744	133,029	38,098	3,115,675	32
Short-term	430,405	23	97	430,331	—
Total available-for-sale investments	$ 3,451,149	$ 133,052	$ 38,195	$ 3,546,006	$ 32

(1) Represents the amount of non-credit other-than-temporary impairment losses remaining in accumulated other comprehensive income on securities that also had a credit impairment. These losses are included in gross unrealized losses as of June 30, 2019 and December 31, 2018.

(2) Includes Ambac's holdings of the secured notes issued by Ambac LSNI in connection with the Rehabilitation Exit Transactions.

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The amortized cost and estimated fair value of available-for-sale investments, excluding VIE investments, at June 30, 2019, by contractual maturity, were as follows:

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 885,076	$ 885,352
Due after one year through five years	1,094,834	1,114,706
Due after five years through ten years	391,425	411,322
Due after ten years	287,559	316,218
	2,658,894	2,727,598
Residential mortgage-backed securities	211,081	252,260
Collateralized debt obligations	136,547	136,153
Other asset-backed securities	316,077	344,883
Total	$ 3,322,599	$ 3,460,894

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

Unrealized Losses on Fixed Income Securities:

The following table shows gross unrealized losses and fair values of Ambac's available-for-sale investments, excluding VIE investments, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at June 30, 2019 and December 31, 2018:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
June 30, 2019:						
Fixed income securities:						
Municipal obligations	$ 21,593	$ 325	$ 25,981	$ 584	$ 47,574	$ 909
Corporate obligations	22,520	78	34,130	359	56,650	437
Foreign obligations	281	—	3,061	14	3,342	14
U.S. government obligations	2,833	21	2,272	18	5,105	39
Residential mortgage-backed securities	4,500	62	—	—	4,500	62
Collateralized debt obligations	83,555	441	—	—	83,555	441
Other asset-backed securities	4,394	13	5,167	42	9,561	55
	139,676	940	70,611	1,017	210,287	1,957
Short-term	4,695	2	—	—	4,695	2
Total temporarily impaired securities	$ 144,371	$ 942	$ 70,611	$ 1,017	$ 214,982	$ 1,959

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	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
December 31, 2018:						
Fixed income securities:						
Municipal obligations	$ 537,904	$ 15,878	$ 28,533	$ 1,198	$ 566,437	$ 17,076
Corporate obligations	306,506	8,634	190,273	8,570	496,779	17,204
Foreign obligations	1,161	1	5,163	60	6,324	61
U.S. government obligations	5,643	135	58,495	478	64,138	613
Residential mortgage-backed securities	34,852	793	—	—	34,852	793
Collateralized debt obligations	123,848	1,727	—	—	123,848	1,727
Other asset-backed securities	13,813	33	77,479	591	91,292	624
	1,023,727	27,201	359,943	10,897	1,383,670	38,098
Short-term	115,374	97	—	—	115,374	97
Total temporarily impaired securities	**$ 1,139,101**	**$ 27,298**	**$ 359,943**	**$ 10,897**	**$ 1,499,044**	**$ 38,195**

Management has determined that the unrealized losses reflected in the tables above are temporary in nature as of June 30, 2019 and December 31, 2018 based upon (i) no unexpected principal and interest payment defaults on these securities; (ii) analysis of the creditworthiness of the issuer and financial guarantor, as applicable, and analysis of projected defaults on the underlying collateral; (iii) management has no intent to sell these investments in debt securities; and (iv) it is not more likely than not that Ambac will be required to sell these debt securities before the anticipated recovery of its amortized cost basis. The assessment under (iv) is based on a comparison of future available liquidity from the investment portfolio against the projected net cash outflow from operating activities and debt service. For purposes of this assessment, available liquidity from the investment portfolio is comprised of the fair value of securities for which management has asserted its intent to sell, the fair value of other securities that are available for sale and in an unrealized gain position, trading securities plus the scheduled maturities and interest payments from the remaining securities in the portfolio. To the extent that securities that management intends to sell are in an unrealized loss position, they would have already been considered other-than-temporarily impaired with the amortized cost written down to fair value. Because the above-described assessment indicates that future available liquidity exceeds projected net cash outflow, it is not more likely than not that we would be required to sell securities in an unrealized loss position before the recovery of their amortized cost basis. In the liquidity assessment described above, principal payments on securities pledged as collateral are not considered to be available for other liquidity needs until the collateralized positions are projected to be settled.

As of June 30, 2019, for securities that have indications of possible other-than-temporary impairment but which management does not intend to sell and will not more likely than not be required to sell, management compared the present value of cash flows expected to be collected to the amortized cost basis of the securities to assess whether the amortized cost will be recovered. Cash flows were discounted at the effective interest rate implicit in the security at the date of acquisition (or Fresh Start Reporting Date of April 30, 2013 for securities purchased prior to that date) or for debt securities that are beneficial interests in securitized financial assets, at a rate equal to the current yield used to accrete the beneficial interest. For floating rate securities, future cash flows and the discount rate used were both adjusted to reflect changes in the index rate applicable to each security as of the evaluation date. Of the securities that were in a gross unrealized loss position at June 30, 2019, $45,718 of the total fair value and $573 of the unrealized loss related to below investment grade and non-rated securities. The remainder of gross unrealized losses as of June 30, 2019, are primarily on investment grade fixed-rate securities purchased during periods of lower interest rates. Management believes that the timely receipt of all principal and interest on these positions is probable.

Ambac's assessment about whether a decline in value is other-than-temporary reflects management's current judgment regarding facts and circumstances specific to a security and the factors noted above. If that judgment changes, Ambac may ultimately record a charge for other-than-temporary impairment in future periods.

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Realized Gains and Losses and Other-Than-Temporary Impairments:

The following table details amounts included in net realized gains (losses) and other-than-temporary impairments included in earnings for the affected periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Gross realized gains on securities	$ 10,218	$ 41,974	$ 34,437	$ 53,028
Gross realized losses on securities	(211)	(1,641)	(4,499)	(3,029)
Net foreign exchange (losses) gains	25,853	6,815	23,155	2,011
Net realized gains (losses)	**$ 35,860**	**$ 47,148**	**$ 53,093**	**$ 52,010**
Net other-than-temporary impairments [1]	**$ —**	**$ (1,014)**	**$ (29)**	**$ (1,313)**

(1) Other-than-temporary impairments exclude impairment amounts recorded in other comprehensive income under ASC Paragraph 320-10-65-1, which comprise non-credit related amounts on securities that are credit impaired but which management does not intend to sell and it is not more likely than not that the company will be required to sell before recovery of the amortized cost basis.

Future changes in our estimated liquidity needs could result in a determination that Ambac no longer has the ability to hold securities that are in an unrealized loss position, which could also result in additional other-than-temporary impairment charges.

The following table presents a roll-forward of Ambac's cumulative credit losses on debt securities held as of June 30, 2019 and 2018 for which a portion of an other-than-temporary impairment was recognized in other comprehensive income:

	Six Months Ended June 30,	
	2019	2018
Balance, beginning of period	**$ 12,454**	**$ 67,085**
Additions for credit impairments recognized on:		
Securities not previously impaired	—	226
Securities previously impaired	—	98
Reductions for credit impairments previously recognized on:		
Securities that matured or were sold during the period	(774)	(28,677)
Balance, end of period	**$ 11,680**	**$ 38,732**

Counterparty Collateral, Deposits with Regulators and Other Restrictions:

Ambac routinely pledges and receives collateral related to certain transactions. Cash, cash equivalents and securities held directly in Ambac's investment portfolio with a fair value of $119,853 and $102,904 at June 30, 2019 and December 31, 2018, respectively, were pledged to derivative counterparties. Ambac's derivative counterparties have the right to re-pledge the investment securities and as such, these pledged securities are separately classified on the Consolidated Balance Sheets as "Fixed income securities pledged as collateral, at fair value". Refer to *Note 9. Derivative Instruments* for further information on cash collateral. There was no cash or securities received from other counterparties that were re-pledged by Ambac.

Securities carried at $7,613 and $5,975 at June 30, 2019 and December 31, 2018, respectively, were deposited with governmental authorities or designated custodian banks as required by laws affecting insurance companies. Invested assets carried at $1,412 at June 30, 2019 were deposited as security in connection with a letter of credit issued for an office lease.

Securities with a fair value of $205,960 and $209,983 at June 30, 2019 and December 31, 2018, respectively, were pledged as collateral and as sources of funding to repay the Secured Notes issued by Ambac LSNI. The securities may not be transferred or repledged by Ambac LSNI. Collateral may be sold to fund redemptions of the Secured Notes. Ambac Assurance also pledged for the benefit of the holders of Secured Notes (other than Ambac Assurance) the proceeds of interest payments and partial redemptions of the Secured Notes held by Ambac Assurance. The amount of such proceeds held by Ambac Assurance was $0 and $19,405 at June 30, 2019 and December 31, 2018, respectively, and is included in Restricted cash on the Consolidated Balance Sheet.

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Guaranteed Securities:

Ambac's fixed income portfolio includes securities covered by guarantees issued by Ambac Assurance and other financial guarantors ("insured securities"). The published rating agency ratings on these securities reflect the higher of the financial strength rating of the financial guarantor or the rating of the underlying issuer. Rating agencies do not always publish separate underlying ratings (those ratings excluding the insurance by the financial guarantor). In the event these underlying ratings are not available from the rating agencies, Ambac will assign an internal rating. The following table represents the fair value, including the value of the financial guarantee, and weighted-average underlying rating, excluding the financial guarantee, of the insured securities at June 30, 2019 and December 31, 2018, respectively:

	Municipal Obligations	Corporate Obligations [3]	Mortgage and Asset-backed Securities	Total	Weighted Average Underlying Rating [1]
June 30, 2019:					
Ambac Assurance Corporation [2]	$ 164,258	$ 585,922	$ 450,449	$ 1,200,629	CCC-
National Public Finance Guarantee Corporation	13,587	—	—	13,587	BBB-
Total	$ 177,845	$ 585,922	$ 450,449	$ 1,214,216	CCC-
December 31, 2018:					
Ambac Assurance Corporation [2]	$ 833,241	$ 656,473	$ 599,185	$ 2,088,899	CC
National Public Finance Guarantee Corporation	15,600	—	—	15,600	BBB-
Total	$ 848,841	$ 656,473	$ 599,185	$ 2,104,499	CC

(1) Ratings are based on the lower of Standard & Poor's or Moody's rating. If unavailable, Ambac's internal rating is used.

(2) Includes asset-backed securities with a fair value of $0 and $144,672 at June 30, 2019 and December 31, 2018, respectively, insured by Ambac UK.

(3) Represents Ambac's holdings of secured notes issued by Ambac LSNI in connection with the Rehabilitation Exit Transactions. These secured notes are insured by Ambac Assurance.

Other Investments:

Ambac's investment portfolio includes interests in various pooled investment funds. The fair value and additional information about investments in pooled funds, by investment type, is summarized in the table below. Except as noted in the table, fair value as reported is determined using NAV as a practical expedient. In addition to these investments, Ambac has unfunded commitments at June 30, 2019 of $25,000 with an investment fund that focuses on middle-market enterprise debt and preferred equity.

	Fair Value			
Class of Funds	**June 30, 2019**	**December 31, 2018**	**Redemption Frequency**	**Redemption Notice Period**
Real estate properties [1]	$ 15,831	$ 16,123	quarterly	10 business days
Interest rate products [2] [7]	233,904	177,357	daily, weekly or monthly	0 - 30 days
Illiquid investments [3]	38,385	84,297	quarterly	180 days
Insurance-linked investments [4]	27,752	29,318	quarterly	90-120 days
Equity market investments [5] [7]	50,691	43,954	daily	0 days
Credit products [6]	60,000	—	quarterly	90 days
Total equity investments in pooled funds	$ 426,563	$ 351,049		

(1) Investments consist of UK property to generate income and capital growth.

(2) This class of funds includes investments in a range of instruments including leveraged loans, CLOs, asset-backed securities and floating rate notes to generate income and capital appreciation. Funds with less frequent redemption periods limit redemptions to as little as 15% per period. Funds with a same day redemption notice period are redeemable only weekly, while funds that may be redeemed any business day have notice periods of 15-30 days.

(3) This class seeks to obtain high long-term total return through investments with low liquidity and defined term, resulting in expected capital distributions to subscribers in the second half of 2019 and 2023.

(4) This class aims to provide returns from the insurance and reinsurance markets through investments in catastrophe bonds, life insurance and other insurance linked investments. Redemption periods are quarterly, subject to 90-day notice for January/July redemption dates and 120-day notice for April/October redemption dates. Ambac provided its redemption notice and received $24,804 in July 2019 in settlement of $24,698 of the above June 30, 2019 balance for insurance-linked investment funds.

(5) Investments represent a diversified exposure to global equity market returns through holdings of various regional market index funds.

(6) This class seeks to generate superior risk-adjusted returns through selective asset sourcing, active trading and hedging strategies within structured credit markets, including mortgage-backed securities, commercial real estate securities and loans, CLOs, REITs and asset-backed securities. Redemptions prior to June 30, 2020, or with 60 days' notice are subject to a 5% fee. Aggregate fund-level redemptions may be limited to 25% of the fund's assets per quarter.

(7) Interest rate products include $78,998 at June 30, 2019 and $27,154 at December 31, 2018 and equity market investments include $50,691 at June 30, 2019 and $43,954 at December 31, 2018 that have readily determinable fair values priced through pricing vendors.

Ambac also holds an equity interest in an unconsolidated trust created in connection with the 2014 sale of Segregated Account junior surplus notes, which is accounted for under the equity method.

Investment Income:

Net investment income was comprised of the following for the affected periods:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Fixed income securities	$ 74,137	$ 60,499	$ 117,803	$ 169,848
Short-term investments	5,481	2,438	9,594	5,278
Loans	182	179	366	367
Investment expense	(1,471)	(1,374)	(2,882)	(3,200)
Securities available-for-sale and short-term	78,329	61,742	124,881	172,293
Other investments	8,130	4,920	16,420	4,609
Total net investment income	**$ 86,459**	**$ 66,662**	**$ 141,301**	**$ 176,902**

Net investment income from Other investments primarily represents changes in fair value on securities classified as trading or under the fair value option, income from investment limited partnerships accounted for under the equity method and the above noted equity interest in an unconsolidated trust accounted for under the equity method.

The portion of net unrealized gains (losses) related to trading securities still held at the end of each period is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Net gains (losses) recognized during the period on trading securities	$ 6,766	$ 3,632	$ 13,713	$ 2,053
Less: net gains (losses) recognized during the reporting period on trading securities sold during the period	2,664	344	3,572	1,325
Unrealized gains (losses) recognized during the reporting period on trading securities still held at the reporting date	**$ 4,102**	**$ 3,288**	**$ 10,141**	**$ 728**

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9. DERIVATIVE INSTRUMENTS

The following tables summarize the gross fair values of individual derivative instruments and the impact of legal rights of offset as reported in the Consolidated Balance Sheets as of June 30, 2019 and December 31, 2018:

	Gross Amounts of Recognized Assets / Liabilities	Gross Amounts Offset in the Consolidated Balance Sheet	Net Amounts of Assets/ Liabilities Presented in the Consolidated Balance Sheet	Gross Amount of Collateral Received / Pledged Not Offset in the Consolidated Balance Sheet	Net Amount
June 30, 2019:					
Derivative Assets:					
Interest rate swaps	$ 72,395	$ 239	$ 72,156	$ —	$ 72,156
Futures contracts	220	—	220	—	220
Total non-VIE derivative assets	$ 72,615	$ 239	$ 72,376	$ —	$ 72,376
Derivative Liabilities:					
Credit derivatives	$ 861	$ —	$ 861	$ —	$ 861
Interest rate swaps	87,623	239	87,384	86,427	957
Total non-VIE derivative liabilities	$ 88,484	$ 239	$ 88,245	$ 86,427	$ 1,818
Variable Interest Entities Derivative Assets:					
Currency swaps	$ 62,941	$ —	$ 62,941	$ —	$ 62,941
Total VIE derivative assets	$ 62,941	$ —	$ 62,941	$ —	$ 62,941
Variable Interest Entities Derivative Liabilities:					
Interest rate swaps	$ 1,818,273	$ —	$ 1,818,273	$ —	$ 1,818,273
Total VIE derivative liabilities	$ 1,818,273	$ —	$ 1,818,273	$ —	$ 1,818,273
December 31, 2018:					
Derivative Assets:					
Interest rate swaps	$ 59,768	$ 300	$ 59,468	$ —	$ 59,468
Total non-VIE derivative assets	**$ 59,768**	**$ 300**	**$ 59,468**	**$ —**	**$ 59,468**
Derivative Liabilities:					
Credit derivatives	$ 1,459	$ —	$ 1,459	$ —	$ 1,459
Interest rate swaps	72,161	300	71,861	67,126	4,735
Futures contracts	3,379	—	3,379	3,379	—
Total non-VIE derivative liabilities	**$ 76,999**	**$ 300**	**$ 76,699**	**$ 70,505**	**$ 6,194**
Variable Interest Entities Derivative Assets:					
Currency swaps	$ 66,302	$ —	$ 66,302	$ —	$ 66,302
Total VIE derivative assets	**$ 66,302**	**$ —**	**$ 66,302**	**$ —**	**$ 66,302**
Variable Interest Entities Derivative Liabilities:					
Interest rate swaps	$ 1,712,062	$ —	$ 1,712,062	$ —	$ 1,712,062
Total VIE derivative liabilities	**$ 1,712,062**	**$ —**	**$ 1,712,062**	**$ —**	**$ 1,712,062**

Amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral are not offset against fair value amounts recognized for derivative instruments on the Consolidated Balance Sheets. The amounts representing the right to reclaim cash collateral and posted margin, recorded in “Other assets” were $35,435 and $102,904 as of June 30, 2019 and December 31, 2018, respectively. There were no amounts held representing an obligation to return cash collateral as of June 30, 2019 and December 31, 2018.

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The following tables summarize the location and amount of gains and losses of derivative contracts in the Consolidated Statements of Total Comprehensive Income (Loss) for the three and six months ended June 30, 2019 and 2018:

	Location of Gain or (Loss) Recognized in Consolidated Statements of Total Comprehensive Income (Loss)	Amount of Gain or (Loss) Recognized in Consolidated Statement of Total Comprehensive Income (Loss)			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2019	2018	2019	2018
Non-VIE derivatives:					
Credit derivatives	Net gains (losses) on derivative contracts	$ 310	$ (217)	$ 783	$ (563)
Interest rate swaps	Net gains (losses) on derivative contracts	(7,377)	1,620	(10,109)	6,163
Futures contracts	Net gains (losses) on derivative contracts	(28,345)	7,529	(42,245)	28,523
Total Non-VIE derivatives		$ (35,412)	$ 8,932	(51,571)	34,123
Variable Interest Entities:					
Currency swaps	Income (loss) on variable interest entities	$ 3,713	$ 14,143	(3,361)	5,526
Interest rate swaps	Income (loss) on variable interest entities	(36,370)	163,229	(106,211)	213,038
Total Variable Interest Entities		(32,657)	177,372	(109,572)	218,564
Total derivative contracts		$ (68,069)	$ 186,304	$ (161,143)	$ 252,687

Credit Derivatives:

Credit derivatives, which are privately negotiated contracts, provide the counterparty with credit protection against the occurrence of a specific event such as a payment default or bankruptcy relating to an underlying obligation. Credit derivatives issued are insured by Ambac Assurance. None of the outstanding credit derivative transactions at June 30, 2019, include ratings based collateral-posting triggers or otherwise require Ambac to post collateral regardless of Ambac's ratings or the size of the mark to market exposure to Ambac.

The portfolio of our credit derivatives were written on a "pay-as-you-go" basis. Similar to an insurance policy execution, pay-as-you-go provides that Ambac pays interest shortfalls on the referenced transaction as they are incurred on each scheduled payment date, but only pays principal shortfalls upon the earlier of (i) the date on which the assets designated to fund the referenced obligation have been disposed of and (ii) the legal final maturity date of the referenced obligation.

Ambac maintains internal credit ratings on its guaranteed obligations, including credit derivative contracts, solely to indicate management's view of the underlying credit quality of the guaranteed obligations. The gross principal notional outstanding for CDS contracts was $284,350 and $295,342 as of June 30, 2019 and December 31, 2018, respectively, all of which had internal Ambac ratings of AA in both periods.

Interest Rate Derivatives:

Ambac, through its subsidiary Ambac Financial Services ("AFS"), uses interest rate swaps and US Treasury futures contracts to provide an economic hedge against the effects of rising interest rates elsewhere in the Company, including on Ambac's financial guarantee exposures. Additionally, AFS provided interest rate swaps to states, municipalities and their authorities, asset-backed issuers and other entities in connection with their financings. As of June 30, 2019 and December 31, 2018 the notional amounts of AFS's derivatives are as follows:

	Notional	
Type of Derivative	June 30, 2019	December 31, 2018
Interest rate swaps—receive-fixed/pay-variable	$ 341,415	$ 493,368
Interest rate swaps—pay-fixed/receive-variable	1,266,634	1,121,532
US Treasury futures contracts—short	1,375,000	1,760,000

Derivatives of Consolidated Variable Interest Entities

Certain VIEs consolidated under the Consolidation Topic of the ASC entered into derivative contracts to meet specified purposes within the securitization structure. The notional for VIE derivatives outstanding as of June 30, 2019 and December 31, 2018 are as follows:

	Notional	
Type of VIE Derivative	June 30, 2019	December 31, 2018
Interest rate swaps—receive-fixed/pay-variable	$ 1,393,935	$ 1,399,532
Interest rate swaps—pay-fixed/receive-variable	1,150,451	1,176,748
Currency swaps	329,626	344,992
Credit derivatives	9,530	10,254

Contingent Features in Derivatives Related to Ambac Credit Risk

Ambac's over-the-counter interest rate swaps are centrally cleared when eligible. Certain interest rate swaps remain with professional swap-dealer counterparties and direct customer counterparties. These non-cleared swaps are generally executed under standardized derivative documents including collateral support and master netting agreements. Under these agreements, Ambac is required to post collateral in the event net unrealized losses exceed predetermined threshold levels. Additionally, given that Ambac

Assurance is no longer rated by an independent rating agency, counterparties have the right to terminate the swap positions.

As of June 30, 2019 and December 31, 2018, the net liability fair value of derivative instruments with contingent features linked to Ambac's own credit risk was $86,696 and $67,071, respectively, related to which Ambac had posted cash and securities as collateral with a fair value of $103,764 and $83,700, respectively. All such ratings-based contingent features have been triggered as requiring maximum collateral levels to be posted by Ambac while preserving counterparties' rights to terminate the contracts. Assuming all such contracts terminated on June 30, 2019, settlement of collateral balances and net derivative liabilities would result in a net receipt of cash and/or securities by Ambac. If counterparties elect to exercise their right to terminate, the actual termination payment amounts will be determined in accordance with derivative contract terms, which may result in amounts that differ from market values as reported in Ambac's financial statements.

10. INCOME TAXES

Ambac files a consolidated Federal income tax return with its subsidiaries. Ambac and its subsidiaries also file separate or combined income tax returns in various states, local and foreign jurisdictions. The following are the major jurisdictions in which Ambac and its subsidiaries operate and the earliest tax years subject to examination:

Jurisdiction	Tax Year
United States	2010
New York State	2013
New York City	2014
United Kingdom	2015
Italy	2014

As of June 30, 2019 Ambac estimates it had U.S. federal ordinary net loss carryforwards totaling approximately $3,476,826, which, if not utilized, will begin expiring in 2029, and will fully expire in 2032, with the exception of the estimated tax loss generated during the six months ended June 30, 2019 of $53,122, which if Ambac remains in a loss position at year end 2019, will expire in 2040.

In accordance with the Income Tax Topic of the ASC, a valuation allowance is recognized if, based on the weight of available evidence, it is more-likely-than-not that some, or all, of the deferred tax asset will not be realized. As a result of the risks and uncertainties associated with future operating results, management believes it is more likely than not that the Company will not generate sufficient U.S. federal, state and/or local taxable income to recover the deferred tax operating assets and therefore maintains a full valuation allowance.

Consolidated Pretax Income (Loss)

U.S. and foreign components of pre-tax income (loss) were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
U.S.	$ (57,408)	$ 13,104	$ (120,812)	$ 310,846
Foreign	(42,699)	(6,796)	(20,505)	3,771
Total	**$ (100,107)**	**$ 6,308**	**$ (141,317)**	**$ 314,617**

Provision (Benefit) for Income Taxes

The components of the provision for income taxes were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2019	2018	2019	2018
Current taxes				
U. S. federal	$ —	$ —	$ —	$ —
U.S. state and local	284	645	(3,242)	1,682
Foreign	27,873	2,544	34,339	2,505
Current taxes	28,157	3,189	31,097	4,187
Deferred taxes				
Foreign	165	(1,194)	(784)	413
Deferred taxes	165	(1,194)	(784)	413
Provision for income taxes	**$ 28,322**	**$ 1,995**	**$ 30,313**	**$ 4,600**

NOL Usage

Pursuant to the intercompany tax sharing agreement, to the extent Ambac Assurance generates taxable income after September 30, 2011, which is offset with "Allocated NOLs" of $3,650,000, it is obligated to make payments ("Tolling Payments"), subject to certain credits, to Ambac in accordance with the following NOL usage table, where the "Applicable Percentage" is applied to the aggregate amount of federal income tax liability that would have been paid if the Allocated NOLs were not available. Pursuant to the Closing Agreement between Ambac and the Internal Revenue Service ("IRS"), the IRS will receive 12.5% of Tier C and 17.5% of Tier D payments, if made.

NOL Usage Table

NOL Usage Tier	Allocated NOLs			Applicable Percentage
A	The first	$479,000		15%
B	The next	$1,057,000	after Tier A	40%
C	The next	$1,057,000	after Tier B	10%
D	The next	$1,057,000	after Tier C	15%

As a result of positive taxable income at Ambac Assurance in 2017 and 2018, Ambac accrued approximately $44,381 of tax tolling payments.

- In May 2018, Ambac executed a waiver under the intercompany tax sharing agreement pursuant to which

Ambac Assurance was relieved of the requirement to make the 2017 tax tolling payment of approximately $27,868 by June 1, 2018. Ambac also agreed to continue to defer receipt of the 2017 tax tolling payment from Ambac Assurance until such time as OCI consents to the payment.

- Ambac accrued $16,513 of tolling payments based on Allocated NOLs used by Ambac Assurance in 2018, which was paid in July 2019.

For the six months ended June 30, 2019, Ambac Assurance generated a taxable loss of $60,991, therefore no additional Tolling Payments have been accrued.

Ambac's tax positions are subject to review by the OCI, which may lead to the adoption of positions that reduce the amount of tolling payments otherwise available to Ambac.

As of June 30, 2019, the remaining balance of the $3,650,000 NOL allocated to Ambac Assurance was $2,224,112. As of June 30, 2019 Ambac's NOL was $1,252,714.

11. LEASES

Ambac adopted the New Lease Standard as further described in Note 2, *Basis of Presentation and Significant Accounting Policies*. A contract contains a lease if it conveys the right to control the use of identified property, plant, or equipment for a period of time in exchange for consideration. Ambac's evaluation of whether certain contracts contain leases may require judgment regarding what party controls the asset and whether the asset is physically distinct.

The New Lease Standard provides practical expedients that affect a reporting entity's ongoing accounting. For contracts where Ambac is the lessee, we have elected the short-term lease recognition exemption for all leases that qualify. For those leases that qualify for that exemption, we will not recognize ROU assets or lease liabilities. For all contracts where Ambac is the lessee and lessor we have also elected the practical expedient to not separate lease and non-lease components.

Lessee information:

Ambac is the lessee in operating leases of corporate offices, data centers and equipment. Our leases, in effect at June 30, 2019, have remaining lease terms ranging from 1 to 11 years. One data center lease has an automatic renewal of one-year unless either party elects to terminate by providing 120 days notice prior to the renewal. This renewal feature is not recognized in the lease liability or right-of-use asset as it is not reasonably certain we will elect to renew. No other leases contain extension or termination provisions.

Lease costs are included in operating expenses on the consolidated statement of comprehensive income. The components of lease costs, net of sub-lessor income, is as follows:

	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Operating lease cost	$ 2,088	$ 3,614
Variable Lease Cost	122	301
Sublease income	(280)	(345)
Total lease cost	$ 1,930	$ 3,570

Ambac is required to make variable lease payments under certain leases which primarily related to variable costs of the lessor. Such costs include taxes, insurance, maintenance and electricity.

Supplemental information related to leases is as follows:

Three Months Ended	Three Months Ended June 30, 2019	Six Months Ended June 30, 2019
Cash paid for amounts included in the measurement of operating lease liabilities	$ 1,743	$ 3,286
Right-of-use assets obtained in exchange for operating lease liabilities (non-cash) [1]	14,939	29,299

[1] Includes new right-of-use assets of $14,360 for the six months ended June 30, 2019 for leases which existed prior to the New Lease Standard implementation date of January 1, 2019.

Supplemental balance sheet information related to leases is as follows:

	June 30, 2019
Operating leases:	
Operating lease right of use assets	$ 26,529
Operating lease liabilities	29,664
Weighted average remaining lease term:	
Operating leases	10.0 years
Weighted average discount rate:	
Operating leases	7.9%

Operating lease right of use assets and operating lease liabilities are included in Other assets and Other liabilities, respectively, on the consolidated balance sheet. The discount rate used to initially measure the right of use assets and lease liabilities was based on Ambac's estimated secured borrowing rate. The Ambac Note, more fully described in Note 1. Background and Business Description in the Consolidated Financial Statements included Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, was a significant data point in estimating this rate.

Future undiscounted lease payments to be made are as follows:

As of June 30, 2019	Operating Leases
2019 (six months)	$ 2,043
2020	4,099
2021	3,970
2022	3,970
2023	3,970
Thereafter	25,883
Total lease payments	43,935
Less: imputed interest	(14,271)
Total	$ 29,664

Lessor information:

Ambac is the lessor in one operating sublease of corporate office space which has a remaining term of 10.5 years. There are no extension or termination provisions.

Future undiscounted lease payments to be received are as follows:

As of June 30, 2019	Operating Leases
2019 (six months)	$ 172
2020	1,038
2021	1,051
2022	1,078
2023	1,131
Thereafter	7,571
Total lease receipts	$ 12,041

12. COMMITMENTS AND CONTINGENCIES

The following commitments and contingencies provide an update of those discussed in *Note 18: Commitments and Contingencies* in the Notes to Consolidated Financial Statements included Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and should be read in conjunction with the complete descriptions provided in the aforementioned Form 10-K.

Litigation Against Ambac

Monterey Bay Military Housing, LLC, et al. v. Ambac Assurance Corporation, et al. (United States District Court, Northern District of California, San Jose Division, Case No. 17-cv-04992-BLF, filed August 28, 2017). On February 15, 2019, Ambac Assurance and the other defendants filed a motion to dismiss the second amended complaint (filed on December 17, 2018, following the court's dismissal of the first amended complaint without prejudice on July 17, 2018). On April 16, 2019, Plaintiffs filed a brief in opposition to the defendants' motion to dismiss the second amended complaint. Ambac Assurance and the other defendants filed reply briefs on May 16, 2019, and the court held a hearing on the motion to dismiss the second amended complaint on July 18, 2019. A decision has not yet been issued.

Financial Oversight and Management Board for Puerto Rico, et al. v. Autonomy Master Fund Limited, et al. (United States District Court, District of Puerto Rico, No. 19-ap-00291, filed May 2, 2019). On May 2, 2019, the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board"), together with the Official Committee of Unsecured Creditors for the Commonwealth (the "Committee"), as Plaintiffs, filed an adversary proceeding against certain parties that filed proofs of claim on account of general obligation bonds issued by the Commonwealth of Puerto Rico, including Ambac Assurance. The complaint seeks declarations that the general obligation bonds are unsecured obligations and, in the alternative, seeks to avoid any security interests that holders of such bonds may have. On June 13, 2019, at the request of the Plaintiffs, the District Court stayed the case until September 1, 2019 as to all defendants; on July 24, 2019, the District Court referred this matter to mediation and further stayed the case until November 30, 2019.

Financial Oversight and Management Board for Puerto Rico, et al. v. Ambac Assurance Corporation, et al. (United States District Court, District of Puerto Rico, No. 19-ap-00363, filed May 20, 2019). On May 20, 2019, the Oversight Board, together with the Committee, as Plaintiffs, filed an adversary proceeding against certain parties that filed proofs of claim on account of bonds issued by the Puerto Rico Highways and Transportation Authority ("PRHTA"), including Ambac Assurance. The complaint seeks declarations that the PRHTA bonds are only secured by revenues on deposit with the PRHTA Fiscal Agent and that PRHTA bondholders have no security interest in any other property of PRHTA or the Commonwealth, and in the alternative, to the extent such other security interests exist, the complaint seeks to avoid other security interests that holders of PRHTA bonds may have. On June 14, 2019, at the request of the Plaintiffs, the District Court stayed the case until September 1, 2019 as to all defendants; on July 24, 2019, the District Court referred this matter to mediation and further stayed the case until November 30, 2019.

From time to time, Ambac is subject to allegations concerning its corporate governance that may lead to litigation, including derivative litigation, and while the monetary impacts may not be material, the matters may distract management and the Board of Directors from their principal focus on Ambac's business, strategy and objectives.

Ambac Assurance's estimates of projected losses for RMBS transactions consider, among other things, the RMBS transactions' payment waterfall structure, including the application of interest and principal payments and recoveries, and depend in part on our interpretations of contracts and other bases of our legal rights. From time to time, bond trustees and other transaction participants have employed different contractual interpretations and have commenced, or threatened to commence, litigation to resolve these differences. It is not possible to predict whether additional disputes will arise, nor the outcomes of any potential litigation. It is possible that there could be unfavorable outcomes in this or other disputes or proceedings and that our interpretations may prove to be incorrect, which could lead to changes to our estimate of loss reserves.

Ambac Assurance has periodically received various regulatory inquiries and requests for information with respect to investigations and inquiries that such regulators are conducting. Ambac Assurance has complied with all such inquiries and requests for information.

The Company is involved from time to time in various routine legal proceedings, including proceedings related to litigation with present

or former employees. Although the Company's litigation with present or former employees is routine and incidental to the conduct of its business, such litigation can result in large monetary awards when a civil jury is allowed to determine compensatory and/or punitive damages for, among other things, termination of employment that is wrongful or in violation of implied contracts.

It is not reasonably possible to predict whether additional suits will be filed or whether additional inquiries or requests for information will be made, and it is also not possible to predict the outcome of litigation, inquiries or requests for information. It is possible that there could be unfavorable outcomes in these or other proceedings. Legal accruals for litigation against the Company which are probable and reasonably estimable, and management's estimated range of loss for such matters, are not material to the operating results or financial position of the Company. For the litigation matters the Company is defending that do not meet the "probable and reasonably estimable" accrual threshold and where no loss estimates have been provided above, management is unable to make a meaningful estimate of the amount or range of loss that could result from unfavorable outcomes. Under some circumstances, adverse results in any such proceedings could be material to our business, operations, financial position, profitability or cash flows. The Company believes that it has substantial defenses to the claims above and, to the extent that these actions proceed, the Company intends to defend itself vigorously; however, the Company is not able to predict the outcomes of these actions.

Litigation Filed or Joined by Ambac

In the ordinary course of their businesses, certain of Ambac's subsidiaries assert claims in legal proceedings against third parties to recover losses already paid and/or mitigate future losses. The amounts recovered and/or losses avoided which may result from these proceedings is uncertain, although recoveries and/or losses avoided in any one or more of these proceedings during any quarter or fiscal year could be material to Ambac's results of operations in that quarter or fiscal year.

Puerto Rico:

Lex Claims, LLC et al. v. Alejandro Garcia Padilla et al. (United States District Court, District of Puerto Rico, No. 16-2374, filed July 20, 2016). Following confirmation of the COFINA Plan, several parties appealed the District Court's confirmation order to the First Circuit Court of Appeals. On April 12, 2019, the Oversight Board and the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF") moved to dismiss these appeals as equitably moot because the COFINA Plan has been consummated. On August 7, 2019, the First Circuit denied certain of the motions to dismiss, but without prejudice to reconsideration of the mootness issue by the panel that decides the appeals.

Ambac Assurance Corporation v. Bank of New York Mellon (United States District Court, Southern District of New York. No. 1:17-cv-03804, filed May 2, 2017). Following confirmation of the COFINA Plan, several parties appealed the District Court's confirmation order to the First Circuit Court of Appeals. On April 12, 2019, the Oversight Board and AAFAF moved to dismiss these appeals as equitably moot because the COFINA Plan has been consummated. On August 7, 2019, the First Circuit denied certain of the motions to dismiss, but without prejudice to reconsideration of the mootness issue by the panel that decides the appeals.

Bank of New York Mellon v. COFINA, et al. (United States District Court, District of Puerto Rico, No. 1:17-ap-00133, filed May 16, 2017). Following confirmation of the COFINA Plan, several parties appealed the District Court's confirmation order to the First Circuit Court of Appeals. On April 12, 2019, the Oversight Board and AAFAF moved to dismiss these appeals as equitably moot because the COFINA Plan has been consummated. On August 7, 2019, the First Circuit denied certain of the motions to dismiss, but without prejudice to reconsideration of the mootness issue by the panel that decides the appeals.

Official Committee of Unsecured Creditors v. Whyte (United States District Court, District of Puerto Rico, No. 1:17-ap-00257, filed September 8, 2017) (the Commonwealth-COFINA Dispute). On February 21, 2019, on the joint motion of the agents for the Commonwealth and COFINA, the Oversight Board, AAFAF, and all participating interested parties, the District Court dismissed this case with prejudice. Following confirmation of the COFINA Plan, several parties appealed the District Court's confirmation order to the First Circuit Court of Appeals. On April 12, 2019, the Oversight Board and AAFAF moved to dismiss these appeals as equitably moot because the COFINA Plan has been consummated. On August 7, 2019, the First Circuit denied certain of the motions to dismiss, but without prejudice to reconsideration of the mootness issue by the panel that decides the appeals.

Ambac Assurance Corporation v. Puerto Rico, et al. (United States District Court, District of Puerto Rico, No. 1:17-ap-00159, filed June 8, 2017). On June 24, 2019, the First Circuit affirmed the District Court's dismissal of Ambac Assurance's claims for relief on the grounds that PROMESA deprives courts of jurisdiction to review the Oversight Board's certification determinations, and that PROMESA prohibits the Title III court from interfering with the political or governmental powers of the Commonwealth or the Commonwealth's property or revenues.

Financial Oversight and Management Board for Puerto Rico v. Public Buildings Authority (United States District Court, District of Puerto Rico, No. 1:18-ap-00149, filed December 21, 2018). On December 21, 2018, the Oversight Board, together with the Committee, as Plaintiffs, filed a complaint against the Puerto Rico Public Buildings Authority ("PBA") seeking declaratory judgment that the leases between PBA and its lessees-many of whom are agencies and instrumentalities of the Commonwealth-are "disguised financings," not true leases, and therefore should not be afforded administrative expense priority under the Bankruptcy Code. On March 12, 2019, Ambac Assurance and other interested parties were permitted to intervene in order to argue that the PBA leases are valid leases, and are entitled to administrative expense treatment under the Bankruptcy Code. Certain intervenor-defendants filed counterclaims for declarations to this effect, and a motion for judgment on the pleadings. On June 16, 2019, the Oversight Board announced that it had entered into a plan support agreement ("PSA") with certain general obligation and PBA bondholders that includes a proposed resolution of claim objections to and issues surrounding both general obligation and PBA bonds, including a proposed settlement of this adversary proceeding. On June 27, 2019, the Oversight Board moved to stay this adversary

proceeding while it pursues confirmation of the plan contemplated in the PSA. On July 9, 2019, Ambac Assurance objected to the motion to stay. On July 24, 2019, the District Court referred this case to mediation and ordered this case stayed until November 30, 2019.

In re Financial Oversight and Management Board for Puerto Rico (United States District Court, District of Puerto Rico, No. 1:17-bk-03283), *Omnibus Objection of (I) Financial Oversight and Management Board, Acting Through its Special Claims Committee, and (II) Official Committee of Unsecured Creditors, Pursuant to Bankruptcy Code Section 502 and Bankruptcy Rule 3007, to Claims Filed or Asserted by Holders of Certain Commonwealth General Obligation Bonds* (Dkt. No. 4784, filed January 14, 2019). On January 14, 2019, the Oversight Board and the Committee filed an omnibus claim objection in the Commonwealth's Title III case challenging claims arising from certain general obligation bonds issued by the Commonwealth in 2012 and 2014 totaling approximately $6 billion, none of which are held or insured by Ambac Assurance. The court subsequently ordered certain consolidated procedures permitting parties in interest an opportunity to participate in litigation of the objection. On April 11, 2019, Ambac Assurance filed a notice of participation in support of the objection, advancing the argument, among other things, that the PBA leases are true leases, but the associated debt nonetheless should be included in the Commonwealth's debt ceiling calculation such that the 2012 and 2014 general obligation bond issuances are null and void and claims arising therefrom should be disallowed. On June 16, 2019, the Oversight Board announced that it had entered into a PSA with certain general obligation and PBA bondholders that includes a proposed resolution of claim objections to and issues surrounding both general obligation and PBA bonds, including a proposed settlement of this omnibus claim objection. On June 25, 2019, the Oversight Board moved to stay proceedings related to this omnibus claim objection while it pursues confirmation of the plan contemplated in the PSA. On July 9, 2019, Ambac Assurance objected to the motion to stay. On July 24, 2019, the District Court referred this case to mediation and ordered this case stayed until November 30, 2019.

In re Financial Oversight and Management Board for Puerto Rico (United States District Court, District of Puerto Rico, No. 1:17-bk-03283), *Ambac Assurance Corporation's Motion and Memorandum of Law in Support of Its Motion Concerning Application of the Automatic Stay to the Revenues Securing PRIFA Rum Tax Bonds* (Dkt. No. 7176, filed May 30, 2019). On May 30, 2019, Ambac Assurance filed a motion seeking an order that the automatic stay does not apply to certain lawsuits Ambac Assurance seeks to bring or to continue relating to bonds issued by the Puerto Rico Infrastructure Financing Authority ("PRIFA"), or, in the alternative, for relief from the automatic stay to pursue such lawsuits or for adequate protection of Ambac Assurance's collateral. On July 24, 2019, the District Court referred this case to mediation and ordered this case stayed until November 30, 2019.

Student Loans Exposure:

Nat'l Collegiate Master Student Loan Trust v. Pa. Higher Education Assistance Agency (PHEAA) (Delaware Court of Chancery, C.A. No. 12111-VCS, filed March 21, 2016). Plaintiffs purporting to act on behalf of fifteen National Collegiate Student Loan Trusts filed a lawsuit against PHEAA, a servicer of loans in the Trusts, alleging improprieties and deficiencies in servicing practices and seeking an order compelling PHEAA to submit to an emergency audit. Other matters that have been contested in this litigation include the appointment of a successor Owner Trustee of the Trusts, because Wilmington Trust Company has resigned from its role as Owner Trustee, citing irreconcilable differences with Plaintiffs. Ambac Assurance guaranteed certain securities issued by three of the Trusts and indirectly insures certain securities in six other Trusts. On October 23, 2017, Ambac Assurance filed a motion to intervene in the action for the limited purpose of being heard regarding the appointment of a successor Owner Trustee and regarding WTC's contractual commitment and obligation to remain in that role until such appointment is made. On April 10, 2018, the court (Vice Chancellor Slights) granted Ambac Assurance's motion to intervene. On November 14, 2018, the court appointed Hon. Joseph J. Farnan, Jr. as Special Master and granted him authority to resolve non-dispositive disputes among the parties, including disputes concerning instructions to the Owner Trustee. The order appointing the Special Master also raises the annual expense caps that apply to the Owner Trustee and Indenture Trustee. On June 21, 2019, the Special Master denied an application by certain residual equity interest holders in the Trusts, which sought to compel the Owner Trustee to appoint certain counsel for the Trusts in CFPB v. Nat'l Collegiate Master Student Loan Trust (United States District Court, District of Delaware, Case No. 1:17-cv-01323, filed September 18, 2017). The residual equity interest holders have appealed the Special Master's ruling to Vice Chancellor Slights. Oral argument on that appeal is scheduled for October 1, 2019.

RMBS Litigation:

In connection with Ambac Assurance's efforts to seek redress for breaches of representations and warranties and fraud related to the information provided by both the underwriters and the sponsors of various transactions and for failure to comply with the obligation by the sponsors to repurchase ineligible loans, Ambac Assurance has filed various lawsuits:

- Ambac Assurance Corporation and the Segregated Account of Ambac Assurance Corporation v. Countrywide Home Loans, Inc., Countrywide Securities Corp., Countrywide Financial Corp., and Bank of America Corp. (Supreme Court of the State of New York, County of New York, Case No. 653979/2014, filed on December 30, 2014). Discovery has been completed. The court has not yet set a schedule for summary judgment or for trial.
- Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. Countrywide Securities Corp., Countrywide Financial Corp. (a.k.a. Bank of America Home Loans) and Bank of America Corp. (Supreme Court of the State of New York, County of New York, Case No. 651612/2010, filed on September 28, 2010). In August and October 2018, Defendants filed pre-trial motions seeking to (1) strike Ambac Assurance's jury demand for its fraudulent-inducement claim; (2) strike Ambac Assurance's jury demand for its successor-liability claim; (3) bifurcate the trials for Ambac Assurance's primary- and successor-liability claims; (4) limit the loans for which Ambac Assurance may seek to recover damages; (5) preclude Ambac Assurance from using sampling to prove liability or damages for breach of contract;

and (6) dismiss Ambac Assurance's fraudulent-inducement claim as duplicative of its contract claim. On December 30, 2018, the court denied all six of these pre-trial motions in their entirety and Defendants appealed. On January 24, 2019, the court ordered that trial be put off until the First Department resolves Defendants' appeals, provided that Defendants perfected the appeals for the May 2019 Term at the First Department. Defendants perfected their appeals for the May Term by filing their opening appeal briefs in the First Department on February 19, 2019; Ambac Assurance filed its opposition brief on March 20, 2019; and Defendants filed their reply briefs on March 29, 2019. Oral argument on Defendants' appeals of these six pre-trial motions was held in the First Department on May 2, 2019.

- Ambac Assurance Corporation v. U.S. Bank National Association (United States District Court, Southern District of New York, Docket No. 18-cv-5182 (LGS), filed June 8, 2018 (the "SDNY Action")); In the matter of HarborView Mortgage Loan Trust 2005-10 (Minnesota state court, Docket No. 27-TR-CV-17-32 (the "Minnesota Action")). On February 11, 2019, Ambac Assurance filed a petition for certiorari with the United States Supreme Court for review of the denial of Ambac Assurance's motion to dismiss the Minnesota Action. On March 21, 2019, the United States Supreme Court directed U.S. Bank to respond to this petition for certiorari, which U.S. Bank did on May 22, 2019. Ambac Assurance filed a reply brief on June 5, 2019. The petition has been distributed for the October 1, 2019 conference. On July 16, 2019, the court granted in part and denied in part U.S. Bank's motion to dismiss the SDNY Action. The court dismissed Ambac Assurance's breach-of-contract and breach-of-fiduciary-duty claims based on U.S. Bank's acceptance of the settlement; and dismissed Ambac Assurance's declaratory judgment claims regarding the occurrence of an Event of Default and U.S. Bank's future distribution of trust recoveries through the waterfall. The court denied the motion to dismiss Ambac Assurance's breach-of-contract claims based on U.S. Bank's past distribution of trust recoveries through the waterfall.
- In re application of Deutsche Bank National Trust Company as Trustee of the Harborview Mortgage Loan Trust Mortgage Loan Pass-Through Certificates, Series 2006-9 (Supreme Court of the State of New York, County of New York, No. 654208/2018), filed August 23, 2018. In opposing DBNT's request for an order instructing it to accept the proposed settlement concerning Harborview 2006-9, Ambac Assurance sought a period of discovery before resolution on the merits. Ambac Assurance has issued document requests to DBNT and subpoenas for documents to Countrywide Home Loans and Bank of America N.A. and DBNT has issued document requests to Ambac Assurance. At an initial conference on April 15, 2019, the court encouraged the parties to meet and confer regarding a case schedule pursuant to which discovery would be completed within four months.

Other Litigation

U.S. Securities and Exchange Commission (the "SEC") v. Citigroup Global Markets Inc. ("Citigroup") (United States District Court Southern District of New York, Docket No. 11-CV-7387, filed in October 2011). This suit related to a collateralized debt obligation transaction arranged by Citigroup in which Ambac Credit Products, LLC ("ACP") (insured by Ambac Assurance) provided credit protection through a credit default swap to a bank counterparty that was exposed to the transaction. Citigroup was found to have misled ACP and the other parties to the transaction, and the SEC and Citigroup reached a settlement of this action for $285,000. The presiding judge approved the settlement in August of 2014. A fair fund has been established to distribute the $285,000 (plus interest and $2,550 received from a related proceeding less costs and taxes). RCB Fund Services (the "Distribution Agent") was appointed as distribution agent for the fund and invited participants in the CDO transaction to provide information regarding their investments in the CDO transaction. Ambac Assurance filed a submission with the requested information on February 28, 2018. The Distribution Agent, in consultation with the SEC, developed a distribution plan for the fair fund, which was filed with the Court on July 1, 2019. On the same day, the SEC filed with the Court a memorandum in support for an order to approve the distribution plan. The distribution plan provides for ACP and Ambac Assurance to receive approximately $142,000 from the fair fund. The Court approved the distribution plan at the conclusion of the hearing on August 8, 2019. Ambac will record such amounts in net income in the period in which all contingencies are resolved and the gain is realized. Ambac has not recorded any receivable for its estimated portion of these settlement proceeds.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Following this summary is a discussion addressing the consolidated results of operations and financial condition of Ambac Financial Group, Inc. ("Ambac" or "the Company") for the periods indicated. This discussion should be read in conjunction with Ambac's Annual Report on Form 10-K for the year ended December 31, 2018, the CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 below and Risk Factors set forth in Part II, Item 1A of this Form 10-Q.

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contains certain financial measures, in particular the presentation of Adjusted Earnings and Adjusted Book Value, which are not presented in accordance with U.S. generally accepted accounting principles ("GAAP"). We are presenting these non-GAAP financial measures because they provide greater transparency and enhanced visibility into the underlying drivers of our business. We do not intend for these non-GAAP financial measures to be a substitute for any GAAP financial measures and they may differ from similar reporting provided by other companies. Readers of this Form 10-Q should use these non-GAAP financial measures only in conjunction with the comparable GAAP financial measures. Adjusted Earnings and Adjusted Book Value are non-GAAP financial measures that adjust for the impact of certain non-recurring or non-economic GAAP accounting requirements and include the addition of certain items that the Company has or expects to realize in the future, but that are not reported under GAAP. We provide reconciliations to the most directly comparable GAAP measures; Adjusted Earnings to Net income attributable to common stockholders and Adjusted Book Value to Total Ambac Financial Group, Inc. stockholders' equity.

CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Management has included in Parts I and II of this Quarterly Report on Form 10-Q, including this MD&A, statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as "estimate," "project," "plan," "believe," "anticipate," "intend," "planned," "potential" and similar expressions, or future or conditional verbs such as "will," "should," "would," "could," and "may," or the negative of those expressions or verbs, identify forward-looking statements. We caution readers that these statements are not guarantees of future performance. Forward-looking statements are not historical facts but instead represent only our beliefs regarding future events, which may by their nature be inherently uncertain and some of which may be outside our control. These statements may relate to plans and objectives with respect to the future, among other things which may change. We are alerting you to the possibility that our actual results may differ, possibly materially, from the expected objectives or anticipated results that may be suggested, expressed or implied by these forward-looking statements. Important factors that could cause our results to differ, possibly materially, from those indicated in the forward-looking statements include, among others, those discussed under "Risk Factors" in Part I, Item 1A of the 2018 Annual Report on Form 10-K and in Part II, Item 1A of this quarterly Report on Form 10-Q.

Any or all of management's forward-looking statements here or in other publications may turn out to be incorrect and are based on management's current belief or opinions. Ambac's actual results may vary materially, and there are no guarantees about the performance of Ambac's securities. Among events, risks, uncertainties or factors that could cause actual results to differ materially are: (1) the highly speculative nature of Ambac's common stock and volatility in the price of Ambac's common stock; (2) uncertainty concerning the Company's ability to achieve value for holders of its securities, whether from Ambac Assurance Corporation ("Ambac Assurance") or from transactions or opportunities apart from Ambac Assurance; (3) changes in Ambac Assurance's estimated representation and warranty recoveries or loss reserves over time; (4) failure to recover claims paid on Puerto Rico exposures or incurrence of losses in amounts higher than expected; (5) adverse effects on Ambac's share price resulting from future offerings of debt or equity securities that rank senior to Ambac's common stock; (6) potential of rehabilitation proceedings against Ambac Assurance; (7) dilution of current shareholder value or adverse effects on Ambac's share price resulting from the issuance of additional shares of common stock; (8) inadequacy of reserves established for losses and loss expenses and possibility that changes in loss reserves may result in further volatility of earnings or financial results; (9) increased fiscal stress experienced by issuers of public finance obligations or an increased incidence of Chapter 9 filings or other restructuring proceedings by public finance issuers, including an increased risk of loss on revenue bonds of distressed public finance issuers due to a recent judicial decision adverse to revenue bond holders; (10) the Company's inability to realize the expected recoveries included in its financial statements; (11) insufficiency or unavailability of collateral to pay secured obligations; (12) credit risk throughout the Company's business, including but not limited to credit risk related to residential mortgage-backed securities, student loan and other asset securitizations, public finance obligations (including obligations of the Commonwealth of Puerto Rico and its instrumentalities and agencies as well as obligations relating to privatized military housing projects) and exposures to reinsurers; (13) credit risks related to large single risks, risk concentrations and correlated risks; (14) the risk that the Company's risk management policies and practices do not anticipate certain risks and/or the magnitude of potential for loss; (15) risks associated with adverse selection as the Company's insured portfolio runs off; (16) adverse effects on operating results or the Company's financial position resulting from measures taken to reduce risks in its insured portfolio; (17) disagreements or disputes with Ambac Assurance's primary insurance regulator; (18) our inability to mitigate or remediate losses, commute or reduce insured exposures or achieve recoveries or investment objectives, or the failure of any transaction intended to accomplish one or more of these objectives to deliver anticipated results; (19) the Company's substantial indebtedness could adversely affect its financial condition and operating flexibility; (20) the Company may not be able to obtain financing or raise capital on acceptable terms or at all due to its substantial indebtedness and financial condition; (21) the Company may not be able to generate the significant amount of cash needed to service its debt and financial obligations, and may not be able to refinance its indebtedness; (22) restrictive covenants in agreements and instruments may impair the Company's ability to pursue or achieve its business strategies; (23) loss of control rights in transactions for which we provide insurance due to a finding that Ambac Assurance has defaulted; (24) the Company's results of operation may be adversely affected by events or circumstances that result in the accelerated amortization of the Company's insurance intangible asset; (25) adverse tax consequences or other costs resulting from the characterization of the Company's surplus notes or other obligations as equity; (26) risks attendant to the change in composition of securities in the Company's investment portfolio; (27) changes in tax law; (28) changes in prevailing interest rates; (29) changes on inter-bank lending rate reporting practices or the method pursuant to which LIBOR rates are determined; (30) factors that may influence the amount of installment premiums paid to the Company; (31) default by one or more of Ambac Assurance's portfolio investments, insured issuers or counterparties; (32) market risks impacting assets in the Company's investment portfolio or the value of our assets posted as collateral in respect of interest rate swap transactions; (33) risks relating to determinations of amounts of impairments taken on investments; (34) the risk of litigation and regulatory inquiries or investigations, and the risk of adverse outcomes in connection therewith, which could have a material adverse effect on the Company's business, operations, financial position, profitability or cash flows; (35) actions of stakeholders whose interests are not aligned with broader interests of the Company's stockholders; (36) the Company's inability to realize value from Ambac UK or other subsidiaries of Ambac Assurance; (37) system security risks; (38) market spreads and pricing on interest rate derivatives insured or issued by the Company; (39) the risk of volatility in income and earnings, including volatility due to the application of fair value accounting; (40) changes in accounting principles or practices that may impact the Company's reported financial results; (41) legislative and regulatory developments, including intervention by regulatory authorities; (42) the economic impact of "Brexit"; (43) operational risks, including with respect to internal processes, risk and investment

models, systems and employees, and failures in services or products provided by third parties; (44) the Company's financial position that may prompt departures of key employees and may impact the Company's ability to attract qualified executives and employees; (45) fluctuations in foreign currency exchange rates could adversely impact the insured portfolio in the event of loss reserves or claim payments denominated in a currency other than US dollars and the value of non-US dollar denominated securities in our investment portfolio; and (46) other risks and uncertainties that have not been identified at this time.

EXECUTIVE SUMMARY

Company Overview:

See *Note 1. Background and Business Description* to the Consolidated Financial Statements, included in Part I, Item 1 in this Form 10-Q and *Note 1. Background and Business Description* in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for a description of the Company and our key strategic priorities to achieve our primary goal to maximize stockholder value.

Ambac Assurance and Subsidiaries:

A key strategy for Ambac is to increase the value of its investment in Ambac Assurance by actively managing its assets and liabilities. Asset management primarily entails maximizing the risk adjusted return on non-VIE invested assets and managing liquidity to help ensure resources are available to meet operational and strategic cash needs. These strategic cash needs include activities associated with Ambac's liability management and loss mitigation programs.

Asset Management:

Investment portfolios are subject to internal investment guidelines, as well as limits on types and quality of investments imposed by applicable insurance laws and regulations. As part of its investment strategy, and in accordance with the aforementioned guidelines, Ambac Assurance and Ambac Assurance UK Limited ("Ambac UK"), a subsidiary of Ambac Assurance, purchase distressed Ambac-insured securities based on their relative risk/reward characteristics. The investment portfolios of Ambac Assurance and Ambac UK also hold fixed income securities and funds that include a variety of other assets including, but not limited to, corporate bonds, asset backed and mortgage backed securities, municipal bonds, high yield bonds, leveraged loans, equities, real estate and insurance-linked securities. Refer to *Note 8. Investments* to the Consolidated Financial Statements, included in Part I, Item 1 in this Form 10-Q for further details of fixed income investments by asset class.

At June 30, 2019, Ambac owned $427 million of distressed Ambac-insured bonds, including $146 million of Puerto Rico bonds insured by Ambac Assurance. Subject to applicable internal and regulatory guidelines, market conditions and other constraints, Ambac will continue to opportunistically purchase Ambac-insured securities.

Liability and Insured Exposure Management:

Ambac Assurance's Risk Management Group focuses on the analysis, implementation and execution of commutations, risk reduction or defeasance and loss recovery strategies. Analysts evaluate the estimated timing and severity of projected policy claims as well as the potential impact of loss mitigation or remediation strategies in order to target and prioritize policies, or portions thereof, for commutation, reinsurance, refinancing, restructuring or other risk reduction strategies. For targeted policies, analysts will engage with bondholders, issuers and other economic stakeholders to negotiate, structure and execute such strategies. During 2019, Ambac's successes included:

- On February 12, 2019, the COFINA Plan of Adjustment ("POA") became effective. The POA, including certain related commutation transactions, and subsequent distributions resulted in a reduction of Ambac Assurance's insured exposure to COFINA by approximately 77% or $620 million to $185 million and a reduction in overall Puerto Rico exposure from $1.9 billion to $1.3 billion. Subsequent redemptions of obligations of the COFINA Class 2 Trust (as further described in the *Financial Guarantees in Force* section included in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended December 2018) brought COFINA net par outstanding down to $178 million as of June 30, 2019;
- On June 17, 2019, an Irish scheme of arrangement (the "Arrangement") under Part 9 of the Irish Companies Act 2014 was approved for the restructuring of Ballantyne Re plc ("Ballantyne"). This restructuring allowed for the commutation of $900 million of Ambac UK's net par outstanding. See below under Financial Guarantees in Force for further details of the Arrangement.
- In January 2019, completed work with an issuer to refinance two watch list asset backed lease securitizations with net par outstanding of $95 million at December 31, 2018;
- In February 2019, completed a commutation, via a refunding, of an adversely classified public finance transaction with net par outstanding of $350 million at December 31, 2018;
- During the first two quarters of 2019, Ambac worked closely with servicers and owners of Master Servicing Rights to exercise clean-up calls on several watch list and adversely classified RMBS transactions with total net par outstanding of $70 million at December 31, 2018; and
- During the first two quarters of 2019, Ambac benefited from the final paydown, refunding, or partial commutation of three watch list exposures and three adversely classified exposures that were subject to risk remediation efforts, including aircraft asset backed securitization transactions, public finance general obligation and transportation transactions, investor owned utility transaction, and an international university transaction with total net par outstanding at December 31, 2018 of $269 million.

The following table provides a comparison of total, adversely classified credits ("ACC") and watch list credits net par outstanding in the insured portfolio at June 30, 2019 and December 31, 2018. Net par exposures within the U.S. public finance market includes capital appreciation bonds which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bonds.

($ in billions)	June 30, 2019	December 31, 2018	Variance	
Total	$ 42.2	$ 46.9	$ (4.7)	(10)%
ACC	8.3	10.9	(2.5)	(23)%
Watch list	8.9	9.0	(0.1)	(2)%

The overall reduction in total net par outstanding resulted from active de-risking initiatives at Ambac Assurance and Ambac UK, including the transactions noted above, as well as scheduled maturities, amortizations, commutations, refundings and calls.

The decrease in adversely classified credit exposures is primarily due to active risk reductions and paydowns or calls by issuers, mostly related to Puerto Rico, Ballantyne, public finance, aircraft asset backed and residential mortgage-backed securities.

Although our insured portfolio has generally performed satisfactorily in 2019, we continue to experience stress in certain insured exposures, particularly related to our exposure to Puerto Rico consisting of several different issuing entities (all below investment grade). Each issuing entity has its own credit risk profile attributable to discreet revenue sources, direct general obligation pledges and general obligation guarantees. Refer to Part 1, Item 1 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for additional information regarding the different issuing entities that encompass Ambac's exposures to Puerto Rico.

Ambac:

As of June 30, 2019 cash, investments and receivables of Ambac were $469 million.

($ in millions)	
Cash and short-term investments	$ 312
Other investments (1)	112
Receivables (2)	45
Total	**$ 469**

(1) Includes surplus notes (fair value of $61 million) issued by Ambac Assurance that are eliminated in consolidation.

(2) Includes accruals for tolling payments from Ambac Assurance in accordance with the Amended Tax Sharing Agreement ($44 million, of which $16.5 million was received in July 2019), investment income due and accrued and other receivables.

As a result of a taxable loss at Ambac Assurance in the first quarter of 2019, Ambac has not accrued any additional tax tolling payments. There are no assurances that Ambac Assurance will be able to generate taxable income for 2019 and therefore make future tolling payments to Ambac. Ambac's tax positions are subject to review by the Office of the Commissioner of Insurance for the State of Wisconsin ("OCI"), which may lead to the adoption of positions that reduce the amount of tolling payments otherwise available to Ambac.

Financial Statement Impact of Foreign Currency:

The impact of foreign currency as reported in Ambac's Consolidated Statement of Total Comprehensive Income for the six months ended June 30, 2019 included the following:

($ in millions)	
Net income (1)	$ 13
Gain (loss) on foreign currency translation	(4)
Unrealized (losses) on non-functional currency available-for-sale securities	(20)
Impact on total comprehensive income (loss)	**$ (11)**

(1) A portion of Ambac UK's, and to a lesser extent Ambac Assurance's, assets and liabilities are denominated in currencies other than its functional currency and accordingly, we recognized net foreign currency transaction gains/(losses) as a result of changes to foreign currency rates through our Consolidated Statement of Total Comprehensive Income (Loss). Refer to Note 2. Basis of Presentation and Significant Accounting Policies to the Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q for further details on transaction gains and losses.

Future changes to currency rates may adversely affect our financial results. Refer to Part II, Item 7A in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for further information on the impact of future currency rate changes on Ambac's financial instruments.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Ambac's Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"), which require the use of material estimates and assumptions. For a discussion of Ambac's critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Ambac's Annual Report on Form 10-K for the year ended December 31, 2018.

FINANCIAL GUARANTEES IN FORCE

Financial guarantee products were sold in three principal markets: U.S. public finance, U.S. structured finance and international finance. The following table provides a breakdown of guaranteed net par outstanding by market at June 30, 2019 and December 31, 2018. Net par exposures within the U.S. public finance market include capital appreciation bonds which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bonds. Guaranteed net par outstanding includes the exposures of policies insuring variable interest entities ("VIEs") consolidated in accordance with the Consolidation Topic of the ASC, *Consolidation.* Guaranteed net par outstanding excludes the exposures of policies that insure bonds which have been refunded or pre-refunded and excludes exposure of the policy that insures the notes issued by Ambac LSNI as defined in *Note 1. Background and Business Description* in the Notes to the Consolidated Financial Statements included in Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018:

($ in millions)	June 30, 2019	December 31, 2018
Public Finance [1][2]	$ 20,843	$ 23,442
Structured Finance	8,197	9,947
International Finance	13,147	13,538
Total net par outstanding	**$ 42,187**	**$ 46,927**

(1) Includes $5,722 and $5,759 of Military Housing net par outstanding at June 30, 2019 and December 31, 2018, respectively.

(2) Includes $1,253 and $1,880 of Puerto Rico net par outstanding at June 30, 2019 and December 31, 2018, respectively. Components of Puerto Rico net par outstanding includes capital appreciation bonds which are reported at the par amount at the time of issuance of the related insurance policy as opposed to the current accreted value of the bonds.

Total net par outstanding decreased $4,740 million from December 31, 2018.

- Reductions in public finance net par outstanding included $829 million from calls of insured exposures, $627 million relating to COFINA, $360 million relating to commutations via refunding of adversely classified public finance general obligation and transportation transactions, $25 million relating to a remediation related refunding of a watch list public finance transaction and $768 million from scheduled paydown activity.
- Reductions in structured finance net par were primarily due to the commutation of Ballantyne, an adversely classified structured insurance transaction, totaling $900 million, RMBS commutations and paydowns of $530 million and refundings of two watch list asset backed securitizations totaling $95 million.
- Decreases in international finance were primarily due to policy runoff including paydowns, including a risk remediation related reduction to aircraft asset-backed securitizations totaling $212 million and a decrease in foreign exchange rates of $57 million, primarily related to changes in the British Pound.

Although insured net par outstanding has decreased during 2019, the size of the portfolio is significantly greater than the equity of Ambac. Accordingly, financial stress in the insured portfolio could have a material adverse effect on Ambac's financial condition and results of operations.

Exposure Currency

The table below shows the distribution by currency of Ambac Assurance's insured exposure as of June 30, 2019:

Currency (Amounts in millions)	Net Par Amount Outstanding in Base Currency	Net Par Amount Outstanding in U.S. Dollars
U.S. Dollars	$ 29,450	$ 29,450
British Pounds	£ 8,323	10,571
Euros	€ 1,568	1,784
Australian Dollars	A$ 545	382
Total		**$ 42,187**

Ambac discloses its exposures by currency to help interested parties understand its insured book of business. These insured exposures do not represent the cash outflows that may result from such insurance policies.

Puerto Rico

Ambac has exposure to the Commonwealth of Puerto Rico (the "Commonwealth") and its instrumentalities across several different issuing entities with total net par exposure of $1.3 billion as of June 30, 2019. Each has its own credit risk profile attributable to, as applicable, discrete revenue sources, direct general obligation pledges and/or general obligation guarantees. Refer to Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for additional information regarding the different issuing entities that encompass Ambac's exposures to Puerto Rico.

Financial Developments

COFINA Debt Restructuring

On January 16-17, 2019, the hearings for the confirmation of the COFINA Plan of Adjustment ("POA") and the Commonwealth 9019 motion were held. On February 4, 2019, the COFINA POA was confirmed and the Commonwealth 9019 motion was approved by the U.S. District Court for the District of Puerto Rico. On February 12, 2019, the COFINA POA went effective. As a result of the POA and related transactions, Ambac Assurance's insured COFINA bond exposure decreased by $603 million net par to approximately $202 million net par (a reduction of $5.5 billion of net principal and interest to $1.8 billion of net principal and interest). As a result of the POA, commutations, amendments, and subsequent redemptions of obligations of the COFINA Class 2 Trust (as further described in the *Financial Guarantees in Force* section included in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended December 2018), COFINA net par outstanding decreased to $178 million as of June 30, 2019. Ambac Assurance's remaining policy obligation of $178 million net par is an asset of the COFINA Class 2 Trust, which also holds a ratable distribution of cash and new COFINA bonds, the interest and principal from which can be used to partially offset Ambac's remaining insurance liability.

At this time, it is unclear what impact the COFINA restructuring will have on the prospective recoveries of Ambac Assurance's other insured Puerto Rico instrumentalities.

Fiscal Plan

On May 9, 2019, the Oversight Board certified its own version of a new Commonwealth Fiscal Plan, which supersedes the previous Commonwealth Fiscal Plan certified on October 23, 2018. In the latest Commonwealth Fiscal Plan, the annual Commonwealth budget surpluses are lower in the short term but larger in the long term because of a longer than previously expected rollout of federal disaster spending. The new surplus through fiscal 2024 is just under $14 billion, whereas the previous plan was almost $18 billion. The plan projects a 30-year surplus of $19.7 billion, but $5.4 billion of that money may not be available to the Commonwealth because it is being generated by public corporations. This compares to a 30-year surplus of just under $13 billion under the previous fiscal plan.

As was the case with prior fiscal plans for the Commonwealth of Puerto Rico, the new Commonwealth Fiscal Plan lacks a high degree of transparency regarding the underlying data, assumptions and rationales supporting those assumptions, making reconciliation and due diligence difficult. As a result, it is difficult to assess the possible impact that Fiscal Plan changes may have

on creditor outcomes or Ambac's financial condition, including liquidity, loss reserves and capital resources.

It is unclear if there will be subsequent Fiscal Plan revisions and re-certifications by the Oversight Board, and what the related implications may be for Ambac's insured exposures. Counsel for the Oversight Board told the Title III court during the July 24, 2019 omnibus hearing that the Oversight Board is aiming to file a Commonwealth Plan of Adjustment within the next few weeks or as soon as reasonably possible.

On June 7, 2019, the Oversight Board certified its own version of the Fiscal Plan for the Puerto Rico Highways and Transportation Authority ("PRHTA"). Without considering Fiscal Plan measures, the PRHTA's total financial surplus over the six-year plan period is projected to be $31million. However, after taking into account the measures set forth in the Fiscal Plan, the Oversight Board states that the cumulative surplus over that six-year period would grow to $493 million.

It is unknown if and when a PRHTA Plan of Adjustment will be filed by the Oversight Board or confirmed by the court overseeing the Title III proceedings. It is also unknown if and when other Puerto Rico instrumentalities, which have debt outstanding insured by Ambac Assurance, will be filed under Title III and what effect their Fiscal Plans and/or Plans of Adjustment may have on Ambac's financial position. No assurances can be given that Ambac's financial profile will not suffer a materially negative impact as an ultimate result of the Commonwealth Fiscal Plan, a Commonwealth Plan of Adjustment, or any future changes or revisions to the Commonwealth Fiscal Plan or Fiscal Plans and/or Plans of Adjustment for PRHTA or other Puerto Rico instrumentalities.

Commonwealth Liquidity

On February, 15, 2019, the Oversight Board filed a complaint in the United States District Court for the District of Puerto Rico to compel the Puerto Rico Senate to provide its bank account balances. On April 4, 2019, the Oversight Board and Puerto Rico Senate President Senator Thomas Rivera-Schatz filed a joint stipulation to dismiss without prejudice the Oversight Board's suit to compel the Puerto Rico Senate to provide bank account balances and other financial information. According to the stipulation, the Puerto Rico Senate has provided the requested information to the Oversight Board, instructed the applicable financial institutions to provide updates to that information on no less than a monthly basis and agreed to continue providing information regarding restrictions on funds in its bank accounts.

As of the May 31, 2019 bank account report published by AAFAF, the balances of bank accounts for various Puerto Rico government entities and instrumentalities totaled $14 billion. According to the report, various account balances are considered restricted for different government entities or due to Title III proceedings. However, it is unclear if these restricted designations are inaccurate or outdated since any legal analysis that may have been conducted to determine the restricted or unrestricted nature of funds in non-Treasury Single Account bank accounts has not been made publicly available. Consequently, the purported lack of access to restricted funds could limit the financial flexibility of the Commonwealth and its instrumentalities to provide essential and non-essential services. More generally, the lack of clear, consistent and complete information regarding account balances could further strain debt resolution timelines and potential severities for creditors, including Ambac Assurance.

On March 15, 2019, the Oversight Board announced the release of the Duff & Phelps, LLC report on the bank and investment account balances held by 164 Commonwealth entities and instrumentalities but signaled that the comprehensive forensic investigation into the liquidity of the Puerto Rico government would continue. The Oversight Board said the report is one element of the probe into the sources and uses of public funds, and legal restrictions on these funds to protect the ability of the Government to provide public services to the people of Puerto Rico. The report uses labels for summarized bank account information, including "Reconciled" which refers to bank account information which has been reconciled to information received from a financial institution. After reconciling the financial information provided by the Commonwealth and the financial institutions holding the funds, the report found a total 1,159 accounts with a total value of about $10.2 billion belonging to the Commonwealth entities and instrumentalities, as of June 30, 2018. The report said the cash balances were self-reported by the Commonwealth entities as restricted and unrestricted, but this classification continues under analysis. According to the report, the cash balance of all identified accounts totals to $11.6 billion, of which $10.2 billion represents the total value of reconciled accounts belonging to Commonwealth entities in Title III. The report indicates the reconciled unrestricted cash position is $4.6 billion, but states that it does not purport to determine if any of the funds are validly restricted or contended to be restricted in litigation. Additional or updated detailed bank account information, especially with regards to any comprehensive forensic investigation that has or is being conducted, has not been made publicly available.

As of July 12, 2019, the Treasury Single Account cash position, as reported by the Puerto Rico Treasury Department, was $7.2 billion and still exceeds the $1.1 billion threshold to access Community Disaster Loan financing.

Political Developments

Resignation of Governor Ricardo Rosselló

On July 24, 2019, Governor Ricardo Rosselló announced his resignation as Governor of the Commonwealth of Puerto Rico effective August 2, 2019. Rosselló stepped-down following a number of resignations of cabinet and administration officials, the arrest of two of those officials, former Puerto Rico Education Secretary Julia Keleher and former Puerto Rico Health Insurance Administration Executive Director Angela Aviles, in connection with a federal probe targeting corruption, and the disclosure of nearly 900 pages of exchanges leaked and published by The Center for Investigative Journalism showing inflammatory remarks in a group text between Rosselló, his top aides, his Cabinet members and others.

On July 31, 2019, Governor Rosselló issued a press release announcing he had selected Pedro R. Pierluisi, a former Puerto Rico Secretary of Justice and Resident Commissioner, to serve as the Secretary of State (next in succession order from the governor). On August 2, 2019, Rosselló stepped down and Pierluisi was sworn in as Governor following Pierluisi's confirmation as Secretary of State by the House of Representatives of Puerto Rico. However, on August 7, 2019, the Supreme Court of Puerto Rico ruled that Pierluisi's swearing-in was unconstitutional given that he had only been approved as Secretary of State by only one chamber of Puerto

Rico's congress. On the same date, Pierluisi was removed from office and Secretary of Justice Wanda Vázquez (next in succession order after Secretary of State) was sworn in as the new Governor, per Act 7-1952.

The level of governmental uncertainty and leadership turnover occurring in Puerto Rico is unprecedented. Increased political uncertainty at the local level may have a potential impact on federal support of Commonwealth needs going forward. In addition, appointing new or inexperienced public officials at the cabinet or agency level could result in poor public policy or financial management and performance, which may in turn negatively impact creditor outcomes and Ambac's results of operations and financial condition.

The political turmoil in Puerto Rico has already affected the administration of federal aid as evidenced by FEMA issuing a press release on July 25, 2019 stating that FEMA has reinstated the manual drawdown process for the Commonwealth of Puerto Rico requiring the Puerto Rico government to first receive approval from FEMA to draw down grant funds for Hurricanes Irma and Maria recover due to the ongoing leadership changes within the Puerto Rican government, combined with continued concern over Puerto Rico's history of fiscal irregularities and mismanagement; and Housing and Urban Development ("HUD") Secretary Ben Carson issuing a press release on August 2, 2019 stating that HUD will appoint a federal financial monitor to oversee the disbursement of disaster recovery dollars to Puerto Rico to address Puerto Rico's alleged corruption, fiscal irregularities and mismanagement.

It is unclear how the political situation in Puerto Rico will be stabilized, if and how it may further impact or delay distribution of federal aid, and how creditors of the Commonwealth of Puerto Rico will be ultimately affected.

Plan Support Agreement

On June 16, 2019, the Oversight Board announced that it had entered into a Plan Support Agreement ("PSA") with certain holders of approximately $3 billion in general obligation and Puerto Rico Public Buildings Authority bonds. The agreement includes a framework for a plan of adjustment to resolve $35 billion in liabilities, including a restructuring of $18 billion in constitutional debt. Such a plan would also reduce the amount of Commonwealth-related bonds outstanding to less than $12 billion - a reduction of more than 60%. According to the Oversight Board, the Commonwealth's debt service, including principal and interest over the next 30 years, would be cut by about half, to $21 billion from $43 billion. In conjunction, over $50 billion of pension obligations are expected to be adjusted.

It is unknown if and how the PSA may be modified, when exactly a Commonwealth Plan of Adjustment will be filed and what elements of the PSA may be incorporated into a Commonwealth Plan of Adjustment ("POA"), what Commonwealth instrumentalities may have their debt adjusted as a result of the PSA or Commonwealth POA, and what effect the PSA or Commonwealth POA will have on debt outstanding that insured by Ambac Assurance. No assurances can be given that Ambac's financial profile will not suffer a materially negative impact as an ultimate result of the PSA or Commonwealth POA or any future changes or revisions therein.

Stay on Litigation

On July 24, 2019, Judge Swain ordered a 120-day stay on claims objections and adversary proceedings, which is set to expire on November 30, 2019. The purpose of the stay is to identify efficiently the issues that must be litigated or otherwise resolved to achieve confirmation of a plan of adjustment for the Commonwealth (and other debtors and potential debtors in Title III proceedings) and prioritize such issues and develop efficient approaches to the resolution of such issues. In mediation, parties in the cases and Judge Barbara Houser will focus on identifying key and gating issues, assess their crosscutting and collateral implications, seek to reach substantial consensus as to the prioritization of matters for litigation or mediation, and formulate a proposed schedule and appropriate notice and participation mechanisms that are as standardized and comprehensive as possible. The terms of the order require participation by the following parties:

- The Oversight Board;
- AAFAF;
- The official committee of unsecured creditors;
- The official committee of retired employees;
- The movants or plaintiffs in each of the adversary proceedings and contested matters that are listed in the appendix attached to the motion, and the applicable defendants and respondents; and
- Parties in interest who have appeared in such proceedings to date (or appropriate representatives of such groups).

At the Omnibus hearing, also on July 24, 2019, Judge Houser stated she hopes that working with the various parties would result in successfully coming to agreed or substantially agreed scheduling orders, and then, in addition, through substantive mediation, a substantially consensual plan or plans for the Title III debtors in these cases.

Ambac Post-COFINA Title III Litigation Update

Ambac Assurance is or was a party to eleven litigations related to its Puerto Rico exposures, and recently filed a notice of participation in a twelfth. Four of these litigations are COFINA-related cases that have been, or will soon be, dismissed by operation of the COFINA Plan of Adjustment ("POA") that was confirmed on February 4, 2019, and became effective on February 12, 2019. Several parties are presently appealing the confirmation of the POA. A fifth is another COFINA-related case that had been stayed pending resolution of an interpleader action related to COFINA funds, but which will be permitted to proceed by operation of the POA now that the interpleader action has been resolved. The three remaining active litigations are an appeal relating to the Puerto Rico Highways and Transportation Authority pending before the United States Court of Appeals for the First Circuit; an adversary proceeding relating to the Puerto Rico Public Buildings Authority pending before the United States District Court for the District of Puerto Rico; and an omnibus claim objection to claims premised on certain Commonwealth general obligation bonds, also pending before the United States District Court for the District of Puerto Rico. The remainder of these litigations are stayed under Title III of PROMESA. Ambac is unable to predict when and how the issues raised in these cases (other than those already dismissed by operation of the POA) will be resolved. If Ambac Assurance is unsuccessful in any of these proceedings, Ambac's financial

condition, including liquidity, loss reserves and capital resources may suffer a material negative impact.

Refer to Note 16. Commitments and Contingencies to the Consolidated Financial Statements, included in Part II, Item 8 in this Form 10-K and Note 12. Commitments and Contingencies to the Consolidated Financial Statements, included in Part I, Item 1 in this Form 10-Q for further information about Ambac's litigation relating to Puerto Rico.

Other Legal Developments

On December 21, 2018, the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") and the Official Committee of Unsecured Creditors of All Title III Debtors (Other than COFINA) (the "Committee") filed an adversary proceeding in the Commonwealth's Title III case alleging that the leases securing the bonds issued by the Puerto Rico Public Buildings Authority ("PBA") are "disguised financings," not true leases, and therefore should not be afforded administrative expense priority under the Bankruptcy Code. On March 12, 2019, Ambac Assurance (among others) was permitted to intervene in the adversary proceeding to defend its interests as a holder and insurer of PBA bonds.

On January 15, 2019, the Oversight Board and the Committee filed an omnibus claim objection in the Commonwealth's Title III case challenging claims arising from certain general obligation bonds issued by the Commonwealth in 2012 and 2014 totaling approximately $6 billion, none of which are held or insured by Ambac Assurance. The court subsequently ordered certain consolidated procedures permitting parties in interest an opportunity to participate in litigation of the objection. On April 11, 2019, Ambac Assurance filed a notice of participation in support of the objection.

On February 15, 2019, the United States Court of Appeals for the First Circuit issued an opinion in the consolidated appeals brought by certain parties who argued that the members of the Oversight Board were appointed in violation of the U.S. Constitution's Appointments Clause. The First Circuit ruled that the Oversight Board members (other than the ex-officio Member) must be, and were not, appointed in compliance with the Appointments Clause. The First Circuit declined to dismiss the Oversight Board's Title III petitions and did not render ineffective any otherwise valid actions of the Oversight Board prior to the issuance of the ruling. The First Circuit stated that the ruling will not take effect for 90 days, "so as to allow the President and the Senate to validate the currently defective appointments or reconstitute the Board in accordance with the Appointments Clause." The First Circuit held that during the 90-day stay period, the Oversight Board may continue to operate as it had prior to the ruling. The First Circuit subsequently extended the stay period by an additional 60 days, until July 15, 2019. On April 23, 2019, the Oversight Board filed a petition for certiorari in the United States Supreme Court, and has sought to stay the effectiveness of the First Circuit's ruling until the Supreme Court proceedings have concluded. It is unclear how this ruling will impact the restructuring process, mediation discussions and relevant litigation with respect to Ambac's Puerto Rico exposures.

On March 26, 2019, the U.S. Court of Appeals for the First Circuit, affirming a decision by the U.S. District Court overseeing the PROMESA Title III proceedings for the PRHTA, found that under Sections 928(a) and 922(d) of the U.S. Bankruptcy Code, municipal issuers of revenue bonds secured by special revenues are permitted, but not required, to apply special revenues to pay debt service on such revenue bonds during the pendency of bankruptcy proceedings for such municipal issuers. The complainants had sought an order compelling PRHTA, as the debtor, to continue to make debt service payments on its revenue bonds from pledged special revenues during the pendency of its Title III case, but the First Circuit affirmed the District Court's dismissal of the complaint, holding that it could not compel the issuer to make such payments. The First Circuit has not yet ruled on Ambac's appeal involving similar issues. It is unclear how this ruling may ultimately impact Ambac's revenue bond municipal exposures, inclusive of Puerto Rico.

Summary

Ambac has considered these developments and other factors in evaluating its Puerto Rico loss reserves. During the quarter ended June 30, 2019, Ambac had incurred losses associated with its Domestic Public Finance insured portfolio of $50 million, which was impacted by the continued uncertainty and volatility of the situation in Puerto Rico. While management believes its reserves are adequate to cover losses in its Public Finance insured portfolio, there can be no assurance that Ambac may not incur additional losses in the future, particularly given the developing economic, political, and legal circumstances in Puerto Rico. Such additional losses may have a material adverse effect on Ambac's results of operations and financial condition.

Ballantyne Re Plc

Following entry into a lock-up agreement with Ballantyne Re plc ("Ballantyne"), Assured Guaranty Europe plc and Assured Guaranty Corp., certain Ballantyne Class A Noteholders, Security Life of Denver Insurance Company ("SLD") and Swiss Re Life and Health America Inc. ("SRLHA") Ballantyne commenced, under Irish law, a restructuring transaction in respect of its obligations under its Class A-1 Notes, Class A-2a Notes, Class A-2b Notes, Class A-3a Notes, Class A-3b Notes, Class A-3c Notes and Class A-3d Notes (together, the "Scheme Notes") (the "Restructuring"). The Class A-2a Notes, the Class A-3a Notes, the Class A-3b Notes, the Class A-3c Notes and the Class A-3d Notes had a guarantee from Ambac UK (the "Ambac UK Guaranteed Notes").

The Restructuring was commenced by Ballantyne on April 25, 2019 and was implemented through an Irish scheme of arrangement (the "Arrangement") under Part 9 of the Irish Companies Act 2014 which required the consent of the requisite majorities of the relevant Class A Noteholders at each Arrangement meeting. The Arrangement was approved on June 17, 2019 and the Restructuring was implemented on the terms proposed.

The key features of the Restructuring were as follows:

- the novation of the indemnity reinsurance agreement between Ballantyne and SLD dated November 19, 2008 (as amended) to SRLHA (the "Novation");
- the disbursement of the assets from Ballantyne's reinsurance trust account to effectuate the Novation and make payment to the holders of Scheme Notes in full and final satisfaction of their claims against Ballantyne; and
- the commutation of the obligations of Ambac UK in respect of the Ambac UK Guaranteed Notes.

With the approval of the Arrangement and the implementation of the Restructuring, it is intended that Ballantyne will be wound-up by way of a solvent liquidation.

With the successful implementation of the Restructuring, Ambac UK has ceased to have any exposure with respect to the obligations of Ballantyne.

Exposure Concentrations within each Market

The table below shows Ambac's ten largest U.S. public finance exposures, by repayment source, as a percentage of total financial guarantee net par outstanding at June 30, 2019:

($ in millions)	Bond Type	Ambac Ratings [1]	Net Par Outstanding [2]	% of Total Net Par Outstanding
New Jersey Transportation Trust Fund Authority - Transportation System	Lease and Tax-backed Revenue	BBB+	$ 783	1.9%
Massachusetts Commonwealth - GO	General Obligation	AA	586	1.4%
Mets Queens Baseball Stadium Project, NY, Lease Revenue	Stadium	BBB	549	1.3%
Hickam Community Housing LLC	Housing Revenue	BBB	467	1.1%
Bragg Communities, LLC	Housing Revenue	A-	418	1.0%
Puerto Rico Highways & Transportation Authority, Transportation Revenue	Lease and Tax-backed Revenue	BIG	414	1.0%
Puerto Rico Infrastructure Financing Authority, Special Tax Revenue	Lease and Tax-backed Revenue	BIG	403	1.0%
New Jersey Economic Development Authority - School Facilities Construction	Lease and Tax-backed Revenue	BBB+	400	0.9%
Monterey Bay, CA - Military Housing	Housing Revenue	BBB+	326	0.8%
Fort Bliss/White Sand Missile Range Housing LP	Housing Revenue	BBB+	308	0.7%
Total			$ 4,654	11.0%

(1) Internal credit ratings are provided solely to indicate the underlying credit quality of guaranteed obligations based on the view of Ambac Assurance. In cases where Ambac Assurance has insured multiple tranches of an issue with varying internal ratings, or more than one obligation of an issuer with varying internal ratings, a weighted average rating is used. Ambac Assurance credit ratings are subject to revision at any time and do not constitute investment advice. BIG denotes credits deemed below investment grade.

(2) Net Par includes capital appreciation bonds, which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bonds.

Net par related to the top ten U.S. public finance exposures reduced $535 million from December 31, 2018. Changes in these exposure amounts will occur due to scheduled paydowns, calls and refundings executed during the period. During 2019, due to a deal restructuring and commutation, Puerto Rico Sales Tax Financing Corporation Senior Sales Tax Revenue (COFINA) and Massachusetts Port Authority Special Facility Revenue Bonds, respectively, were removed from the top ten largest U.S. public finance exposures offset by the addition of Monterey Bay, CA - Military Housing and Fort Bliss/White Sand Missile Range Housing LP.

The table below shows Ambac's ten largest structured finance transactions, as a percentage of total financial guarantee net par outstanding at June 30, 2019:

($ in millions)	Bond Type	Ambac Rating[1]	Net Par Outstanding	% of Total Net Par Outstanding
Progress Energy Carolinas, Inc.	Investor Owned Utility	A-	$ 450	1.1%
Timberlake Financial, LLC	Structured Insurance	BBB	429	1.0%
Wachovia Asset Securitization Issuance II, LLC 2007-HE2	Mortgage Backed Securities	BBB	420	1.0%
Wachovia Asset Securitization Issuance II, LLC 2007-HE1	Mortgage Backed Securities	BBB	289	0.7%
Option One Mortgage Loan Trust 2007-FXD1	Mortgage Backed Securities	BIG	223	0.5%
Terwin Mortgage Trust Asset-Backed Certificates, Series 2006-6	Mortgage Backed Securities	BIG	211	0.5%
Impac CMB Trust Series 2005-7	Mortgage Backed Securities	BIG	188	0.4%
Countrywide Asset-Backed Certificates Trust 2005-16	Mortgage Backed Securities	BIG	186	0.4%
Ownit Mortgage Trust 2006-OT1	Mortgage Backed Securities	BIG	181	0.4%
Basin Electric Power Cooperative	Investor Owned Utility	A-	169	0.4%
Total			$ 2,746	6.5%

(1) Internal credit ratings are provided solely to indicate the underlying credit quality of guaranteed obligations based on the view of Ambac Assurance, and for Ambac UK related transactions, based on the view of Ambac UK. In cases where Ambac Assurance or Ambac UK has insured multiple tranches of an issue with varying internal ratings, or more than one obligation of an issuer with varying internal ratings, a weighted average rating is used. Ambac Assurance and Ambac UK credit ratings are subject to revision at any time and do not constitute investment advice. BIG denotes credits deemed below investment grade.

Net par related to the top ten U.S. structured finance exposures reduced $877 million from December 31, 2018. The change in top U.S. structured finance exposures primarily relates to the Ballantyne commutation and paydowns of RMBS during the six months ended June 30, 2019. As a result of the commutation, Ballantyne Re Plc was removed from the top ten largest U.S. structured finance exposures offset by the addition of Basin Electric Power Cooperative.

The table below shows our ten largest international finance transactions as a percentage of total financial guarantee net par outstanding at June 30, 2019. Except where noted, all international finance transactions included in the table below are insured by Ambac UK:

($ in millions)	Country-Bond Type	Ambac Rating[1]	Net Par Outstanding	% of Total Net Par Outstanding
Mitchells & Butlers Finance plc-UK Pub Securitisation	UK-Asset Securitizations	A+	$ 1,297	3.1%
Capital Hospitals plc [2]	UK-Infrastructure	A-	867	2.1%
Aspire Defence Finance plc	UK-Infrastructure	BBB+	841	2.0%
Anglian Water	UK-Utility	A-	781	1.9%
Posillipo Finance II S.r.l	Italy-Sub-Sovereign	BBB-	734	1.7%
National Grid Gas	UK-Utility	A-	721	1.7%
Ostregion Investmentgesellschaft NR 1 SA [2]	Austria-Infrastructure	BIG	695	1.6%
RMPA Services plc	UK-Infrastructure	BBB+	560	1.3%
Catalyst Healthcare (Manchester) Financing plc [2]	UK-Infrastructure	BBB-	520	1.2%
National Grid Electricity Transmission	UK-Utility	A-	484	1.1%
Total			$ 7,500	17.8%

(1) Internal credit ratings are provided solely to indicate the underlying credit quality of guaranteed obligations based on the view of Ambac Assurance, and for Ambac UK related transactions, based on the view of Ambac UK. In cases where Ambac Assurance or Ambac UK has insured multiple tranches of an issue with varying internal ratings, or more than one obligation of an issuer with varying internal ratings, a weighted average rating is used. Ambac Assurance and Ambac UK credit ratings are subject to revision at any time and do not constitute investment advice. BIG denotes credits deemed below investment grade.

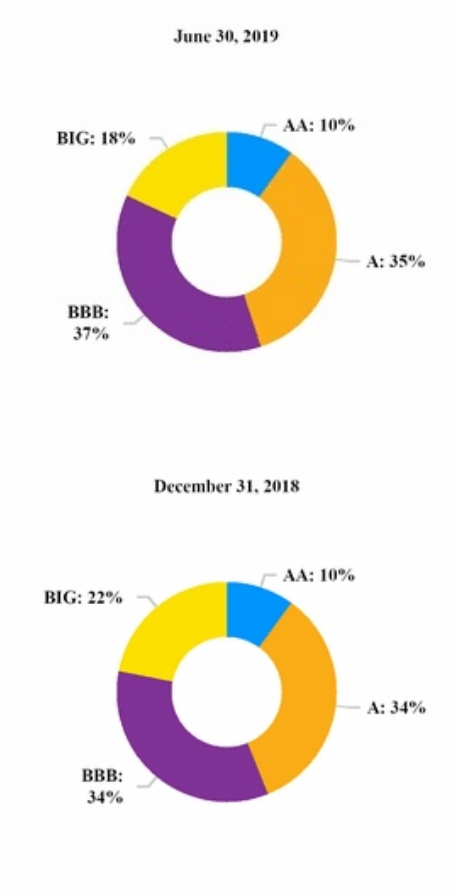
(2) A portion of this transaction is insured by an insurance policy issued by Ambac Assurance.

Net par related to the top ten international finance exposures reduced $86 million from December 31, 2018. International exposures are impacted by changes in foreign exchange rates, certain indexation rates and scheduled and unscheduled paydowns. During 2019, there was no change in the listing of exposures included within the top ten largest international exposures.

The concentration of net par amongst the top categories noted above (as a percentage of net par outstanding) has decreased since December 31, 2018 for both public finance and structured finance exposures and increased since December 31, 2018 for international exposures. Given that Ambac has not written any new insurance policies since 2008, the risk exists that the insured portfolio becomes increasingly concentrated to large and/or below investment grade exposures.

Ratings Distribution

The following charts provide a rating distribution of net par outstanding based upon internal Ambac credit ratings[1] and a distribution by bond type of Ambac's below investment grade net par exposures at June 30, 2019 and December 31, 2018. Below investment grade is defined as those exposures with an Ambac internal credit rating below BBB-:



Note: AAA is less than 1% in both periods.

(1) Internal credit ratings are provided solely to indicate the underlying credit quality of guaranteed obligations based on the view of Ambac Assurance, and for Ambac UK related transactions, based on the view of Ambac UK. Ambac Assurance and Ambac UK credit ratings are subject to revision at any time and do not constitute investment advice.

Summary of Below Investment Grade Exposure ($ in millions)	Net Par Outstanding June 30, 2019	December 31, 2018
Public Finance:		
Lease and tax-backed [1]	$ 1,388	$ 2,025
General obligation [1]	412	434
Housing [2]	191	314
Transportation	27	378
Health care	25	25
Other	142	146
Total Public Finance	2,185	3,322
Structured Finance:		
RMBS	3,835	4,205
Structured Insurance	—	900
Student loans	665	714
Other	33	53
Total Structured Finance	4,533	5,872
International Finance:		
Other	768	924
Total International Finance	768	924
Total	$ 7,486	$ 10,118

(1) Lease and tax-backed revenue includes $1,108 and $1,735 of Puerto Rico net par at June 30, 2019 and December 31, 2018, respectively. General obligation includes $145 and $145 of Puerto Rico net par at June 30, 2019 and December 31, 2018, respectively. Components of Puerto Rico net par outstanding includes capital appreciation bonds which are reported at the par amount at the time of issuance of the related insurance policy as opposed to the current accreted value of the bonds.

(2) Relates to military housing net par.

The decrease in below investment grade exposures is primarily due to (i) the commutation or restructuring of certain structured insurance, lease and tax-backed and transportation transactions (including the Ballantyne and COFINA commutations), (ii) upgrades of certain military housing exposure, (iii) paydowns or calls by issuers, mostly related to residential mortgage-backed and other asset-backed securities and (iv) a termination of an international aircraft asset-backed transaction. Despite the decrease in below investment grade exposures, such exposures could increase as a relative proportion of the guarantee portfolio given that stressed borrowers generally have less ability to prepay or refinance their debt. Accordingly, due to these and other factors, it is not unreasonable to expect the proportion of below investment grade exposure in the guarantee portfolio to increase in the future.

RESULTS OF OPERATIONS

Net loss attributable to common stockholders for the three months ended June 30, 2019 was $(128) million compared to net income attributable to common stockholders of $4 million for the three months ended June 30, 2018. The decrease was primarily due to the impact of the Ballantyne restructuring and commutation which drove (i) higher insurance intangible amortization for the three months ended June 30, 2019 compared to the three months ended June 30, 2018, (ii) lower net premiums earned and (iii) a higher provision for income taxes, partially offset by (i) higher investment income and (ii) a loss and loss expense benefit for the three months ended June 30, 2019 compared to an expense for the three months ended June 30, 2018. The Ballantyne restructuring also positively impacted net realized gains on investment securities and adversely impacted other income as a result of changes in foreign currencies. Additionally, the three months ended June 30, 2019 included a net loss on derivative contracts compared to a net gain for the three months ended June 30, 2018.

Net loss attributable to common stockholders for the six months ended June 30, 2019 was $(172) million compared to net income attributable to common stockholders of $310 million for the six months ended June 30, 2018. The decrease was primarily driven by (i) a lower losses and loss expenses benefit for the six months ended June 30, 2019 compared to the six months ended June 30, 2018, (ii) higher insurance intangible amortization, (iii) lower net premiums earned, (iv) lower net investment income, (v) net losses on derivative contracts compared to net gains for the six months ended June 30, 2018, and (vi) higher interest expense, partially offset by (i) higher gains on consolidated VIEs and (ii) lower operating expenses.

The Ballantyne restructuring transactions completed in June 2019, resulted in an aggregate loss of $83 million included in net loss attributable to common stockholders for the three and six months ended June 30, 2019. The COFINA restructuring completed in February 2019 resulted in an aggregate gain of $30 million included in net loss attributable to common stockholders for the six months ended June 30, 2019. As described further below, these transactions, along with the impact of the February 2018 Rehabilitation Exit Transactions, significantly impact the comparability of the results of operations for the periods presented.

A summary of our financial results is shown below:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Revenues:				
Net premiums earned	$ 8	$ 26	$ 36	$ 57
Net investment income	86	67	141	177
Net realized investment gains (losses)	36	47	53	52
Net gains (losses) on derivative contracts	(35)	9	(52)	34
Net realized gains (losses) on extinguishment of debt	—	—	—	3
Income (loss) on variable interest entities	3	1	19	1
Expenses:				
Losses and loss expenses (benefit)	(133)	33	(121)	(215)
Insurance intangible amortization	226	23	263	52
Operating expenses	29	26	54	62
Interest expense	67	62	135	111
Provision for income taxes	28	2	30	5
Net income (loss) attributable to common stockholders	**$ (128)**	**$ 4**	**$ (172)**	**$ 310**

The following paragraphs describe the consolidated results of operations of Ambac and its subsidiaries for the three and six months ended June 30, 2019 and 2018, respectively.

Rehabilitation Exit Transactions. On February 12, 2018, Ambac Assurance executed the Rehabilitation Exit Transactions under which Deferred Amounts and a substantial portion of Ambac Assurance senior surplus notes were settled at a discount, with holders (other than Ambac) receiving in exchange, a consideration package of cash and debt securities (as more fully discussed in *Note 1. Background and Business Description* in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018). As described further below, the completion of the Rehabilitation Exit Transactions, including the related changes to invested assets, loss reserves and debt of the Company, has a significant impact on the comparability of the results of operation for the six months ended June 30, 2019 as compared to the six months ended June 30, 2018.

Net Premiums Earned. Net premiums earned primarily represent the amortization into income of collected insurance premiums. We present accelerated premiums, which result from calls and other accelerations of insured obligations separate from normal net premiums earned. When an insured bond has been retired, any remaining unearned premium revenue ("UPR") is recognized at that time to the extent the financial guarantee contract is legally extinguished, causing accelerated premium revenue. For installment premium paying transactions, we offset the recognition of any remaining UPR by the reduction of the related premium

receivable to zero (as it will not be collected as a result of the retirement), which may cause negative accelerated premium revenue.

Net premiums earned decreased $18 million and $21 million for the three and six months ended June 30, 2019, respectively, compared to the same periods in the prior year. Normal net premiums earned and accelerated premiums are reconciled to total net premiums earned in the table below. The following table provides a breakdown of net premiums earned by market:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Normal Premium Earned:				
Public finance	$ 7	$ 10	$ 15	$ 20
Structured finance	3	4	6	9
International finance	4	6	10	12
Total normal premiums earned	14	20	30	41
Accelerated Earnings:				
Public finance	2	5	21	14
Structured Finance	(6)	1	(7)	1
International finance	(2)	—	(8)	—
Accelerated earnings	(6)	6	6	16
Total net premiums earned	$ 8	$ 26	$ 36	$ 57

The decrease in normal premiums earned in the three and six months ended June 30, 2019, is primarily attributable to the continued runoff of the portfolio in all markets. Terminations and accelerations, including those which occurred in prior periods, result in lower normal premiums earned in current and future periods. Public Finance normal earned premiums were also impacted by a large reinsurance cession in the fourth quarter of 2018.

The increase in public finance accelerated earnings in the six months ended June 30, 2019, is primarily related to de-risking activity including the COFINA restructuring that occurred in February 2019. Structured finance negative accelerated earnings in the three and six months ended June 30, 2019, is primarily related to the Ballantyne commutation. International negative accelerated earnings in the six months ended June 30, 2019, is related to the termination of two commercial asset-backed exposures.

Net Investment Income. Net investment income primarily consists of interest and net discount accretion on fixed income securities classified as available-for-sale, including investments in Ambac-insured securities. Investments in Ambac-insured securities are made opportunistically based on their risk/reward characteristics. As described further below, investment income from holdings of Ambac-insured securities for the periods presented have primarily been driven by restructuring transactions involving RMBS, Puerto Rico and Ballantyne bonds. Also, included in net investment income are net gains and (losses) on pooled investment funds and certain other investments that are classified as trading securities with changes in fair value recognized in earnings. Trading securities are included in Other investments on the Consolidated Balance Sheets. Most trading securities are currently in the Ambac UK portfolio and consist of pooled fund investments in diversified asset classes including equities, hedge funds (liquidated in the fourth quarter of 2018), loans, insurance-linked securities and property.

Net investment income from Ambac-insured securities, available for sale and short-term securities other than Ambac-insured and Other investments is summarized in the table below:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Securities available-for-sale: Ambac-insured (including Secured Notes)	$ 58	$ 49	$ 87	$ 147
Securities available-for-sale and short-term other than Ambac-insured	20	13	38	25
Other investments (includes trading securities)	8	5	16	5
Net investment income	$ 87	$ 67	$ 141	$ 177

Net investment income increased $20 million for the three months ended June 30, 2019 and decreased $36 million for the six months ended June 30, 2019, compared to the same periods in the prior year. The increase for the three months ended June 30, 2019 was driven primarily by accelerated accretion on Ballantyne bonds resulting from the June 2019 restructuring plus positive returns on fund investments. Income from other Ambac-insured securities declined due to the reduced amounts of Ambac-insured RMBS resulting from sales subsequent to the 2018 Rehabilitation Exit Transactions and Ambac-insured COFINA bonds following the restructuring of February 2019.

The decrease in net investment income for the six months ended June 30, 2019, compared to the same period in the prior year is due primarily to the reduced amount of Ambac-insured RMBS and COFINA bonds following their respective restructuring transactions noted above. The impact of lower RMBS and COFINA bonds was partially offset by increased income from Secured Notes and uninsured COFINA bonds received in the restructurings, accelerated accretion on Ballantyne bonds in connection with the Ballantyne restructuring in June 2019, and stronger overall market performance on funds.

Income from other investments was higher for the three months ended June 30, 2019, due to 2018 losses from hedge fund positions no longer held in 2019 and stronger gains on equity index funds

for the six months ended June 30, 2018. Results from other asset classes were mixed.

Net Other-Than-Temporary Impairment Losses. Net other-than-temporary impairment losses recorded in earnings include only credit related impairment amounts to the extent management does not intend to sell and it is not more likely than not that the Company will be required to sell before recovery of the amortized cost basis. Non-credit related impairment amounts are recorded in other comprehensive income. Alternatively, non-credit related impairment is reported through earnings as part of net other-than-temporary impairment losses if management intends to sell securities or it is more likely than not that the Company will be required to sell before recovery of amortized cost less any current period credit impairment.

Net other-than-temporary impairments for the three and six month periods ended June 30, 2019, related to management's intent to sell securities. For the three month and six month periods ended June 30, 2018, net other-than-temporary impairments included credit related impairments on certain securities and also included some losses due to management's intent to sell securities.

Net Realized Investment Gains (Losses). The following table provides a breakdown of net realized gains (losses) for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Net gains on securities sold or called	**$ 10**	$ 40	**$ 30**	$ 50
Net foreign exchange gains (losses)	**26**	7	**23**	2
Total net realized gains (losses)	**$ 36**	**$ 47**	**$ 53**	**$ 52**

Net realized gains on securities sold or called for the three months and six months ended June 30, 2019 included $7 million and $26 million, respectively, of net gains related to the impact of the COFINA restructuring, including sales of Ambac-insured Puerto Rico COFINA bonds and sales of new uninsured COFINA bonds received in the restructuring. Also included in realized gains for the three and six months ended June 30, 2019 are $23 million of realized foreign exchange gains arising from the settlement of Ballantyne bonds held in the investment portfolio.

Net Gains (Losses) on Derivative Contracts. Net gains (losses) on derivative contracts includes results from the Company's interest rated derivatives portfolio and its runoff credit derivatives portfolio. The interest rate derivatives portfolio is positioned to benefit from rising rates as a partial economic hedge against interest rate exposure in the financial guarantee and investment portfolios. Results in Net gains (losses) on interest rate derivatives generally reflect mark-to-market gains (losses) in the portfolio caused by increases (declines) in forward interest rates during the periods, the carrying cost of the portfolio, and the impact of the Ambac CVA and counterparty credit adjustments as discussed below. Results from credit derivatives were not significant to the periods presented.
Net gains (losses) on interest rate derivatives for the three and six months ended June 30, 2019, were ($36) million and $(52) million, compared to $9 million and $35 million for the three and six months ended June 30, 2018. The net loss for the three and six months ended June 30, 2019, reflects declines in forward interest rates, partially offset by lower net carrying costs compared to the three and six months ended June 30, 2018, which experienced increases in interest rates.

The fair value of derivatives include valuation adjustments to reflect Ambac's own credit risk and counterparty credit risk. Within the interest rate derivatives portfolio, an Ambac CVA is generally applicable for uncollateralized derivative liabilities that may not be offset by derivative assets under a master netting agreement. There was no Ambac CVA included in the fair value of interest rate derivatives for the periods presented. Counterparty credit adjustments are generally applicable for uncollateralized derivative assets that may not be offset by derivative liabilities under a master netting agreement. Inclusion of counterparty credit adjustments in the valuation of interest rate derivatives resulted in gains (losses) within Net gains (losses) on interest rate derivatives of $(3) million for the three and six months ended June 30, 2019, respectively, and was less than $1 million for both the three and six months ended June 30, 2018.

Net Realized Gains (Losses) on Extinguishment of Debt. There was no net realized gains (losses) on extinguishment of debt for the three and six months ended June 30, 2019 compared to net realized gains of less than a million dollars and $3 million for the three and six months ended June 30, 2018, respectively. The gains for the six months ended June 30, 2018, related to surplus notes received by Ambac Assurance in settlement of Deferred Amounts held in its investment portfolio in connection with the Rehabilitation Exit Transactions.

Income (loss) on Variable Interest Entities. Included within Income (loss) on variable interest entities are income statement amounts relating to VIEs consolidated under the Consolidation Topic of the ASC as a result of Ambac's variable interest arising from financial guarantees written by Ambac's subsidiaries, including gains or losses attributable to consolidating or deconsolidating VIEs during the periods reported. Generally, the Company's consolidated VIEs are entities for which Ambac has provided financial guarantees on all of or a portion of its assets or liabilities. In consolidation, assets and liabilities of the VIEs are initially reported at fair value and the related insurance assets and liabilities are eliminated. However, the amount of VIE net assets (liabilities) that remain in consolidation generally result from the net positive (negative) projected cash flows from (to) the VIEs which are attributable to Ambac's insurance subsidiaries in the form of financial guarantee insurance premiums, fees and losses. In the case of VIEs with net negative projected cash flows, the net liability is generally to be funded by Ambac's insurance subsidiaries through insurance claim payments. Differences between the net carrying value of the insurance accounts under the Financial Services—Insurance Topic of the ASC and the carrying value of the consolidated VIE's net assets or liabilities are recorded through income at the time of consolidation or deconsolidation. Additionally, terminations or other changes to Ambac's financial guarantee insurance policies that impact projected cash flows between a consolidated VIE and Ambac could result in gains or losses, even if such policy changes do not result in deconsolidation of the VIE.

Income (loss) on variable interest entities was $3 million and $19 million for the three and six months ended June 30, 2019, compared

to income of $1 million and $1 million for the three and six months ended June 30, 2018. Income on variable interest entities for the six months ended June 30, 2019, included a VIE consolidation gain of $15 million related to the restructuring of Puerto Rico COFINA debt. Under the restructuring, Ambac-insured COFINA bonds that were not commuted were deposited into a newly formed trust, called the COFINA Class 2 Trust. This Trust is a VIE that Ambac has determined must be consolidated. Refer to Part I, Item 2, "Management's Discussion and Analysis — Financial Guarantees in Force" in this Quarterly Report on Form 10-Q for further discussion of the COFINA Debt Restructuring. Income on variable interest entities for the three months ended June 30, 2019 and the three and six months ended June 30, 2018 reflects gains from consolidated VIEs' net assets.

Losses and Loss Expenses. Losses and loss expenses are based upon estimates of the aggregate losses inherent in the non-derivative financial guarantee portfolio for insurance policies issued to beneficiaries, including unconsolidated VIEs. Losses and loss expenses for the six months ended June 30, 2018 included interest on Deferred Amounts pursuant to the Segregated Account Rehabilitation Plan that were discharged on February 12, 2018.

Ambac records as a component of its loss reserve estimate subrogation recoveries related to securitized loans in RMBS transactions with respect to which Ambac Assurance is pursuing claims for breaches of representations and warranties. Ambac does not include potential recoveries attributed solely to fraudulent inducement claims in our litigations in our estimate of subrogation recoveries. Generally, the sponsor of an RMBS transaction provided representations and warranties with respect to the securitized loans, including representations with respect to the loan characteristics, the absence of borrower fraud in the underlying loan pools or other misconduct in the origination process and attesting to the compliance of loans with the prevailing underwriting policies. Ambac has recorded representation and warranty subrogation recoveries, net of reinsurance, of approximately $1.736 billion and $1.744 billion at June 30, 2019 and December 31, 2018, respectively. Refer to Note 2. Basis of Presentation and Significant Accounting Policies to the Consolidated Financial Statements included in Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for more information regarding the estimation process for R&W subrogation recoveries.

The following provides details, by bond type, for losses and loss expenses (benefit) incurred for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
RMBS [1]	**$ (69)**	$ (26)	**$ (108)**	$ 20
Domestic Public Finance	**50**	44	**120**	33
Student Loans	**(4)**	(4)	**(7)**	(1)
Ambac UK and Other Credits	**(111)**	19	**(125)**	2
Interest on Deferred Amounts	**—**	—	**—**	21
Discount on Rehabilitation Exit Transactions	**—**	—	**—**	(288)
Totals [2]	**$ (134)**	**$ 33**	**$ (121)**	**$ (215)**

(1) The losses and loss expense (benefit) associated with changes in estimated representation and warranties was $4 and $8 for the three and six months ended June 30, 2019, respectively, and $17 and $18 for the three and six months ended June 30, 2018, respectively.

(2) Includes loss expenses incurred (benefit) of ($1) and $28 for the three and six months ended June 30, 2019, respectively, and $40 and $47 for the three and six months ended June 30, 2018, respectively.

Losses and loss expenses (benefit) for the three and six months ended June 30, 2019 were driven by the following:

- Favorable development within Ambac UK and Other Credits primarily due to the Ballantyne commutation;
- Favorable RMBS development as a result of credit improvement, a trustee settlement related to Lehman sponsored transactions of $19 million and the impact on excess spread from declines in interest rates; partially offset by,
- Higher projected losses in domestic public finance driven mostly by a lower discount rates and additions to Puerto Rico loss reserves.

Losses and loss expenses (benefit) for the three and six months ended June 30, 2018 were driven by the following:

- Higher projected losses in domestic public finance largely driven by Military Housing loss expenses incurred and additions to Puerto Rico loss reserves;
- A portion of Ambac UK's loss reserves are denominated in currencies other than their functional currency of British Pounds resulting in incurred losses (gains) when the British Pound depreciates (appreciates). Ambac recognized $17 million and $6 million in foreign exchange losses for the three and six months ended June 30, 2018;
- For the three months ended June 30, 2018, there was positive RMBS development as a result of clean up calls on transactions and favorable credit developments. The three and six months ended June 30, 2018 were adversely impacted by the impact of higher interest rates on excess spread;
- Discount achieved pursuant to the Rehabilitation Exit Transactions for the six months ended June 30, 2018, partially offset by interest on Deferred Amounts through the Rehabilitation Exit Transactions date.

Insurance Intangible Amortization. Insurance intangible amortization for the three and six months ended June 30, 2019 was $226 million and $263 million, respectively, an increase of $203 million and $211 million over the three and six months ended June 30, 2018, respectively. The increase is primarily due to accelerated amortization as a result of the Ballantyne commutation that occurred in the second quarter of 2019.

Operating Expenses. Operating expenses consist of gross operating expenses plus reinsurance commissions. The following table provides details of operating expenses for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Compensation	$ 17	$ 14	$ 32	$ 30
Non-compensation	12	12	22	32
Gross operating expenses [1]	29	26	54	62
Reinsurance commissions, net	—	—	—	—
Total operating expenses	**$ 29**	**$ 26**	**$ 54**	**$ 62**

Gross operating expense for the three months ended June 30, 2019, were $29 million, an increase of $3 million from the three months ended June 30, 2018. The increase was due to the following:

- Higher compensation costs primarily due to an improvement in performance metrics, mostly for Ambac UK incentive compensation, which was impacted by the Ballantyne commutation, partially offset by lower salaries as a result of reduced headcount.
- Although non-compensation costs were flat as compared to the three months ended June 30, 2018, the following variances are identified. Lower costs for the three months ended June 30, 2019 for (i) $2.5 million of costs associated with the 2018 AMPS Exchange; (ii) $1.3 million of lower legal, consulting and advisory fees in connection with the exit from rehabilitation of the Segregated Account, of which $0.8 million relates to advisory services provided for the benefit of OCI. These decreases were partially offset by higher legal, consulting and advisory fees associated with various initiatives.

Gross operating expenses for the six months ended June 30, 2019 were $54 million, a decrease of $8 million from the six months ended June 30, 2018. The decrease was due to the following:

- Higher compensation costs primarily due to an improvement in performance metrics, mostly on Ambac UK incentive compensation, partially offset by a decrease of awards granted related to the Rehabilitation Exit Transactions of $2.4 million and $0.9 million related to the settlement of a previously granted performance restricted stock unit award issued to the former CEO that vested upon the Segregated Account's exit from rehabilitation.
- Lower non-compensation costs primarily due to (i) $14.5 million of lower legal, consulting and advisory fees in connection with the exit from rehabilitation of the Segregated Account, of which $4.8 million relates to advisory services provided for the benefit of OCI and (ii) $2.5 million of costs associated with the August 2018 AMPS Exchange. These decreases were partially offset by higher legal, consulting and advisory fees associated with various initiatives of $6.0 million.

With the conclusion of the Segregated Account rehabilitation, the duties of the Wisconsin Insurance Commissioner as rehabilitator of the Segregated Account have been discharged. Legal and consulting services provided for the benefit of OCI amounted to $0.5 million and $1.0 million during the three and six months ended June 30, 2019, respectively, and $1.3 million and $5.8 million during the three and six months ended June 30, 2018, respectively.

Interest Expense. Interest expense includes accrued interest on the Ambac note, Tier 2 notes, surplus notes and other debt obligations. Additionally, interest expense includes discount accretion when the debt instrument carrying value is at a discount to par.

The following table provides details by type of obligation for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
($ in millions)	**2019**	**2018**	**2019**	**2018**
Surplus notes [1]	$ 24	$ 15	$ 48	$ 36
Ambac note	37	40	74	63
Tier 2 notes [2]	6	6	13	10
Other	—	1	—	2
Total interest expense	**$ 67**	**$ 62**	**$ 135**	**$ 111**

(1) The amounts include junior surplus notes.

(2) The amounts include unfunded commitment fees applicable prior to the issuance of the Tier 2 notes of $1 million in the six months ended June 30, 2018.

The increase in interest expense for the three and six months ended June 30, 2019, compared to the three and six months ended June 30, 2018, primarily reflects the impact of the Rehabilitation Exit Transactions that resulted in the issuance of the Ambac Note and Tier 2 Notes. Additionally, surplus notes outstanding increased in the third quarter of 2018 due to surplus notes issued by Ambac Assurance in connection with the AMPS Exchange and resales of notes to the market. Refer to Note 13 in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for further information on the Ambac Note and Tier 2 Notes.

Surplus note principal and interest payments require the approval of OCI. Except for a one-time payment of approximately six months of interest on the surplus notes (other than junior surplus notes) outstanding immediately after the Rehabilitation Exit Transactions, annually from 2011 through 2019, OCI issued its disapproval of the requests of Ambac Assurance to pay the full interest on outstanding surplus notes issued by Ambac on the annual scheduled interest payment date of June 7th. Ambac Assurance has not requested to pay interest on any junior surplus notes since their issuance. The interest on the outstanding surplus notes and junior surplus notes were accrued for and Ambac is accruing interest on the interest amounts following each scheduled interest payment date. Total accrued and unpaid interest for surplus

notes and junior surplus notes outstanding to third parties were $281 million and $133 million, respectively, at June 30, 2019.

Provision for Income Taxes. The provision for income taxes for the three and six months ended June 30, 2019, was $28 million and $30 million, respectively, an increase of $26 million and $25 million, respectively, compared to the provision for income taxes reported for three and six months ended June 30, 2018. The change for the three and six months ended June 30, 2018, compared to the prior year was primarily attributable to the taxable income at Ambac UK associated with the Ballantyne restructuring.

LIQUIDITY AND CAPITAL RESOURCES

Ambac Financial Group, Inc. Liquidity. Ambac's liquidity is primarily dependent on its cash, investments and receivables totaling $469 million as of June 30, 2019, and secondarily on its expense sharing and other arrangements with Ambac Assurance.

Ambac's investments include securities directly and indirectly issued by and/or insured by Ambac Assurance, some of which are eliminated in consolidation. Securities issued or insured by Ambac Assurance are generally less liquid than investment grade and other traded investments.

Pursuant to the amended and restated tax sharing agreement among Ambac, Ambac Assurance and certain affiliates (the "Amended TSA"), Ambac Assurance is required to make payments ("tolling payments") to Ambac with respect to the utilization of net operating loss carry-forwards ("NOLs"). Ambac has accrued $28 million of tolling payments based on NOLs used by Ambac Assurance on its 2017 tax return, as filed. In May 2018, Ambac executed a waiver under the intercompany tax sharing agreement pursuant to which Ambac Assurance was relieved of the requirement to make this payment by June 1, 2018, and has agreed to defer this payment until such time as OCI consents to the payment. Ambac accrued $16 million of tolling payments based on NOLs used by Ambac Assurance in 2018, which was paid in July 2019. Ambac's tax positions are subject to review by the OCI, which may lead to the adoption of positions that reduce the amount of tolling payments otherwise available to Ambac.

Under an inter-company cost allocation agreement, Ambac is reimbursed by Ambac Assurance for a portion of certain operating costs and expenses and, if approved by OCI, entitled to an additional payment of up to $4 million per year to cover expenses not otherwise reimbursed. OCI approved this $4 million reimbursement, which was paid in April 2019.

It is highly unlikely that Ambac Assurance will be able to make dividend payments to Ambac for the foreseeable future and therefore cash and investments, payments under the intercompany cost allocation agreement and future tolling payments, if any, will be Ambac's principal source of liquidity in the near term. Refer to Part I, Item 1, "Insurance Regulatory Matters — Dividend Restrictions, Including Contractual Restrictions" in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and Note 8. Insurance Regulatory Restrictions to the Consolidated Financial Statements included in Part II, Item 8, in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for more information on dividend payment restrictions.

The principal use of liquidity is the payment of operating expenses, including costs to explore opportunities to grow and diversify Ambac, and the making of investments. Contingencies could cause material liquidity strains.

Ambac Assurance Liquidity. Ambac Assurance's liquidity is dependent on its liquid investments and, over time, the net impact of sources and uses of funds. The principal sources of Ambac Assurance's liquidity are gross installment premiums on insurance policies, principal and interest receipts from investments, sales of investments, proceeds from repayment of affiliate loans, recoveries on claim payments, including from litigation and reinsurance recoveries. Termination of installment premium policies on an accelerated basis may adversely impact Ambac Assurance's liquidity.

The principal uses of Ambac Assurance's liquidity are the payment of operating and loss adjustment expenses, claims and commutation and related expense payments on insurance policies, ceded reinsurance premiums, principal and interest payments on the Ambac Note, surplus note principal and interest payments, Tier 2 Note payments, additional loans to affiliates and tolling payments due to Ambac under the Amended TSA. Interest and principal payments on surplus notes are subject to the approval of OCI, which has full discretion over payments regardless of the liquidity position of Ambac Assurance. Any such payment on surplus notes would require either payment or collateralization of a portion of the Tier 2 Notes under the terms of the Tier 2 Note indenture. See *Note 13. Long-term Debt* in the Notes to Consolidated Financial Statements, included in Part II, Item 8, in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for further discussion of the payment terms and conditions of the Tier 2 Notes.

Ambac Assurance manages its liquidity risk by maintaining comprehensive analyses of projected cash flows and maintaining specified levels of cash and short-term investments at all times.

Ambac Assurance is limited in its ability to pay dividends pursuant to the terms of its Auction Market Preferred Shares ("AMPS"), which state that dividends may not be paid on the common stock of Ambac Assurance unless all accrued and unpaid dividends on the AMPS for the then current dividend period have been paid, provided that dividends on the common stock may be made at all times for the purpose of, and only in such amounts as are necessary for enabling Ambac (i) to service its indebtedness for borrowed money as such payments become due or (ii) to pay its operating expenses. If dividends are paid on the common stock for such purposes, dividends on the AMPS become cumulative until the date that all accumulated and unpaid dividends have been paid on the AMPS. Ambac Assurance has not paid dividends on the AMPS since 2010. Refer to Part I, Item 1, "Insurance Regulatory Matters - Dividend Restrictions, Including Contractual Restrictions" in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, and Note 8. Insurance Regulatory Restrictions to the Consolidated Financial Statements included in Part II, Item 8, in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for more information on dividend payment restrictions.

Our ability to realize RMBS representation and warranty ("R&W") subrogation recoveries is subject to significant uncertainty, including risks inherent in litigation, collectability of such amounts from counterparties (and/or their respective parents and affiliates),

timing of receipt of any such recoveries, intervention by the OCI, which could impede our ability to take actions required to realize such recoveries, and uncertainty inherent in the assumptions used in estimating the amount of such recoveries. The amount of these subrogation recoveries is significant and if we are unable to recover any amounts or recover materially less than our estimated recoveries, our future available liquidity to pay claims and meet our other obligations would be reduced materially. See Part I, Item 1A. *Risk Factors* in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for more information about risks relating to our RMBS R&W subrogation recoveries

Ambac Financial Services ("AFS") Liquidity. AFS uses interest rate derivatives as an economic hedge against the effects of rising interest rates elsewhere in the Company, including on Ambac's financial guarantee exposures. These derivatives include interest rate swaps previously provided to states, municipalities and their authorities, asset-backed issuers and other entities in connection with their financings. The principal uses of liquidity by AFS are payments on intercompany loans, payments under derivative contracts (primarily interest rate swaps and US Treasury futures), collateral posting and operating expenses. AFS borrows cash and securities from Ambac Assurance to meet liquidity needs under an established lending agreement with defined borrowing limits that has received non-disapproval from OCI.

Cash Flow Statement Discussion. The following table summarizes the net cash flows for the periods presented.

	Six Months Ended June 30,	
($ in million)	2019	2018
Cash provided by (used in):		
Operating activities	$ (265)	$ (1,312)
Investing activities	313	1,015
Financing activities	(85)	(282)
Foreign exchange impact on cash and cash equivalents	—	(1)
Net cash flow	**$ (37)**	**$ (579)**

Operating activities

The following represents the significant cash activities during the six months ended June 30, 2019 and 2018:

- During the six months ended June 30, 2018, the cash outflow from the Rehabilitation Exit Transactions to third parties was $1,354 million of which $1,162 million is included in operating activities and $191 million is included in financing activities as it related to payments for surplus note principal. Refer to Note 1. Background and Business Description in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for details regarding the Rehabilitation Exit Transactions.
- Cash provided by (used in) operating activities related to interest rate derivatives were $(51) million for the six months ended June 30, 2019, and $46 million for the six months ended June 30, 2018.
- Cash used in operating activities related to income taxes were $1 million for the six months ended June 30, 2019 and $27 million for the six months ended June 30, 2018.
- During the six months ended June 30, 2019, Ambac made payments of interest on long-term debt of $74 million on the Ambac Note. During the six months ended June 30, 2018, Ambac made payments of interest on long-term debt of $69 million, including $56 million on the Ambac Note, $11 million on surplus notes made in connection with the Rehabilitation Exit Transactions and $2 million on the secured borrowing which has been fully repaid in June 2018.
- Net loss and loss expenses paid, including commutation payments, during the six months ended June 30, 2019 and 2018 are detailed below:

	Six Months Ended June 30,	
($ in million)	2019	2018
Net loss and loss expenses paid (recovered):		
Net losses paid [1]	$ 298	$ 153
Net subrogation received [2]	(114)	(75)
Net loss expenses paid	10	62
Net cash flow	**$ 194**	**$ 140**

(1) Net losses paid includes $213 and $17, related to commutation payments, inclusive of amounts related to Puerto Rico and Ballantyne, for the six months ended June 30, 2019 and 2018, respectively.

(2) For or the six months ended June 30, 2019, subrogation received includes $36 of settlement proceeds related to Lehman sponsored RMBS transactions and $23 related to the COFINA Plan of Adjustment.

Future operating cash flows will primarily be impacted by the level of premium collections, investment coupon receipts and claim and expense payments.

Financing Activities

Financing activities for the six months ended June 30, 2019, include paydowns of the Ambac Note of $22 million, paydowns of VIE debt obligations of $92 million, proceeds of $19 million from the re-issuance of 1,386 shares of Ambac owned AMPS and proceeds of $12 million from issuance of Ambac UK debt.

Financing activities for the six months ended June 30, 2018, include proceeds from the issuance of Tier 2 Notes of $240 million, paydowns of the Ambac Note of $113 million, repayments of a secured borrowing of $74 million, payments for the extinguishment of surplus notes of $191 million, paydowns of VIE debt obligations of $138 million and $9 million of debt issuance costs.

Collateral

AFS hedges a portion of the interest rate risk in the financial guarantee and investment portfolio, along with legacy customer interest rate swaps, with standardized derivative contracts, including financial futures contracts, which contain collateral or margin requirements. Under these hedge agreements, AFS is required to post collateral or margin to its counterparties and futures commission merchants to cover unrealized losses. In addition, AFS is required to post collateral or margin in excess of the amounts needed to cover unrealized losses. All AFS derivative contracts containing ratings-based downgrade triggers that could result in collateral or margin posting or a termination have been triggered. If terminations were to occur, AFS would be required to make termination payments but would also receive a return of collateral or margin in the form of cash or U.S. Treasury obligations with market values equal to or in excess of market values of the swaps and futures contracts. AFS may look to re-establish hedge positions that are terminated early, resulting in additional collateral or margin obligations. The amount of additional collateral or margin posted on derivatives contracts will depend on several variables including

the degree to which counterparties exercise their termination rights and the terms on which hedges can be replaced. All collateral and margin obligations are currently met. Collateral and margin posted by AFS totaled a net amount of $120 million (cash and securities collateral of $35 million and $84 million, respectively), including independent amounts, under these contracts at June 30, 2019.

Ambac Credit Products ("ACP") is not required to post collateral under any of its outstanding credit derivative contracts.

BALANCE SHEET

Total assets increased by approximately $124 million from December 31, 2018 to $14,713 million at June 30, 2019, primarily due to the consolidation of one VIE (causing an increase in assets of $288 million). Other significant changes during the six months ended June 30, 2019 were higher VIE assets as a result of valuation increases, lower premium receivables and lower intangible assets from the continued runoff of the financial guarantee insurance portfolio, including the Ballantyne commutation.

Total liabilities increased by approximately $205 million from December 31, 2018 to $13,160 million as of June 30, 2019, primarily due to the consolidation of one VIE (causing an increase in liabilities of $339 million). Other significant changes during the six months ended June 30, 2019, were higher VIE liabilities as a result of valuation increases and higher long-term debt plus accrued interest payable (including the issuance of debt by Ambac UK of $12 million in connection with the Ballantyne commutation), partially offset by lower unearned premiums from the runoff of the insured portfolio and lower loss reserves (from both claim payments, including commutation payments on Ballantyne and the elimination of loss reserves from the newly consolidated VIE).

As of June 30, 2019, total stockholders' equity was $1,553 million, compared with total stockholders' equity of $1,633 million at December 31, 2018. This decrease was due to Total Comprehensive Loss during 2019 partially offset by an increase of $19 million as a result of the re-issuance of 1,386 shares of Ambac owned Ambac Assurance AMPS (reported in noncontrolling interests). The Comprehensive Loss was primarily driven by the net loss attributable to common stockholders for the six months ended June 30, 2019 of $(172) million, partially offset by unrealized gains on investment securities of $71 million.

Investment Portfolio. Ambac Assurance's investment objective is to achieve the highest risk-adjusted after-tax return on a diversified portfolio of primarily fixed income investments while employing asset/liability management practices to satisfy operating and strategic liquidity needs. Ambac Assurance's investment portfolio is subject to internal investment guidelines and is subject to limits on types and quality of investments imposed by the insurance laws and regulations of the jurisdictions in which it is licensed, primarily the States of Wisconsin and New York. Such guidelines set forth minimum credit rating requirements and credit risk concentration limits. Within these guidelines, which in certain instances may be exceeded with the approval of the applicable regulatory authority, Ambac Assurance opportunistically purchases Ambac Assurance insured securities given their relative risk/reward characteristics. Ambac Assurance's investment policies are subject to oversight by OCI pursuant to the Settlement Agreement, the Stipulation and Order and the indenture for the Tier 2 Notes. The Board of Directors of Ambac Assurance approves any changes to Ambac Assurance's investment policy.

Ambac UK's investment policy is designed with the primary objective of ensuring that Ambac UK is able to meet its financial obligations as they fall due, in particular with respect to policyholder claims. Ambac UK's investment portfolio is primarily fixed income investments and diversified holdings of pooled investment funds. The portfolio is subject to internal investment guidelines and may be subject to limits on types and quality of investments imposed by the PRA as regulator of Ambac UK. Ambac UK's investment policy sets forth minimum credit rating requirements and concentration limits, among other restrictions. The Board of Directors of Ambac UK approves any changes or exceptions to Ambac UK's investment policy.

Ambac Financial Group, Inc.'s investment portfolio's primary objective is to preserve capital and liquidity for strategic uses, including investments in securities issued by or guaranteed by Ambac Assurance, while maximizing income.

Refer to Note 8. Investments to the Unaudited Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q for information about Ambac's consolidated investment portfolio. Ambac's investment policies and objectives do not apply to the assets of VIEs consolidated as a result of financial guarantees written by its insurance subsidiaries.

The following table summarizes the composition of Ambac's investment portfolio, excluding VIE investments, at carrying value at June 30, 2019 and December 31, 2018:

($ in millions)	June 30, 2019	December 31, 2018
Fixed income securities	$ 2,604	$ 3,116
Short-term	772	430
Other investments	469	391
Fixed income securities pledged as collateral	84	—
Total investments [1]	**$ 3,930**	**$ 3,937**

(1) Includes investments denominated in non-US dollar currencies with a fair value of £200 ($254) as of June 30, 2019, and £204 ($259) as of December 31, 2018.

Ambac invests in various asset classes in its fixed income securities portfolio, including securities covered by guarantees issued by Ambac Assurance and Ambac UK. Other investments include diversified equity interests in pooled funds. Refer to Note 8. Investments to the Unaudited Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q for information about securities insured by Ambac's subsidiaries and fixed income and equity interests by asset class.

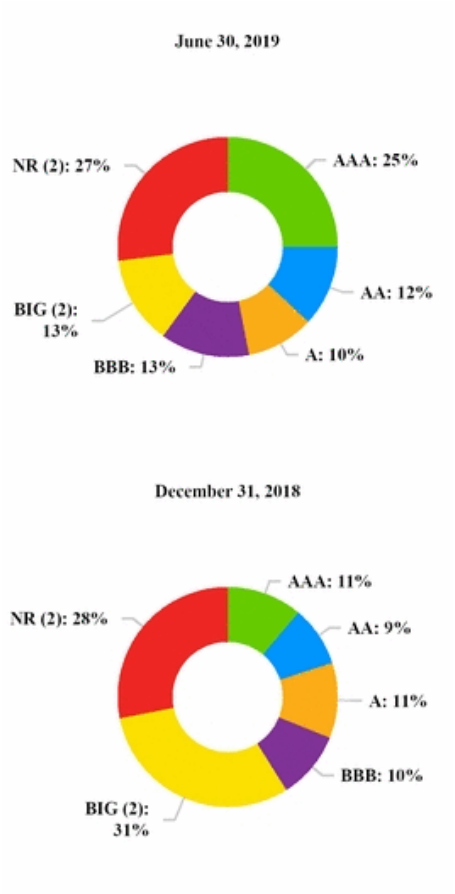
The following table represents the fair value of mortgage and other asset-backed securities at June 30, 2019 and December 31, 2018 by classification:

($ in millions)	June 30, 2019	December 31, 2018
Residential mortgage-backed securities:		
RMBS—Second Lien	$ 133	$ 136
RMBS—First-lien—Alt-A	89	93
RMBS—First Lien—Sub Prime	30	31
Total residential mortgage-backed securities	252	259
Other asset-backed securities		
Military Housing	$ 244	241
Commercial mortgage-backed	49	—
Student Loans	32	32
Credit Cards	18	5
Auto	2	20
Structured Insurance	—	145
Total other asset-backed securities	345	442
Total [1]	$ 597	$ 701

(1) Includes investments guaranteed by Ambac Assurance and Ambac UK. Refer to Note 8. Investments to the Unaudited Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q for further details of Ambac insured securities held in the investment portfolio.

The weighted average rating, which is based on the lower of Standard & Poor's or Moody's ratings, of the mortgage and asset-backed securities is CC and B- as of June 30, 2019, and CC and CCC- as of December 31, 2018, respectively.

The following charts provide the ratings [1] distribution of the fixed income investment portfolio based on fair value at June 30, 2019 and December 31, 2018:



(1) Ratings are based on the lower of Moody's or S&P ratings. If ratings are unavailable from Moody's or S&P, Fitch ratings are used. If guaranteed, rating represents the higher of the underlying or guarantor's financial strength rating.

(2) Below investment grade and not rated bonds insured by Ambac represent 33% and 57% of the 2019 and 2018 combined fixed income portfolio, respectively. The decrease in the percentage of below investment grade and increases in the percentages of AAA-rated holdings since December 31, 2018 were driven by the COFINA restructuring where below investment grade Ambac-insured bonds were exchanged for new COFINA non-rated bonds and cash, with a majority of the new non-rated bonds being sold prior to June 30, 2019. Cash proceeds from the restructuring and sales resulted in the higher percentage of AAA-rated short-term investments at June 30, 2019.

Premium Receivables. Ambac's premium receivables decreased to $442 million at June 30, 2019, from $495 million at December 31, 2018. As further discussed in Note 6. Financial Guarantee Insurance Contracts, the decrease is due to premium receipts, the impact of commutations and other policy terminations and changes in foreign currencies, partially offset by accretion of premium receivable discount.

Premium receivables by payment currency were as follows:

Currency (Amounts in millions)	Premium Receivable in Payment Currency	Premium Receivable in U.S. Dollars
U.S. Dollars	$ 276	$ 276
British Pounds	£ 108	137
Euros	€ 25	28
Australian Dollars	A$ 1	—
Total		$ 442

Reinsurance Recoverable on Paid and Unpaid Losses. Ambac Assurance has reinsurance in place pursuant to surplus share treaty and facultative agreements. To minimize its exposure to losses from reinsurers, Ambac Assurance (i) monitors the financial condition of its reinsurers; (ii) is entitled to receive collateral from its reinsurance counterparties under certain reinsurance contracts; and (iii) has certain cancellation rights that can be exercised by Ambac Assurance in the event of rating agency downgrades of a reinsurer (among other events and circumstances). Ambac Assurance benefited from letters of credit and collateral amounting to approximately $119.2 million from its reinsurers at June 30, 2019. As of June 30, 2019 and December 31, 2018, reinsurance recoverable on paid and unpaid losses were $27 million and $23 million, respectively. The increase was primarily a result of the adverse development in public finance exposures.

Insurance Intangible Asset. Upon Ambac's exit from Chapter 11 bankruptcy on May 1, 2013 (the Fresh Start Reporting Date), an insurance intangible asset was recorded which represented the difference between the fair value and aggregate carrying value of the financial guarantee insurance and reinsurance assets and liabilities. As of June 30, 2019 and December 31, 2018, the net insurance intangible asset was $455 million and $719 million, respectively. Other than through amortization, variance in the insurance intangible asset is solely from translation gains (losses) from the consolidation of Ambac's foreign subsidiary (Ambac UK).

Derivative Assets and Liabilities. The interest rate derivative portfolio is positioned to benefit from rising rates as a partial economic hedge against interest rate exposure in the financial guarantee portfolio. Derivative assets increased from $59 million at December 31, 2018, to $72 million as of June 30, 2019. Derivative liabilities increased from $77 million at December 31, 2018, to $88 million as of June 30, 2019. The net increases resulted primarily from lower interest rates during the six months ended June 30, 2019.

Loss and Loss Expense Reserves and Subrogation Recoverable. Loss and loss expense reserves are based upon estimates of the ultimate aggregate losses inherent in the non-derivative portfolio for insurance policies issued to beneficiaries, including unconsolidated VIEs.

The evaluation process for determining the level of reserves is subject to certain estimates and judgments. Refer to the "Critical Accounting Policies and Estimates" and “Results of Operations” sections of Management’s Discussion and Analysis of Financial Condition and Results of Operations in addition to Basis of Presentation and Significant Accounting Policies and Loss Reserves sections included in Note 2. Basis of Presentation and Significant Accounting Policies and Note 6. Financial Guarantee Insurance Contracts, respectively of the Consolidated Financial Statements included in Part II, Item 8 in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 for further information on loss and loss expenses.

The loss and loss expense reserves, net of subrogation recoverables and before reinsurance as of June 30, 2019 and December 31, 2018, were $(491) million and $(107) million, respectively.

Loss and loss expense reserves are included in the Consolidated Balance Sheets as follows:

($ in millions) Balance Sheet Line Item	Present Value of Expected Net Cash Flows: Claims and Loss Expenses	Present Value of Expected Net Cash Flows: Recoveries (1)	Unearned Premium Revenue	Gross Loss and Loss Expense Reserves
June 30, 2019:				
Loss and loss expense reserves	$ 1,828	$ (274)	$ (60)	$ 1,494
Subrogation recoverable	157	(2,142)	—	(1,985)
Totals	$ 1,985	$ (2,416)	$ (60)	$ (491)
December 31, 2018:				
Loss and loss expense reserves	$ 2,246	$ (313)	$ (107)	$ 1,826
Subrogation recoverable	176	(2,109)	—	(1,933)
Totals	$ 2,422	$ (2,422)	$ (107)	$ (107)

(1) Present value of future recoveries includes R&W subrogation recoveries of $1,762 and $1,771 at June 30, 2019 and December 31, 2018, respectively.

Ambac has exposure to various bond types issued in the debt capital markets. Our experience has shown that, for the majority of bond types, we have not experienced significant claims. The bond types that have experienced significant claims, including through commutations, are residential mortgage-backed securities ("RMBS"), student loan securities and public finance bond types. These bond types represent 93% of our ever-to-date insurance claims recorded, with RMBS comprising 78%. The table below indicates gross par outstanding and the components of gross loss and loss expense reserves related to policies in Ambac's gross loss and loss expense reserves at June 30, 2019 and December 31, 2018:

($ in millions)	Gross Par Outstanding [1][2]	Present Value of Expected Net Cash Flows		Unearned Premium Revenue	Gross Loss and Loss Expense Reserves [1][3]
		Claims and Loss Expenses	Recoveries		
June 30, 2019:					
RMBS	$ 3,358	$ 655	$ (2,044)	$ (15)	$ (1,404)
Domestic Public Finance	2,929	977	(334)	(40)	603
Student Loans	498	264	(38)	(4)	222
Ambac UK and Other Credits	171	6	—	(1)	5
Loss expenses	—	83	—	—	83
Totals	$ 6,956	$ 1,985	$ (2,416)	$ (60)	$ (491)
December 31, 2018:					
RMBS	$ 3,716	$ 696	$ (1,995)	$ (14)	$ (1,313)
Domestic Public Finance	3,987	1,095	(383)	(73)	639
Student Loans	530	271	(39)	(4)	228
Ambac UK and Other Credits	1,170	294	(5)	(16)	273
Loss expenses	—	66	—	—	66
Totals	$ 9,403	$ 2,422	$ (2,422)	$ (107)	$ (107)

(1) Ceded par outstanding on policies with loss reserves and ceded loss and loss expense reserves are $499 and $27, respectively, at June 30, 2019, and $540 and $23, respectively at December 31, 2018. Ceded loss and loss expense reserves are included in Reinsurance recoverable on paid and unpaid losses.

(2) Gross Par Outstanding includes capital appreciation bonds, which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bond.

(3) Loss reserves are included in the balance sheet as Loss and loss expense reserves or Subrogation recoverable dependent on if a policy is in a net liability or net recoverable position.

Variability of Expected Losses and Recoveries

Ambac's management believes that the estimated future loss component of loss reserves (present value of expected net cash flows) are adequate to cover future claims presented, but there can be no assurance that the ultimate liability will not be higher than such estimates.

It is possible that our estimated future losses for insurance policies discussed above could be understated or that our estimated future recoveries could be overstated. We have attempted to identify possible cash flows related to losses and recoveries using more stressful assumptions than the probability-weighted outcome recorded. The possible net cash flows consider the highest stress scenario that was utilized in the development of our probability-weighted expected loss at June 30, 2019, and assumes an inability to execute any commutation transactions with issuers and/or investors. Such stress scenarios are developed based on management's view about all possible outcomes relating to losses and recoveries. In arriving at such view, management makes considerable judgments about the possibility of various future events. Although we do not believe it is possible to have stressed outcomes in all cases, it is possible that we could have stress case outcomes in some or even many cases. See "Risk Factors" in Part I, Item 1A as well as the following descriptions of "RMBS Variability," "Public Finance Variability," "Student Loan Variability," and "Other Credits, including Ambac UK, Variability," in Part II, Item 7 of the Company's 2018 Annual Report on Form 10-K for further discussion of the risks relating to future losses and recoveries that could result in more highly stressed outcomes and in "Risk Factors" in Part II, Item 1A of this Quarterly Report on Form 10-Q.

The occurrence of these stressed outcomes individually or collectively would have a material adverse effect on our results of operations and financial condition and may result in materially adverse consequence for the Company, including (without limitation) impairing the ability of Ambac Assurance to honor its financial obligations; the initiation of rehabilitation proceedings against Ambac Assurance; decreased likelihood of Ambac Assurance delivering value to Ambac, through dividends or otherwise; and a significant drop in the value of securities issued or insured by Ambac or Ambac Assurance.

RMBS Variability:

Ambac has exposure to the U.S. mortgage market primarily through direct financial guarantees of RMBS, including transactions collateralized by first and second liens.

We established a representation and warranty subrogation recovery as further discussed in Note 6. Financial Guarantee Insurance Contracts to the Unaudited Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q. Our ability to realize RMBS representation and warranty recoveries is subject to significant uncertainty, including risks inherent in litigation, collectability of such amounts from counterparties (and/or their respective parents and affiliates), timing of receipt of any such recoveries, intervention by the OCI, which could impede our ability to take actions required to realize such recoveries and uncertainty inherent in the assumptions used in estimating such recoveries.

Changes to assumptions that could make our reserves under-estimated include an increase in interest rates, deterioration in housing prices, poor servicing, the effect of a weakened economy characterized by growing unemployment and wage pressures, and/or illiquidity of the mortgage market. We utilize a model to project losses in our RMBS exposures and changes to reserves, either upward or downward, are not unlikely if we used a different model or methodology to project losses. Additionally, our R&W actual subrogation recoveries could be significantly lower than our estimate of $1,736 million, net of reinsurance, as of June 30, 2019, if the sponsors of these transactions: (i) fail to honor their obligations to repurchase the mortgage loans, (ii) successfully dispute our breach findings or claims for damages, (iii) no longer have the financial means to fully satisfy their obligations under the transaction documents, or (iv) our pursuit of recoveries is otherwise unsuccessful. Failure to realize R&W subrogation recoveries for any reason or the realization of R&W subrogation recoveries materially below the amount recorded on Ambac's consolidated balance sheet would have a material adverse effect on our results of operations and financial condition.

In the case of both first and second-lien exposures, the possible stress case assumes a lower housing price appreciation projection, which in turn drives higher defaults and severities. Using this approach, the possible increase in loss reserves for RMBS credits for which we have an estimate of expected loss at June 30, 2019 could be approximately $35 million. Combined with the absence of any R&W subrogation recoveries, a possible increase in loss reserves for RMBS could be approximately $1.8 billion. Additionally, loss payments are sensitive to changes in interest rates, increasing as interest rates rise. For example an increase in interest rates of 0.50% could increase our estimate of expected losses by approximately $45 million. There can be no assurance that losses may not exceed such amounts.

Public Finance Variability:

Ambac's U.S. public finance portfolio consists predominantly of municipal bonds such as general and revenue obligations and lease and tax-backed obligations of state and local government entities; however, the portfolio also comprises a wide array of non-municipal types of bonds, including financings for not-for-profit entities and transactions with public and private elements, which generally finance infrastructure, housing and other public purpose facilities and interests. The decline in public finance gross loss reserves at June 30, 2019 as compared to December 31, 2018 was primarily related to the COFINA debt restructuring, payments of claims and the commutation of a transportation credit, partially offset by increases in Puerto Rico loss reserves. Total public finance gross loss reserves and related gross par outstanding on Ambac insured obligations by bond type were as follows:

	June 30, 2019		December 31, 2018	
Issuer Type ($ in millions)	**Gross Par Outstanding (1)**	**Gross Loss Reserves**	**Gross Par Outstanding (1)**	**Gross Loss Reserves**
Lease and tax-backed	$ 1,245	$ 496	$ 2,062	$ 528
General obligation	949	21	904	24
Housing	442	29	445	26
Transportation revenue	88	43	471	49
Other	204	14	105	12
Total	**$ 2,929**	**$ 603**	**$ 3,987**	**$ 639**

(1) Gross Par Outstanding includes capital appreciation bonds, which are reported at the par amount at the time of issuance of the insurance policy as opposed to the current accreted value of the bond.

It is possible our loss reserves for public finance credits may be under-estimated if issuers are faced with prolonged exposure to adverse political, judicial, economic, fiscal or socioeconomic events or trends.

Our experience with the city of Detroit in its bankruptcy proceeding was not favorable and renders future outcomes with other public finance issuers even more difficult to predict and may increase the risk that we may suffer losses that could be sizable. We agreed to settlements regarding our insured Detroit general obligation bonds that provide better treatment of our exposures than the city planned to include in its plan of adjustment, but nevertheless required us to incur a loss for a significant portion of our exposure. An additional troubling precedent in the Detroit case, as well as other municipal bankruptcies, is the preferential treatment of certain creditor classes, especially the public pensions. The cost of pensions and the need to address frequently sizable unfunded or underfunded pensions is often a key driver of stress for many municipalities and their related authorities, including entities to whom we have significant exposure, such as Chicago, its school district, the State of New Jersey and many others. Less severe treatment of pension obligations in bankruptcy may lead to worse outcomes for traditional debt creditors. Variability of outcomes applies to even what is generally considered more secure municipal financings, such as dedicated sales tax revenue bonds that capture sales tax revenues for debt service ahead of any amounts being deposited into the general fund of an issuer. In the case of the Puerto Rico COFINA sales tax bonds that were part of the

Commonwealth of Puerto Rico's Title III proceedings, Ambac Assurance and other creditors agreed to settle at a recovery rate equal to about 93% of pre-petition amounts owed on the Ambac insured senior COFINA bonds. In the COFINA case, the senior bonds still received a reduction or "haircut" despite the existence of junior COFINA bonds, which received a recovery rate equal to about 56% of pre-petition amounts owed. The amounts were confirmed as part of the COFINA Plan of Adjustment on February 4, 2019.

In addition, municipal entities may be more inclined to use bankruptcy to resolve their financial stresses if they believe preferred outcomes for various creditor groups can be achieved. We expect municipal bankruptcies and defaults to continue to be challenging to project given the unique political, economic, fiscal, legal, governance and public policy differences among municipalities as well as the complexity, long duration and relative infrequency of the cases themselves in forums with a scarcity of legal precedent.

Another potentially adverse development that could cause the loss reserves on our public finance credits to be underestimated is deterioration in the municipal bond market, resulting from reduced or limited access to alternative forms of credit (such as bank loans) or other exogenous factors, such as the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, which could reduce certain municipal investors' appetite for tax-exempt municipal bonds and over the longer term could potentially put additional pressure on issuers in states with high state and local taxes. These factors could deprive issuers access to funding at a level necessary to avoid defaulting on their obligations.

In addition, a more recent judicial decision in connection with the PRHTA Title III proceedings could cause the loss reserves on our public finance credits to be underestimated. On March 26, 2019, the U.S. Court of Appeals for the First Circuit, affirming a decision by the U.S. District Court overseeing the PROMESA Title III proceedings for the PRHTA, found that under Sections 928(a) and 922(d) of the U.S. Bankruptcy Code, municipal issuers of revenue bonds secured by special revenues are permitted, but not required, to apply special revenues to pay debt service on such revenue bonds during the pendency of bankruptcy proceedings for such municipal issuers. The complainants had sought an order compelling PRHTA, as the debtor, to continue to make debt service payments on its revenue bonds from pledged special revenues during the pendency of its Title III case, but the First Circuit affirmed the District Court's dismissal of the complaint, holding that it could not compel the issuer to make such payments. The First Circuit's decision challenges what had been a commonly understood notion in the municipal finance marketplace that municipal revenues bondholders secured by special revenues (as defined in Chapter 9 of the U.S. Bankruptcy Code) would continue to receive payment during a bankruptcy of the municipal issuer. This decision introduces significant uncertainty into the public finance market and it may make it more difficult for municipal instrumentalities to procure revenue bond financings in the future and increases the credit risk to bondholders of existing special revenue bonds, particularly those from weaker issuers. In the wake of the decision, rating agencies have announced their intention to review ratings given to bonds issued across the country, highlighting the potential contagion effect of Puerto Rico.

While our loss reserves consider our judgment regarding issuers' financial flexibility to adapt to adverse markets, they may not adequately capture sudden, unexpected or protracted uncertainty that adversely affects market conditions.

Our exposures to the Commonwealth of Puerto Rico are under stress arising from the Commonwealth's poor financial condition, weak economy, loss of capital markets access and the severe damage caused by hurricanes Irma and Maria. These factors, taken together with the payment moratorium on debt payments of the Commonwealth and its instrumentalities, ongoing PROMESA Title III proceedings, and certain other provisions under PROMESA, the potential for a restructuring of debt insured by Ambac Assurance, either with or without its consent, and the possibility of protracted litigation as a result of which its rights may be materially impaired, may cause losses to exceed current reserves in a material manner. See "Financial Guarantees in Force" section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for further details on the legal, economic and fiscal developments that have impacted or may impact Ambac Assurance's insured Puerto Rico bonds. In this Form 10-Q, refer to "Financial Guarantees in Force" in Part I, Item 2 in Management's Discussion and Analysis of Financial Condition and Results of Operation and *Note 12. Commitments and Contingencies* to the Consolidated Financial Statements for further updates related to Puerto Rico.

Material additional losses caused by the above-described factors would have a material adverse effect on our results of operations and financial condition. For public finance credits, including Puerto Rico as well as other issuers, for which we have an estimate of expected loss at June 30, 2019, the possible increase in loss reserves could be approximately $1,100 million. Among other things, this estimate includes the possibility that the current Plan Support Agreement (as discussed above in the Financial Guarantees in Force section of this Management Discussion and Analysis) were to become effective. However, there can be no assurance that losses may not exceed such amount.

Student Loan Variability:

Changes to assumptions that could make our reserves under-estimated include, but are not limited to, increases in interest rates, default rates and loss severities on the collateral due to economic or other factors. Such factors may include lower recoveries on defaulted loans or additional losses on collateral or trust assets, including as a result of any enforcement actions by the Consumer Finance Protection Bureau. For student loan credits for which we have an estimate of expected loss at June 30, 2019, the possible increase in loss reserves could be approximately $20 million. Additionally, an increase in interest rates of 0.50% could increase our estimate of expected losses by approximately $20 million. However, there can be no assurance that losses may not exceed such amounts.

Other Credits, including Ambac UK, Variability:

It is possible our loss reserves on other types of credits, including those insured by Ambac UK, may be under-estimated because of various risks that vary widely, including the risk that we may not be able to recover or mitigate losses through our remediation processes. For all other credits, including Ambac UK, for which

we have an estimate of expected loss, the sum of all the highest stress case loss scenarios is approximately $30 million greater than the loss reserves at June 30, 2019. However, there can be no assurance that losses may not exceed such amount. The highest stress case losses at June 30, 2019 are $140 million lower than the December 31, 2018 estimate primarily as a result of the Ballantyne commutation.

Long-term Debt:

Long-term debt consists of senior and junior surplus notes issued by Ambac Assurance, the Ambac Note and Tier 2 Notes issued in connection with the Rehabilitation Exit Transactions, and Ambac UK debt issued in connection with the Ballantyne commutation. The carrying value of each of these as of June 30, 2019 and December 31, 2018 is below:

($ in millions)	June 30, 2019	December 31, 2018
Surplus notes (1)	$ 752	$ 737
Ambac note	1,918	1,940
Tier 2 notes	265	252
Ambac UK debt	12	—
Total Long-term Debt	**$ 2,947**	**$ 2,929**

(1) Amounts include junior surplus notes.

The increase in long-term debt from December 31, 2018 is due to the accretion on the carrying value of surplus notes and Tier 2 Notes, and issuance of Ambac UK debt, partially offset by the optional redemptions of $22 million of the Ambac Note.

VARIABLE INTEREST ENTITIES

Please refer to Note 3. Variable Interest Entities to the Unaudited Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q and Note 2. Basis of Presentation and Significant Accounting Policies and Note 3. Special Purpose Entities, Including Variable Interest Entities to the Consolidated Financial Statements, included in Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, for information regarding special purpose and variable interest entities.

ACCOUNTING STANDARDS

Please refer to Note 2. Basis of Presentation and Significant Accounting Policies to the Unaudited Consolidated Financial Statements, included in Part I, Item 1 in this Form 10-Q, for a discussion of the impact of recent accounting pronouncements on Ambac's financial condition and results of operations.

AMBAC ASSURANCE STATUTORY BASIS FINANCIAL RESULTS

Ambac Assurance statutory financial statements are prepared on the basis of accounting practices prescribed or permitted by the OCI. OCI recognizes only statutory accounting practices prescribed or permitted by the State of Wisconsin ("SAP") for determining and reporting the financial condition and results of operations of an insurance company for determining its solvency under Wisconsin Insurance Law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures manual ("NAIC SAP") has been adopted as a component of prescribed practices by the State of Wisconsin. For further information, see "Ambac Assurance Statutory Basis Financial Results," in Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Note 8. Insurance Regulatory Restrictions to the Consolidated Financial Statements included in Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

Ambac Assurance's statutory policyholder surplus and qualified statutory capital (defined as the sum of policyholders surplus and mandatory contingency reserves) were $1,129 million and $1,652 million at June 30, 2019, respectively, as compared to $1,152 million and $1,648 million at December 31, 2018, respectively. The drivers to the net decrease in policyholder surplus were:

- Statutory net loss of $43 million for the six months ended June 30, 2019 primarily due to loss and loss expenses from adverse development on Puerto Rico credits, including the COFINA settlement, partially offset by investment income and premiums earned;
- Contributions to contingency reserves of $27 million;
- Partially offset by the recognition of a previous deferred gain from the 2015 sale of Ballantyne bonds to Ambac UK of $28 million and increases of $17 million in the fair value of investment securities that are recorded at the lower of amortized cost or fair value.

Surplus notes, the Ambac Note, the Tier 2 Notes and preferred stock issued by Ambac Assurance, are obligations that have claims on the resources of Ambac Assurance which impact Ambac's ability to realize residual value from its equity in Ambac Assurance.

Ambac Assurance statutory surplus is sensitive to multiple factors, including: (i) loss reserve development, (ii) approval by OCI of payments on surplus notes and junior surplus notes, (iii) ongoing interest costs associated with the Ambac Note and Tier 2 Notes, including changes to interest rates as the Ambac Note is a floating rate obligation, (iv) deterioration in the financial position of Ambac Assurance subsidiaries that have their obligations guaranteed by Ambac Assurance, (v) first time payment defaults of insured obligations, which increase statutory loss reserves, (vi) commutations of insurance policies or credit derivative contracts at amounts that differ from the amount of liabilities recorded, (vii) reinsurance contract terminations at amounts that differ from net assets recorded, (viii) changes to the fair value of investments carried at fair value, (ix) settlements of representation and warranty breach claims at amounts that differ from amounts recorded, including failures to collect such amounts or receive recoveries sufficient to pay or redeem the Ambac Note and Tier 2 Notes, (x) realized gains and losses, including losses arising from other than temporary impairments of investment securities, and (xi) future changes to prescribed practices by the OCI.

AMBAC UK FINANCIAL RESULTS UNDER UK ACCOUNTING PRINCIPLES

Ambac UK is required to prepare financial statements under FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland." Ambac UK's shareholder funds under UK GAAP were £379 million at June 30, 2019 as compared to £263 million at December 31, 2018. The increase in shareholders'

funds was primarily due to the loss and loss expenses benefit in the period following the restructuring and commutation of Ballantyne coupled with the receipt of premiums and return on investments. At June 30, 2019, the carrying value of cash and investments was £467 million, a decrease from £499 million at December 31, 2018. The decrease in cash and investments was primarily due to the impact of the restructuring and commutation of Ballantyne as noted above partially offset by continued receipt of premiums and net investment income.

Ambac UK is also required to prepare financial information in accordance with the Solvency II Directive. The basis of preparation of this information is significantly different from both US GAAP and UK GAAP.

Available capital resources under Solvency II were a surplus of £182 million at June 30, 2019, of which £182 million were eligible to meet solvency capital requirements. This is an improvement from December 31, 2018 when available capital resources were a surplus of £95 million of which £90 million were eligible to meet solvency capital requirements. The eligible capital resources at June 30, 2019 and December 31, 2018, were in comparison to regulatory capital requirements of £315 million and £357 million respectively. Ambac UK is therefore deficient in terms of compliance with applicable regulatory capital requirements by £133 million and £267 million at June 30, 2019 and December 31, 2018, respectively. The regulators are aware of the deficiency in capital resources as compared to capital requirements and dialogue between Ambac UK management and its regulators remains ongoing with respect to options for addressing the shortcoming, although such options remain few.

NON-GAAP FINANCIAL MEASURES

In addition to reporting the Company's quarterly financial results in accordance with GAAP, the Company currently reports two non-GAAP financial measures: Adjusted Earnings and Adjusted Book Value. The most directly comparable GAAP measures are net income attributable to common stockholders for Adjusted Earnings and Total Ambac Financial Group, Inc. stockholders' equity for Adjusted Book Value. A non-GAAP financial measure is a numerical measure of financial performance or financial position that excludes (or includes) amounts that are included in (or excluded from) the most directly comparable measure calculated and presented in accordance with GAAP. We are presenting these non-GAAP financial measures because they provide greater transparency and enhanced visibility into the underlying drivers of our business. Adjusted Earnings and Adjusted Book Value are not substitutes for the Company's GAAP reporting, should not be viewed in isolation and may differ from similar reporting provided by other companies, which may define non-GAAP measures differently.

Ambac has a significant U.S. tax net operating loss ("NOL") that is offset by a full valuation allowance in the GAAP consolidated financial statements. As a result of this and other considerations, we utilized a 0% effective tax rate for non-GAAP adjustments; which is subject to change.

The following paragraphs define each non-GAAP financial measure and describe why it is useful. A reconciliation of the non-GAAP financial measure and the most directly comparable GAAP financial measure is also presented below.

Adjusted Earnings (Loss). Adjusted Earnings (Loss) is defined as net income (loss) attributable to common stockholders, as reported under GAAP, adjusted on an after-tax basis for the following:

- *Non-credit impairment fair value (gain) loss on credit derivatives:* Elimination of the non-credit impairment fair value gains (losses) on credit derivatives, which is the amount in excess of the present value of the expected estimated credit losses. Such fair value adjustments are affected by, and in part fluctuate with changes in market factors such as interest rates and credit spreads, including the market's perception of Ambac's credit risk ("Ambac CVA"), and are not expected to result in an economic gain or loss. These adjustments allow for all financial guarantee contracts to be accounted for consistent with the Financial Services – Insurance Topic of ASC, whether or not they are subject to derivative accounting rules.
- *Insurance intangible amortization:* Elimination of the amortization of the financial guarantee insurance intangible asset that arose as a result of Ambac's emergence from bankruptcy and the implementation of Fresh Start reporting. This adjustment ensures that all financial guarantee contracts are accounted for consistent with the provisions of the Financial Services – Insurance Topic of the ASC.
- *Foreign exchange (gains) losses:* Elimination of the foreign exchange gains (losses) on the re-measurement of assets, liabilities and transactions in non-functional currencies. This adjustment eliminates the foreign exchange gains (losses) on all assets, liabilities and transactions in non-functional currencies, which enables users of our financial statements to better view the results without the impact of fluctuations in foreign currency exchange rates and facilitates period-to-period comparisons of Ambac's operating performance.

The following table reconciles net income attributable to common stockholders to the non-GAAP measure, Adjusted Earnings on a dollar amount and per diluted share basis, for all periods presented:

	Three Months Ended June 30,			
	2019		2018	
($ in millions, except share data)	**$ Amount**	**Per Diluted Share**	**$ Amount**	**Per Diluted Share**
Net income (loss) attributable to common stockholders	**$ (128)**	**$ (2.79)**	**$ 4**	**$ 0.09**
Adjustments:				
Non-credit impairment fair value (gain) loss on credit derivatives	—	—	—	0.01
Insurance intangible amortization	**226**	**4.92**	23	0.50
Foreign exchange (gains) losses	**(11)**	**(0.25)**	9	0.18
Adjusted earnings (loss)	**$ 86**	**$ 1.88**	**$ 36**	**$ 0.78**

	Six Months Ended June 30,			
	2019		2018	
($ in millions, except share data)	**$ Amount**	**Per Diluted Share**	**$ Amount**	**Per Diluted Share**
Net income (loss) attributable to common stockholders	**$ (172)**	**$ (3.74)**	**$ 310**	**$ 6.73**
Adjustments:				
Non-credit impairment fair value (gain) loss on credit derivatives	**(1)**	**(0.01)**	1	0.02
Insurance intangible amortization	**263**	**5.72**	52	1.13
Foreign exchange (gain) loss	**(13)**	**(0.29)**	4	0.07
Adjusted earnings (loss)	**$ 77**	**$ 1.68**	**$ 366**	**$ 7.95**

Adjusted Book Value. Adjusted Book Value is defined as Total Ambac Financial Group, Inc. stockholders' equity as reported under GAAP, adjusted for after-tax impact of the following:

- *Non-credit impairment fair value losses on credit derivatives:* Elimination of the non-credit impairment fair value loss on credit derivatives, which is the amount in excess of the present value of the expected estimated economic credit loss. GAAP fair values are affected by, and in part fluctuate with, changes in market factors such as interest rates, credit spreads, including Ambac's CVA that are not expected to result in an economic gain or loss. These adjustments allow for all financial guarantee contracts to be accounted for within Adjusted Book Value consistent with the provisions of the Financial Services—Insurance Topic of the ASC, whether or not they are subject to derivative accounting rules.
- *Insurance intangible asset:* Elimination of the financial guarantee insurance intangible asset that arose as a result of Ambac's emergence from bankruptcy and the implementation of Fresh Start reporting. This adjustment ensures that all financial guarantee contracts are accounted for within Adjusted Book Value consistent with the provisions of the Financial Services—Insurance Topic of the ASC.
- *Net unearned premiums and fees in excess of expected losses:* Addition of the value of the unearned premium revenue ("UPR") on financial guarantee contracts, in excess of expected losses, net of reinsurance. This non-GAAP adjustment presents the economics of UPR and expected losses for financial guarantee contracts on a consistent basis. In accordance with GAAP, stockholders' equity reflects a reduction for expected losses only to the extent they exceed UPR. However, when expected losses are less than UPR for a financial guarantee contract, neither expected losses nor UPR have an impact on stockholders' equity. This non-GAAP adjustment adds UPR in excess of expected losses, net of reinsurance, to stockholders' equity for financial guarantee contracts where expected losses are less than UPR.
- *Net unrealized investment (gains) losses in Accumulated Other Comprehensive Income:* Elimination of the unrealized gains and losses on the Company's investments that are recorded as a component of accumulated other comprehensive income ("AOCI"). The AOCI component of the fair value adjustment on the investment portfolio may differ from realized gains and losses ultimately recognized by the Company based on the Company's investment strategy. This adjustment only allows for such gains and losses in Adjusted Book Value when realized.

The following table reconciles Total Ambac Financial Group, Inc. stockholders' equity to the non-GAAP measure Adjusted Book Value on a dollar amount and per share basis, for all periods presented:

	June 30, 2019		December 31, 2018	
($ in millions, except share data)	**$ Amount**	**Per Share**	**$ Amount**	**Per Share**
Total Ambac Financial Group, Inc. stockholders' equity	**$ 1,493**	**$ 32.78**	**$ 1,592**	**$ 35.12**
Adjustments:				
Non-credit impairment fair value losses on credit derivatives	**1**	**0.02**	1	0.03
Insurance intangible asset	**(455)**	**(9.99)**	(719)	(15.87)
Net unearned premiums and fees in excess of expected losses	**465**	**10.21**	462	10.19
Net unrealized investment (gains) losses in Accumulated Other Comprehensive Income	**(157)**	**(3.45)**	(86)	(1.89)
Adjusted book value	**$ 1,347**	**$ 29.57**	**$ 1,251**	**$ 27.58**

The increase in Adjusted Book Value was primarily attributable to Adjusted Earnings for the six months ended June 30, 2019 and the impact of lower interest rates on the value of expected installment premiums. Adjusted earnings in three and six months ended June 30, 2019 was positively impacted by the Ballantyne commutation.

Factors that impact changes to Adjusted Book Value include many of the same factors that impact Adjusted Earnings, including the majority of revenues and expenses, but generally exclude components of premium earnings since they are embedded in prior period's Adjusted Book Value through the net unearned premiums and fees in excess of expected losses adjustment. Net unearned premiums and fees in excess of expected losses will affect Adjusted Book Value for (i) changes to future premium assumptions (e.g. expected term, interest rates, foreign currency rates, time passage) and (ii) changes to expected losses for policies which do not exceed their related unearned premiums.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the potential for losses that may result from changes in the value of a financial instrument as a result of changes in market conditions. The primary market risks that would impact the value of Ambac's financial instruments are interest rate risk, credit spread risk and foreign currency risk. As a result of the Ballantyne and COFINA commutations, as of June 30, 2019 Ambac's investment portfolio contains a lower amount of Ambac-insured securities. Reallocation of the portfolio composition following these transactions has changed our disclosures relating to sensitivities of interest rates compared to that disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018.

Interest Rate Risk:

Financial instruments for which fair value may be affected by changes in interest rates consist primarily of fixed income investment securities, long-term debt and interest rate derivatives. Fixed income investment securities that are guaranteed by Ambac have interest rate risk characteristics that behave inversely to those associated with future financial guarantee claim payments. Accordingly, such securities are excluded from the interest rate sensitivity table that follows. Changes in fair value resulting from changes in interest rates are driven primarily by the impact of interest rate shifts on the investment portfolio (which produce net fair value losses as rates increase) and long-term debt and the interest rate derivatives portfolio (which produce net fair value gains as rates increase). Interest rate increases would also have a negative economic impact on expected future claim payments within the financial guarantee portfolio, primarily related to RMBS and student loan credits. Ambac performs scenario testing to measure the potential for losses in volatile markets. These scenario tests include parallel and non-parallel shifts in the benchmark interest rate curve.

The interest rate derivatives portfolio is managed as a partial economic hedge against the effects of rising interest rates elsewhere in the Company, including on Ambac's financial guarantee exposures (the "macro-hedge"). The interest rate sensitivity of the interest rate derivatives portfolio attributable to the macro-hedge position would produce mark-to-market gains or losses of approximately $0.7 million for a 1 basis point parallel shift in USD benchmark interest rates up or down at June 30, 2019.

The following table summarizes the estimated change in fair value (based primarily on the valuation methodology discussed in Note 7. Fair Value Measurements to the Consolidated Financial Statements included in Part I, Item 1 in this Form 10-Q) on these financial instruments, assuming immediate changes in interest rates at specified levels at June 30, 2019:

($ in millions)	**Estimated Change in Net Fair Value**	**Estimated Net Fair Value**
300 basis point rise	**$ 129**	**$ (200)**
200 basis point rise	**85**	**(244)**
100 basis point rise	**46**	**(283)**
Base scenario	**—**	**(329)**
100 basis point decline[1]	**(38)**	**(367)**
200 basis point decline[1]	**(67)**	**(396)**

(1) Incorporates an interest rate floor of 0%.

Due to the low interest rate environment as of June 30, 2019, stress scenarios involving interest rate declines greater than 200 basis points are not meaningful to Ambac's portfolios.

Item 4. Controls and Procedures.

In connection with the preparation of this second quarter Form 10-Q, an evaluation was carried out by Ambac's management, with the participation of Ambac's Chief Executive Officer and Chief Financial Officer, of the effectiveness of Ambac's disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives. Based on its evaluation, Ambac's Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2019, Ambac's disclosure controls and procedures were effective.

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2019 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Please refer to Note 12. Commitments and Contingencies of the Unaudited Consolidated Financial Statements located in Part I, Item 1 in this Form 10-Q and Note 16. Commitments and Contingencies in Part II, Item 8 in the Company's Annual Report on Form 10-K for the year ended December 31, 2018 for a discussion on legal proceedings against Ambac and its subsidiaries.

Item 1A. Risk Factors

You should carefully consider the risk factors set forth in the "Risk Factors" section, Item 1A to Part I in our Annual Report on Form 10-K for the year ended December 31, 2018, which are hereby incorporated by reference. These important factors may cause our actual results to differ materially from those indicated by our forward-looking statements, including those contained in this report. Please also see the section entitled "Cautionary Statement Pursuant to the Private Securities Litigation Reform Act of 1995" in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this quarterly report on Form 10-Q. There have been no material changes to the risk factors we have disclosed in the "Risk Factors" section of our aforementioned Annual Report on Form 10-K, other than as described below:

Risks Related to Portfolio Losses

Certain judicial decisions related to the Commonwealth of Puerto Rico's PROMESA Title III proceedings may materially adversely affect our Public Finance insured portfolio

On March 26, 2019, the U.S. Court of Appeals for the First Circuit, affirming a decision by the U.S. District Court overseeing the PROMESA Title III proceedings for the Puerto Rico Highways and Transportation Authority ("PRHTA"), found that under Sections 928(a) and 922(d) of the U.S. Bankruptcy Code, municipal issuers of revenue bonds secured by special revenues are permitted, but not required, to apply special revenues to pay debt service on such revenue bonds during the pendency of bankruptcy proceedings for such municipal issuers. The complainants had sought an order compelling PRHTA, as the debtor, to continue to make debt service payments on its revenue bonds from pledged special revenues during the pendency of its Title III case, but the First Circuit affirmed the District Court's dismissal of the complaint, holding that it could not compel the issuer to make such payments. The First Circuit's decision challenges what had been a commonly understood notion in the municipal finance marketplace that municipal revenues bondholders secured by special revenues (as defined in Chapter 9 of the U.S. Bankruptcy Code) would continue to receive payment during a bankruptcy of the municipal issuer. Although the First Circuit's decision covers only Maine, Massachusetts, New Hampshire, Puerto Rico and Rhode Island, it introduces significant uncertainty into the public finance market, may make it more difficult for municipal instrumentalities to procure revenue bond financings in the future and increases the credit risk to bondholders of existing special revenue bonds, particularly those from weaker issuers. In the wake of the decision, rating agencies have already taken ratings actions on, or announced their intention to review ratings given to, bonds issued across the country highlighting the potential contagion effect of the various Puerto Rico proceedings under PROMESA.

It is unclear how this ruling may ultimately impact Ambac's revenue bond municipal exposures, inclusive of Puerto Rico. However, potential impacts could include ratings downgrades, decreased or more costly access to capital markets to certain issuers to refinance the insured debt or raise new debt, and lower recoveries in a restructuring or bankruptcy. At June 30, 2019, Ambac Assurance insured approximately $5.1 billion of net par of bonds of special revenue issuers, including $617 million net par of watch list exposure and $636 million net par of adversely classified exposure, $516 million of which was Puerto Rico exposure.

Risk Related to International Business

Uncertainty regarding the economic impact of "Brexit" may have an adverse effect on Ambac's insured international portfolio and the value of its foreign investment, both of which primarily reside with its subsidiary Ambac UK

The Government of the United Kingdom ("UK") continues to contend with inconclusively finding resolution in the UK Parliament and with the European Union ("EU") for the terms of the UK's departure from the EU ("Brexit"). Current Brexit discussions do not include details of future post-Brexit trade relations. Current negotiations are designed to reach agreement on transitional arrangements covering the UK's exit from the EU. Assuming a transition agreement is reached, a further, separate, negotiation on a future post-transition trade framework must then begin. It is envisaged that negotiation on the future trade framework would be concluded during the transitional phase, and would be influenced by the nature of the transitional arrangements agreed between the parties.

On April 10, 2019, the European Union agreed to a UK Government request to extend the deadline for the occurrence in law of Brexit, being the date on which the UK leaves the European Union. The revised date is October 31, 2019 ("Exit Date"), however the Exit Date may be triggered earlier in the event the UK Parliament approves the draft departure treaty agreed between the European Union and the UK Government, something which the UK Government has so far been unable to persuade Parliament to do.

One recent consequence of the lack of resolution has been a decision by the current party forming the UK Government, the Conservative Party, to change its leader from Teresa May to Boris Johnson, who also became Prime Minister of the country. The hope of the Conservative Party is this change will assist the country in finding resolution, although outcomes remain uncertain.

There is a material risk that transitional Brexit negotiations are inconclusive so that on October 31, 2019 the UK automatically exits the EU without any transitional arrangement (a "no deal Brexit"), and also with no certain path to negotiating a future trade relationship with the EU. No deal Brexit risk may be increasing as a consequence of the change of Prime Minister of the UK Government.

Absent action by the EU or member states, in the event of a no deal Brexit, the activities in the European Economic Area ("EEA") of UK passporting insurers, including Ambac UK, will become unlawful on the Exit Date. They will lose their legal authorization to serve clients who benefit from policies issued by UK incorporated insurers under freedom of services passporting rights (and thereby may be unable to legally collect premiums or pay claims).

At June 30, 2019, Ambac UK's insured portfolio included four policies in the EU written under current passporting rights, with an aggregate par value of $1.5 billion. In respect of these four policies, there is premium receivable of $30 million and loss and loss expense reserves (net of subrogation recoverable) of $3 million. Absent legally binding transitional arrangements Ambac UK may be unable to collect these premiums or pay the claims to which these premiums receivable and loss and loss expense reserves relate after the Exit Date. Ambac UK's ability to restructure these policies to mitigate this risk is limited. Nonpayment of claims under any of the affected policies could lead to the loss of control rights in the related transaction(s), which would expose Ambac UK to greater risk of loss. In addition, under applicable English law, a court may hold that Ambac UK has an enforceable obligation to pay claims irrespective of the EU regulatory position in law. Consequently Ambac UK could find itself in a position where it was not in receipt of premium on a relevant policy, but chose to pay claims to avoid loss of control rights and/or other consequences of non-payment, notwithstanding the EU regulatory characterization in law.

Additionally, if UK insurers have branches in EEA Member States they may be legally obliged to either capitalize them, as a so-called third country branch from an institution whose home state is outside the EEA, or close them down and no longer be legally represented in those EU jurisdictions. Ambac UK has a branch in Italy, with one remaining policy issued from the branch. The branch is not capitalized separately from Ambac UK. In the event of a no-deal Brexit, the future nature and status of the branch is unclear, particularly with respect to the need for capitalization to support the one remaining branch policy. Given that Ambac UK is undercapitalized in terms of applicable regulatory capital rules it will be difficult for the UK regulator to agree to assets leaving the company for this purpose.

There is a risk that absent agreement with the Italian regulator regarding the future of the branch, under law the Italian regulator could institute insolvent winding up proceedings against the branch as an unlicensed insurance business. In this scenario the one branch policy would then be terminated by operation of law notwithstanding the prejudicial outcome to policy holders. This chain of events could in turn trigger cross defaults with a consequential loss by Ambac UK of its controlling creditor rights in many or all transactions. This would greatly inhibit Ambac UK's ability to exercise its rights in transactions generally, and in particular with respect to mitigating potential or actual loss in those transactions.

The European Insurance and Occupational Pensions Authority ("EIOPA") has made a series of recommendations to EU insurance regulators in light of Brexit. Acting on these recommendations European regulatory authorities have put in place (or are putting in place) legal frameworks that facilitate the orderly run off of branch operations and of insurance policies issued in EEA member states by UK insurers. The effect of these legal frameworks is to allow the continued run off of insurance policies issued in EEA member states by UK insurers prior to Exit Date that terminate after this date in the event that the draft departure agreement has not been approved prior to Exit Date.

In light of no deal Brexit risk, the UK financial regulatory authority has been actively encouraging regulated firms to put into place contingency plans, as have been EU and EU member states' financial regulatory bodies. The Company is in discussion with the PRA and other relevant regulatory authorities to enable the continued orderly run off of its policies issued in the EEA under passporting rights as well as the Italian branch operation in line with the EIOPA recommendations and legal frameworks which have been, or are planned to be, put in place by EEA member states.

In addition to the direct impact on insurers cited above, general uncertainty and the perceptions as to the ultimate impact of Brexit may adversely affect business activity, political stability, foreign exchange rates and economic conditions in the UK, the Eurozone, and the EU, which may result in additional credit stress on Ambac UK's insured portfolio and may ultimately adversely impact Ambac's results of operations and financial condition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities — No matters require disclosure.

(b) Purchases of Equity Securities By the Issuer and Affiliated Purchasers

The following table summarizes Ambac's share purchases during the second quarter of 2019. When restricted stock unit awards issued by Ambac vest or settle, they become taxable compensation to employees. For certain awards, shares may be withheld to cover the employee's portion of withholding taxes. In the second quarter of 2019, Ambac purchased shares from employees that settled restricted stock units to meet employee tax withholdings.

	April 2019	May 2019	June 2019	Second Quarter 2019
Total Shares Purchased [1]	—	23,165	—	23,165
Average Price Paid Per Share	$ —	$ 16.84	$ —	$ 16.84
Total Number of Shares Purchased as Part of Publicly Announced Plan [1]	—	—	—	—
Maximum Number of Shares That may Yet be Purchased Under the Plan	—	—	—	—

(1) There were no other repurchases of equity securities made during the three months ended June 30, 2019. Ambac does not have a stock repurchase program.

Warrants

Each warrant represents the right to purchase one share of Ambac common stock. The warrants are exercisable for cash at any time on or prior to April 30, 2023, at an exercise price of $16.67 per share. The warrants also have a cashless exercise provision.

On November 3, 2016, the Board of Directors of Ambac authorized a $10 million increase to the previously established warrant repurchase program. As of June 30, 2019, Ambac had repurchased 985,331 warrants totaling $8.1 million. In connection with the AMPS Exchange, Ambac issued 824,307 of the repurchased warrants on August 3, 2018, leaving 4,877,783 warrants outstanding. The remaining aggregate repurchase authorization at June 30, 2019 is $11.9 million. Refer to Note 1. Background and Business Description to the Consolidated Financial Statements included in Part II, Item 8 in the Company's Form 10-K for the year ended December 31, 2018 for further discussion of the AMPS Exchange.

Item 3. Defaults Upon Senior Securities — No matters require disclosure.

Item 5. Other Information — No matters require disclosure.

Item 6. Exhibits

Exhibit Number	Description
Other exhibits, filed or furnished, as indicated:	
10.1+	Form of 2019 Performance Stock Unit Award Agreement between Ambac Financial Group, Inc. and Messrs. LeBlanc, Trick and Ksenak.
10.2+	Form of 2019 Performance Stock Unit Award Agreement between Ambac Financial Group, Inc. and Messrs. Barranco, Eisman, Reilly and Ms. Smith.
31.1+	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) Promulgated under the Securities Exchange Act of 1934, as amended.
31.2+	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) Promulgated under the Securities Exchange Act of 1934, as amended.
32.1++	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document - the instance document does not appear in the interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

+ Filed herewith. ++ Furnished herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMBAC FINANCIAL GROUP, INC.

Dated: August 8, 2019

By: **/S/ DAVID TRICK**

Name: **David Trick**

Title: **Chief Financial Officer and Treasurer (Duly Authorized Officer and Principal Financial Officer)**

Exhibit 10.1

AMBAC FINANCIAL GROUP, INC.
PERFORMANCE STOCK UNIT AGREEMENT
FOR LONG-TERM INCENTIVE COMPENSATION AWARD
(Employees with Employment Agreements)

Effective as of [Date], 2019 (the "Grant Date"), [Name] (the "Participant") has been granted an Award under the Ambac Financial Group, Inc. Incentive Compensation Plan (the "Incentive Plan") and in accordance with the Ambac Financial Group, Inc. Long-Term Incentive Compensation Plan (the "LTIP"), which is a subplan to the Incentive Plan. This Agreement evidences the Award, which shall consist of a Full Value Award in the form of performance stock units ("Performance Stock Units"). In addition to the terms and conditions of the Incentive Plan and the LTIP, the Award shall be subject to the following terms and conditions (sometimes referred to as this "Agreement").

1. Defined Terms. Capitalized terms used in this Agreement which are not otherwise defined herein shall have the meaning specified in the Incentive Plan or the LTIP, as applicable.

2. Grant of Performance Stock Units. Subject to the terms of this Agreement, the Incentive Plan and the LTIP, effective as of the Grant Date the Participant is hereby granted [Number] Performance Stock Units (the "Target Performance Units"). This Award contains the right to dividend equivalent units ("Dividend Equivalent Units") with respect to Earned Performance Units (as defined in Section 3(a)) as described in Section 4. Each Performance Stock Unit awarded hereunder shall become earned and vested as described in Section 3 and each Earned Performance Unit (and associated Earned Dividend Equivalent Units thereon as described in Section 4) shall be settled in accordance with Section 5.

3. Earning, Vesting and Forfeiture of Performance Stock Units. The Performance Stock Units shall become earned and vested in accordance with the following:

(a) All Performance Stock Units shall be unearned and unvested unless and until they become earned and vested and nonforfeitable in accordance with this Section 3. The Participant shall have the ability to earn between 0% and 220% of the Target Performance Units, as determined by the Committee, based on the continuing employment of the Participant during the period beginning on January 1, 2019 and ending on the December 31, 2021 (the "Performance Period") and satisfaction of the Performance Goals set forth in Exhibit A hereto (which is incorporated into and forms part of this Agreement). Any Performance Stock Units granted pursuant to this Agreement that become earned in accordance with this Agreement shall be referred to herein as "Earned Performance Units". Except as provided in Section 3(b), if the Participant's termination of employment or service with the Company (the "Termination Date") occurs for any reason prior to the last day of the Performance Period, the Participant's right to all Performance Stock Units (and any associated Dividend Equivalent Units) awarded or credited to the Participant pursuant to this Agreement shall expire and be forfeited immediately and the Participant shall have no further rights with respect to any of the Performance Stock Units (or associated Dividend Equivalent Units). The Earned Performance Units (and any associated Earned Dividend Equivalent Units) shall be settled in accordance with Section 5 hereof.

(b) Notwithstanding the provisions of Section 3(a), (x) if the Participant's Termination Date occurs prior to the last day of the Performance Period by reason of (1) Disability (as defined in the Employment Agreement referenced in clause (4) of this subsection)), (2) Retirement (as defined in Section 3(c)), (3) involuntary termination by the Company other than for Cause (as defined in the Employment Agreement), (4) as a result of the Company's failure to extend the term of the Employment Agreement between Ambac, AAC and the Participant, dated as of [Date] (the "Employment Agreement") pursuant to Section 2 thereof, or (5) termination by the Participant for Good Reason (as defined in the Employment Agreement), the Participant shall be entitled to receive the number of Earned Performance Units (and any associated Earned Dividend Equivalent Units) that the Participant would have been entitled to receive had the Termination Date not occurred prior to the end of the Performance Period based on actual satisfaction of the Performance Goals, and (y) if the Participant's Termination Date occurs prior to the last day of the Performance Period by reason of death, the beneficiaries of Participant shall be entitled to receive the number of Earned Performance Units (and any associated Earned Dividend Equivalent Units) that the Participant would have been entitled to receive had the Termination Date not occurred prior to the end of the Performance Period at a 100% overall payout multiple regardless of the outcome of the Performance Goals, Total Shareholder Return or Relative Total Shareholder Return (which shall be equal to the number of Target Performance Units plus any earned Dividend Equivalent Units).

(c) For purposes of the Award evidenced by this Agreement, (i) the terms "Cause," "Disability" and "Good Reason" shall have the meanings specified in the Employment Agreement, and (ii) the Participant's Termination Date shall be considered to occur on account of "Retirement" if the Participant's Termination Date occurs on or after the date on which the following conditions have been satisfied and such Termination Date does not occur for any other reason: (x) the Participant has attained age 60; (y) the Participant has provided at least ten (10) years of service to the Company; and (z) the Participant has provided at least 90 days' prior notice of his or her Termination Date due to retirement from the Company.

4. Dividend Equivalent Units. The Participant shall be credited with Dividend Equivalent Units as follows:

(a) If, during the Performance Period, a dividend with respect to shares of Common Stock is paid in cash, then as of the dividend payment date, the Participant shall be credited with that number of Dividend Equivalent Units equal to (i) the cash dividend paid with respect to a share of Common Stock, multiplied by (ii) 220% of the Target Performance Units (the "Maximum Performance Units") plus the number of previously credited Dividend Equivalent Units with respect to such Performance Stock Units, if any, divided by (iii) the Fair Market Value of a share of Common Stock on the dividend payment date, rounded down to the nearest whole number.

(b) If, during the Performance Period, a dividend with respect to shares of Common Stock is paid in shares of Common Stock, then as of the dividend payment date the Participant shall be credited with that number of Dividend Equivalent Units equal to (i) the number of shares of Common Stock distributed in the dividend with respect to a share of Common Stock, multiplied by (ii)(A) the number of Maximum Performance Units plus (B) the number of previously credited Dividend Equivalent Units with respect to such Performance Stock Units, if any, rounded down to the nearest whole number.

Dividend Equivalent Units shall be earned on the same basis and to the same extent that the Performance Stock Units to which they relate become Earned Performance Units. Therefore, the Participant shall only earn Dividend Equivalent Units with respect to Earned Performance Units and, to the extent that any Dividend Equivalent Units are credited to the Participant pursuant to this Section 4 and are not earned in accordance with this Agreement, they shall be forfeited and the Participant shall have no further rights with respect thereto under this Agreement or otherwise. Any Dividend Equivalent Units credited to the Participant pursuant to this Section 4 that become earned in accordance with this Agreement are sometimes referred to as "Earned Dividend Equivalent Units".

5. Settlement. Subject to the terms and conditions of this Agreement, the Earned Performance Units (and associated Earned Dividend Equivalent Units) shall be settled as soon as practically possible, but not later than March 15 following the end of the Performance Period (the "Settlement Date") subject to Special Section 409A Rules in Section 17; *provided* that in the case of death of a Participant, the Settlement Date shall be the Participant's Termination Date. Settlement of the Earned Performance Units and Earned Dividend Equivalent Units on the Settlement Date shall be made in the form of shares of Common Stock with one share of Common Stock being issued in settlement of each Earned Performance Unit and each Earned Dividend Equivalent Unit, with any fractional shares of Common Stock being rounded up to the nearest whole number. Upon the settlement of any Earned Performance Unit and associated Earned Dividend Equivalent Units, such Earned Performance Unit and Earned Dividend Equivalent Units shall be cancelled. Any Performance Stock Units and associated Dividend Equivalent Units outstanding as of the last day of the Performance Period that do not become Earned Performance Units and associated Earned Dividend Equivalent Units shall be automatically cancelled as of the last day of the Performance Period.

6. Withholding. The Award and settlement thereof are subject to withholding of all applicable taxes. Such withholding obligations shall be satisfied through amounts that the Participant is otherwise to receive upon settlement.

7. Transferability. The Award is not transferable except as designated by the Participant by will or by the laws of descent and distribution.

8. Heirs and Successors. If any benefits deliverable to the Participant under this Agreement have not been delivered at the time of the Participant's death, such rights shall be delivered to the Participant's estate.

9. Administration. The authority to administer and interpret this Agreement shall be vested in the Committee, and the Committee shall have all the powers with respect to this Agreement as it has with respect to the Incentive Plan and the LTIP. Any interpretation of the Agreement by the Committee and any decision made by it with respect to the Agreement is final and binding on all persons.

10. Adjustment of Award. In the event of a stock dividend, stock split, reverse stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, exchange of shares, sale of assets or subsidiaries, combination, or other corporate transaction that affects the Common Stock, the Committee shall, in order to preserve the benefits or prevent the enlargement of benefits of this Award, and in the manner it determines equitable in its sole discretion, (a) adjust the

number and kind of shares subject to this Award and (b) make any other adjustments that the Committee determines to be equitable (which may include, without limitation, (i) replacement of this Award with other Awards which the Committee determines have comparable value and which are based on stock of a company resulting from the transaction, and (ii) cancellation of this Award in return for cash payment of the current value of this Award, determined as though this Award is fully vested at the time of payment).

11. Notices. Any notice required or permitted under this Agreement shall be deemed given when delivered personally, through Ambac's stock compensation administration system or when deposited in a United States Post Office, postage prepaid, addressed, as appropriate, to Ambac at its principal offices, to the Participant at the Participant's address as last known by the Company or, in either case, such other address as one party may designate in writing to the other.

12. Governing Law. The validity, construction and effect of this Agreement shall be determined in accordance with the laws of the State of New York and applicable federal law.

13. Amendments. The Board of Directors may, at any time, amend or terminate the Incentive Plan, and the Board of Directors or the Committee may amend this Agreement or the LTIP, provided that no amendment or termination may, in the absence of written consent to the change by the affected Participant (or, if the Participant is not then living, the affected beneficiary), adversely affect the rights of any Participant or beneficiary under this Agreement prior to the date such amendment or termination is adopted by the Board of Directors or the Committee, as the case may be.

14. Award Not Contract of Employment. The Award does not constitute a contract of employment or continued service, and the grant of the Award will not give the Participant the right to be retained in the employ or service of the Company, nor any right or claim to any benefit under the Incentive Plan, the LTIP or this Agreement, unless such right or claim has specifically accrued under the terms of the Incentive Plan and this Agreement.

15. Severability. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be overbroad as written, that provision shall be amended to narrow its application to the extent necessary to make the provision enforceable according to applicable law and enforced as amended.

16. Incentive Plan and LTIP Govern. The Award evidenced by this Agreement is granted pursuant to the Incentive Plan, and the Performance Stock Units and this Agreement are in all respects governed by the Incentive Plan (including the LTIP) and subject to all of the terms and provisions thereof, whether such terms and provisions are incorporated in this Agreement by reference or are expressly cited.

17. Special Section 409A Rules. To the fullest extent possible, amounts and other benefits payable under the Agreement are intended to comply with or be exempt from the provisions of section 409A of the Code. This Agreement will be interpreted and administered to the extent possible in a manner consistent with the foregoing statement of intent; provided, however, that the Company does not guarantee the tax treatment of the Award. Notwithstanding any other provision of this Agreement to the contrary, if any payment or benefit hereunder is subject to section 409A of the Code, and if such payment or benefit is to be paid or provided on account of the Participant's termination of employment (or other separation from service):

(a) and if the Participant is a specified employee (within the meaning of section 409A(a)(2)(B) of the Code) and if any such payment or benefit is required to be made or provided prior to the first day of the seventh month following the Participant's separation from service or termination of employment, such payment or benefit shall be delayed until the first day of the seventh month following the Participant's separation from service; and

(b) the determination as to whether the Participant has had a termination of employment (or separation from service) shall be made in accordance with the provisions of section 409A of the Code and the guidance issued thereunder without application of any alternative levels of reductions of bona fide services permitted thereunder.

EXHIBIT A
PERFORMANCE GOALS

Weight of Award between AAC and AFG Performance:

AAC Percentage: 70%
AFG Percentage: 30%
Collectively ("Total Performance")

Performance Goals

The Award evidenced by the Agreement shall be earned based on the satisfaction of the Performance Goals described in this Exhibit A determined based on the rating calculated pursuant to the following table, subject to the RTSR modifier discussed below:

		AAC		AFG
Rating	Payout Multiple	Adjusted Net Asset Value ($mm)	WLACC Outstanding ($bn)	Original Cumulative EBITDA[1] ($mm)
1	2.00	$(180)	$11.5	$35
2	1.00	$(380)	$13.5	$20
3	0.00	$(580)	$15.0	$0

With respect to the AFG Performance Goal, representing 30% of Total Performance, the applicable rating shall be determined based on Original Cumulative EBITDA, however upon the Effective Date, the applicable rating shall be determined based on a weighting of the Original Cumulative EBITDA and the Revised Cumulative EBITDA as described herein. Linear interpolation between the payout multiple of both Original Cumulative EBITDA and Revised Cumulative EBITDA will be applied to determine the respective payout multiple to be used in determining the final payout multiple. The final payout multiple will result in a proportionate number of the Target Performance Units (and associated Dividend Equivalent Units) becoming Earned Performance Units (and Earned Dividend Equivalent Units).

With respect to the AAC Performance Goal, representing 70% of Total Performance, the applicable rating shall be determined as follows: (i) 25% of Total Performance based on the Adjusted Net Asset Value and (ii) 45% of Total Performance based on WLACC Outstanding at the end of the Performance Period. Linear interpolation between payout multiples of Adjusted Net Asset Value and the WLACC Outstanding, as applicable, will result in a proportionate number of the Target Performance Units (and associated Dividend Equivalent Units) becoming Earned Performance Units (and Earned Dividend Equivalent Units).

(1) Upon the execution of a material transaction or acquisition by AFG, revised Cumulative EBITDA (the "Revised Cumulative EBITDA") metrics will be established by the Compensation Committee to incorporate performance goals (the "Revised Performance Metrics") for such material transaction or acquisition. Upon such event, a weighting of Original Cumulative EBITDA and Revised Cumulative EBITDA will occur as follows: (i) the performance of Original Cumulative EBITDA prior to such event shall be measured against the annual projections that derived the Original Cumulative EBITDA metrics up to, but not including, the effective date (the "Effective Date") of such Revised Performance Metrics, as determined by the Compensation Committee, with straight line recognition of the projected annual EBITDA for a partial calendar year, and (ii) the performance of the Revised Cumulative EBITDA will be measured against the Revised Performance Metrics from the Effective Date of such Revised Performance Metrics through the end of the Performance Period (and shall be inclusive of earnings on the remaining capital after a material transaction or acquisition). The projections noted in item (i) above would be equivalent to a target payout multiple of 1.00 (the "Original EBITDA target projections"). Maximum payout multiple of 2.00 would be equivalent to 1.75 times the Original EBITDA target projections and a payout multiple of 0.00 is a cumulative EBITDA of $0 million up to, but not including, the Effective Date. The results in items (i) and (ii) will be weighted as follows: (a) the number of days from the beginning of the Performance Period to but not including the Effective Date multiplied by the resulting payout multiple for (i), plus (b) number of days from and including the Effective Date through the end of the Performance Period multiplied by resulting payout multiple for (ii). The resulting final payout multiple will be weighted 30% of the Total Performance consistent with the AFG Percentage noted above.

All metrics noted in this table shall be neutral to the effects of changes to US GAAP.

All determinations as to whether the Performance Goals have been satisfied will be determined by the Committee in accordance with the provisions of the LTIP, including Section 3(f) thereof.

Notwithstanding anything in this Exhibit A to the contrary, the number of Target Performance Units (and associated Dividend Equivalent Units) that become Earned Performance Units (and Earned Dividend Equivalent Units) based on the level of achievement of the metrics set forth in table above shall be adjusted, either upwards or downwards, based on AFG's RTSR Percentile Ranking for the Performance Period, in accordance with the table below, as determined by the Committee. For the avoidance of doubt, in no event shall the Participant earn more than 220% of the Target Performance Units after the RTSR modifier is applied.

RTSR Percentile Ranking	RTSR Modifier
75th percentile or above	110% of overall payout multiple
Between 25th and 75th percentile	100% of overall payout multiple
25th percentile or below	90% of overall payout multiple

For purposes of this Exhibit A, the following definitions shall apply:

AAC: Ambac Assurance Corporation.

Adjusted Net Asset Value: The value determined by reducing Assets by Liabilities, determined as of the last day of the Performance Period. Additionally, Adjusted Net Asset Value will:

- neutralize the effects of claim payments, loss expense payments, advisor payments and the establishment of loss and loss expense reserves for credits that do not have a GCL, as defined below, at the beginning of the Performance Period;
- measure AAC's foreign subsidiaries utilizing the foreign exchange rate at the beginning of the Performance Period;
- add back costs related to ongoing OCI oversight during Performance Period; and
- add back direct costs of risk remediation activities with respect to credits within WLACC.

AFG: Ambac Financial Group, Inc.

ART Transactions: Alternative Risk Transfer transactions executed by the Company that reduce/eliminate portfolio risk, including by way of proportional reinsurance (e.g. quota share) or other alternative hedging or risk transfer strategies (e.g. excess of loss reinsurance) the impact of which has been approved by the Committee for purposes of reducing WLACC Outstanding. For purposes of this definition, (i) the impact of an ART transaction whereby net par is not reduced but a portion of the risk related to a WLACC is defeased or reduced for some or all of the remaining life of the insured exposure shall count towards calculating the reduction in WLACC Outstanding and (ii) the measure of benefit for the risk retention metric for an ART Transaction will be calculated as follows (a) the net par balance of the portion of the WLACC exposure affected by the ART multiplied by (b) the quotient of the ART coverage period and the remaining expected life of the exposure. To the extent an ART transaction is executed that does not conform to the aforementioned example management will propose an alternative calculation to the Committee to measure the WLACC reduction.

Assets: The sum of the following relating to the Included Entities: cash, invested assets at fair value (except for Ambac-insured investments which will be measured at amortized cost and excluding the Secured Note issued in 2018 in connection with AAC's restructuring as it is included below in liabilities), loans, investment income due and accrued, net receivables (payables) for security sales (purchases), tax tolling payments or dividends made by AAC to AFG, cash, cash equivalents and securities pledged as collateral to counterparties and other receivables.

Included Entities: AAC and its subsidiaries, and may include any other entities that the Committee shall determine.

Liabilities: The sum of the following relating to the Included Entities: the present value of future probability weighted financial guarantee claims and CDS payments reduced by recoveries, including probability weighted estimated subrogation recoveries and reinsurance recoverables, using discount rates in accordance with GAAP ("GCL"), fair value of interest rate derivatives (prior to any AAC credit valuation adjustments), par value and accrued interest on all outstanding surplus notes of AAC (including junior surplus notes), par value and accrued interest on the Ambac Note and Tier 2 Notes issued in 2018 in connection with the Segregated Account rehabilitation exit transactions (net of par value and accrued interest on AAC's holdings of the Secured Note), the liquidation value of outstanding preferred stock and the GAAP carrying value of RMBS secured borrowings, if any. Liabilities will also include the par and accrued interest on any new debt obligations issued in the future.

Original Cumulative EBITDA: AFG's earnings before interest, taxes, depreciation, amortization, and non-controlling interests (as determined under current US GAAP) through the Performance Period. This includes all of AFG's subsidiaries excluding AAC and AAC's subsidiaries. Original Cumulative EBITDA shall be adjusted for the effects of:

- advisor and deal/transaction related costs related to AFG and AAC capital and/or M&A transactions above or below budgeted amounts[2];
- cost of post-employment guarantees;

(2) Revised Cumulative EBITDA from Revised Performance Metrics during the Performance Period will be recognized net of any excluded advisor and/or deal costs incurred during such period.

- cost and impact of AAC and AFG share repurchase (direct and synthetic)[3];
- changes to Board fees and Board imposed expenses;
- litigation and defense costs and any potential litigation gains in excess of damages incurred;
- (cost)/benefit of performance based compensation (above) or below target amounts; and
- any other costs as determined in the sole discretion of the Board.

Peer Group: The entities set forth on Exhibit B hereto. However, in the event that, prior to the end of the Performance Period, there occurs: (i) a merger, acquisition or business combination transaction of a Peer Group member with or by another Peer Group member, only the surviving entity shall remain a member of the Peer Group; (ii) a merger, acquisition or business combination of a Peer Group member with an entity that is not a Peer Group member, or the acquisition or business combination transaction by or with a Peer Group member, where such Peer Group member is the surviving entity and remains publicly traded, such Peer Group member shall remain a member of the Peer Group; (iii) a merger or acquisition or business combination transaction of a Peer Group member by or with an entity that is not a Peer Group member or a "going private" transaction involving a Peer Group member where such Peer Group member is not the surviving entity or is otherwise no longer publicly traded, such Peer Group member shall no longer be a member of the Peer Group; (iv) a stock distribution from a Peer Group member consisting of the shares of a new publicly traded company (a "spin-off"), such Peer Group member shall remain a member of the Peer Group, such distribution shall be treated as a dividend from such Peer Group member based on the closing price of the shares of the spun-off company on its first day of trading and the performance of the shares of the spun-off company shall not thereafter be tracked for purposes of calculating Total Shareholder Return; or (v) a bankruptcy or liquidation of a Peer Group member, such Peer Group member will remain a member of the Peer Group and the Total Shareholder Return of such Peer Group member shall equal -100%.

Relative Total Shareholder Return, or **RTSR**: The percentile rank of the Company's Total Shareholder Return as compared to the Total Shareholder Returns of all members of the Peer Group, ranked in descending order (including the Company), at the end of the Performance Period.

Revised Cumulative EBITDA: For all of AFG's subsidiaries (excluding AAC and AAC's subsidiaries), including any new subsidiary or affiliate resulting from the execution of a material transaction or acquisition by AFG, earnings before interest, taxes, depreciation, amortization, and non-controlling interests (as determined under current US GAAP) as of the Effective Date through the Performance Period that will be measured against Revised Performance Metrics as of the Effective Date.

Revised Performance Metrics: Revised Cumulative EBITDA metrics established as of the Effective Date by the AFG Board and Compensation Committee to incorporate performance goals for a material transaction or acquisition by AFG.

Total Shareholder Return: With respect to each of the Common Stock and the common stock of each of the members of the Peer Group, a rate of return reflecting stock price appreciation, plus the reinvestment of dividends in additional shares of stock, from the beginning of the Performance Period through the end of the Performance Period. For purposes of calculating Total Shareholder Return for each of AFG and the members of the Peer Group, (i) the beginning stock price will be based on the average of the twenty (20) trading days immediately prior to the first day of the Performance Period on the principal stock exchange on which the stock is then listed or admitted to trading and the ending stock price will be based on the average of the last twenty (20) trading days of the Performance Period on the principal stock exchange on which the stock is then listed or admitted to trading and (ii) reinvestment of dividends shall be assumed to be reinvested on the ex-dividend date using the closing stock price on the ex-dividend date.

WLACC Outstanding: The remaining net par outstanding, inclusive of the impact of any ART Transactions executed by the Company during the Performance Period, for watch list and adversely classified credits as identified at the beginning of the Performance Period ("WLACC") by AFG and its subsidiaries, including AAC and Ambac Assurance UK Limited ("Ambac UK"). For purposes of this award, WLACC amounts will exclude new credits added during the Performance Period, including credits added through reinsurance recaptures. Additionally, the WLACC net par outstanding at the beginning of performance period[4] shall incorporate accreted par outstanding at the beginning of the performance period for the following three capital appreciation bond exposures:

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(3) Cost to be calculated based on (i) the amount of capital allocated to share repurchase multiplied by (ii) LIBOR + the average spread earned on AFG investments from the time of such allocation through the end of the Performance Period. For the avoidance of doubt, gains or losses from repurchases are also excluded from the Original Cumulative EBITDA and, to the extent applicable, the Revised Cumulative EDITDA calculation.

(4) Beginning WLACC Outstanding for this award will include the net par outstanding as of December 31, 2018 related to credits added to the watch list in January 2019.

- Single Risk ID: 239961 PHILADELPHIA PA GO
- Single Risk ID: 4224 NEW JERSEY TSP TRT FND-TRS SYS
- Single Risk ID: 813506 ALAMEDA CA CORRID TRAN ATH

Any reductions to WLACC net par outstanding for the above specified exposures will be based on the accreted par outstanding at the beginning of the Performance Period.

For non-U.S. exposures, the currency exchange rates to be used shall be those beginning on the first day of the Performance Period.

EXHIBIT B

PEER GROUP

Assured Guaranty Ltd. (AGO)
MBIA Inc. (MBI)
Syncora Holdings Ltd. (SYCRF)
MGIC Investment Corporation (MTG)
The Navigators Group, Inc. (NAVG)
Radian Group Inc. (RDN)
Mr. Cooper Group (COOP)
ECN Capital Corp. (TSX:ECN)
Element Fleet Management Corp. (TSX:EFN)
Navient Corporation (NAVI)
Enstar Group Limited (ESGR)

Exhibit 10.2

AMBAC FINANCIAL GROUP, INC.
PERFORMANCE STOCK UNIT AGREEMENT
FOR LONG-TERM INCENTIVE COMPENSATION AWARD
(Employees without Employment Agreements)

Effective as of [Date], 2019 (the "Grant Date"), [Name] (the "Participant") has been granted an Award under the Ambac Financial Group, Inc. Incentive Compensation Plan (the "Incentive Plan") and in accordance with the Ambac Financial Group, Inc. Long-Term Incentive Compensation Plan (the "LTIP"), which is a subplan to the Incentive Plan. This Agreement evidences the Award, which shall consist of a Full Value Award in the form of performance stock units ("Performance Stock Units"). In addition to the terms and conditions of the Incentive Plan and the LTIP, the Award shall be subject to the following terms and conditions (sometimes referred to as this "Agreement").

1. Defined Terms. Capitalized terms used in this Agreement which are not otherwise defined herein shall have the meaning specified in the Incentive Plan or the LTIP, as applicable.

2. Grant of Performance Stock Units. Subject to the terms of this Agreement, the Incentive Plan and the LTIP, effective as of the Grant Date the Participant is hereby granted [Number] Performance Stock Units (the "Target Performance Units"). This Award contains the right to dividend equivalent units ("Dividend Equivalent Units") with respect to Earned Performance Units (as defined in Section 3(a)) as described in Section 4. Each Performance Stock Unit awarded hereunder shall become earned and vested as described in Section 3 and each Earned Performance Unit (and associated Earned Dividend Equivalent Units thereon as described in Section 4) shall be settled in accordance with Section 5.

3. Earning, Vesting and Forfeiture of Performance Stock Units. The Performance Stock Units shall become earned and vested in accordance with the following:

(a) All Performance Stock Units shall be unearned and unvested unless and until they become earned and vested and nonforfeitable in accordance with this Section 3. The Participant shall have the ability to earn between 0% and 220% of the Target Performance Units, as determined by the Committee, based on the continuing employment of the Participant during the period beginning on January 1, 2019 and ending on the December 31, 2021 (the "Performance Period") and satisfaction of the Performance Goals set forth in Exhibit A hereto (which is incorporated into and forms part of this Agreement). Any Performance Stock Units granted pursuant to this Agreement that become earned in accordance with this Agreement shall be referred to herein as "Earned Performance Units". Except as provided in Section 3(b), if the Participant's termination of employment or service with the Company (the "Termination Date") occurs for any reason prior to the last day of the Performance Period, the Participant's right to all Performance Stock Units (and any associated Dividend Equivalent Units) awarded or credited to the Participant pursuant to this Agreement shall expire and be forfeited immediately and the Participant shall have no further rights with respect to any of the Performance Stock Units (or associated Dividend Equivalent Units). The Earned Performance Units (and any associated Earned Dividend Equivalent Units) shall be settled in accordance with Section 5 hereof.

(b) Notwithstanding the provisions of Section 3(a), (x) if the Participant's Termination Date occurs prior to the last day of the Performance Period by reason of Disability (as defined in Section 3(c)), Retirement (as defined in Section 3(c)), or involuntary termination by the Company other than for Cause (as defined in Section 3(c)), the Participant shall be entitled to receive the number of Earned Performance Units (and any associated Earned Dividend Equivalent Units) that the Participant would have been entitled to receive had the Termination Date not occurred prior to the end of the Performance Period based on actual satisfaction of the Performance Goals, and (y) if the Participant's Termination Date occurs prior to the last day of the Performance Period by reason of death, the beneficiaries of Participant shall be entitled to receive the number of Earned Performance Units (and any associated Earned Dividend Equivalent Units) that the Participant would have been entitled to receive had the Termination Date not occurred prior to the end of the Performance Period at a 100% overall payout multiple regardless of the outcome of the Performance Goals, Total Shareholder Return or Relative Total Shareholder Return (which shall be equal to the number of Target Performance Units plus any earned Dividend Equivalent Units).

(c) For purposes of the Award evidenced by this Agreement, (i) a Participant's Termination Date shall be considered to occur by reason of "Disability" if his Termination Date occurs on or after the date on which he is entitled to long-term disability benefits under the Company's long-term disability plan (or, if the Participant is not eligible for such plan, if the Participant would be entitled to benefits under such plan if he were eligible) and such Termination Date does not occur for any other reason; (ii) the Participant's Termination Date shall be

considered to occur by reason of "Cause" if the Participant's Termination Date occurs by reason of termination by the Company and is on account of (A) any act or omission by the Participant resulting in, or intending to result in, personal gain at the expense of the Company; (B) the improper disclosure by the Participant of proprietary or confidential information of the Company; or (C) misconduct by the Participant, including, but not limited to, fraud, intentional violation of, or negligent disregard for, the rules and procedures of the Company (including the code of business conduct), theft, violent acts or threats of violence, or possession of controlled substances on the property of the Company; provided, however, that the meaning of "Cause" shall be (1) expanded to include any additional grounds for cause-based termination specified in any contract, policy or plan applicable to the Participant or (2) superseded to the extent expressly provided in such contract, policy or plan; and (iii) the Participant's Termination Date shall be considered to occur on account of "Retirement" if the Participant's Termination Date occurs on or after the date on which the following conditions have been satisfied and such Termination Date does not occur for any other reason: (x) the Participant has attained age 60; (y) the Participant has provided at least ten (10) years of service to the Company; and (z) the Participant has provided at least 90 days' prior notice of his or her Termination Date due to retirement from the Company.

4. Dividend Equivalent Units. The Participant shall be credited with Dividend Equivalent Units as follows:

(a) If, during the Performance Period, a dividend with respect to shares of Common Stock is paid in cash, then as of the dividend payment date, the Participant shall be credited with that number of Dividend Equivalent Units equal to (i) the cash dividend paid with respect to a share of Common Stock, multiplied by (ii) 220% of the Target Performance Units (the "Maximum Performance Units") plus the number of previously credited Dividend Equivalent Units with respect to such Performance Stock Units, if any, divided by (iii) the Fair Market Value of a share of Common Stock on the dividend payment date, rounded down to the nearest whole number.

(b) If, during the Performance Period, a dividend with respect to shares of Common Stock is paid in shares of Common Stock, then as of the dividend payment date the Participant shall be credited with that number of Dividend Equivalent Units equal to (i) the number of shares of Common Stock distributed in the dividend with respect to a share of Common Stock, multiplied by (ii)(A) the number of Maximum Performance Units plus (B) the number of previously credited Dividend Equivalent Units with respect to such Performance Stock Units, if any, rounded down to the nearest whole number.

Dividend Equivalent Units shall be earned on the same basis and to the same extent that the Performance Stock Units to which they relate become Earned Performance Units. Therefore, the Participant shall only earn Dividend Equivalent Units with respect to Earned Performance Units and, to the extent that any Dividend Equivalent Units are credited to the Participant pursuant to this Section 4 and are not earned in accordance with this Agreement, they shall be forfeited and the Participant shall have no further rights with respect thereto under this Agreement or otherwise. Any Dividend Equivalent Units credited to the Participant pursuant to this Section 4 that become earned in accordance with this Agreement are sometimes referred to as "Earned Dividend Equivalent Units".

5. Settlement. Subject to the terms and conditions of this Agreement, the Earned Performance Units (and associated Earned Dividend Equivalent Units) shall be settled as soon as practically possible, but not later than March 15 following the end of the Performance Period (the "Settlement Date") subject to Special Section 409A Rules in Section 17; *provided* that in the case of death of a Participant, the Settlement Date shall be the Participant's Termination Date. Settlement of the Earned Performance Units and Earned Dividend Equivalent Units on the Settlement Date shall be made in the form of shares of Common Stock with one share of Common Stock being issued in settlement of each Earned Performance Unit and each Earned Dividend Equivalent Unit, with any fractional shares of Common Stock being rounded up to the nearest whole number. Upon the settlement of any Earned Performance Unit and associated Earned Dividend Equivalent Units, such Earned Performance Unit and Earned Dividend Equivalent Units shall be cancelled. Any Performance Stock Units and associated Dividend Equivalent Units outstanding as of the last day of the Performance Period that do not become Earned Performance Units and associated Earned Dividend Equivalent Units shall be automatically cancelled as of the last day of the Performance Period.

6. Withholding. The Award and settlement thereof are subject to withholding of all applicable taxes. Such withholding obligations shall be satisfied through amounts that the Participant is otherwise to receive upon settlement.

7. Transferability. The Award is not transferable except as designated by the Participant by will or by the laws of descent and distribution.

8. Heirs and Successors. If any benefits deliverable to the Participant under this Agreement have not been delivered at the time of the Participant's death, such rights shall be delivered to the Participant's estate.

9. Administration. The authority to administer and interpret this Agreement shall be vested in the Committee, and the Committee shall have all the powers with respect to this Agreement as it has with respect to the Incentive Plan and the LTIP.

Any interpretation of the Agreement by the Committee and any decision made by it with respect to the Agreement is final and binding on all persons.

10. Adjustment of Award. In the event of a stock dividend, stock split, reverse stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, exchange of shares, sale of assets or subsidiaries, combination, or other corporate transaction that affects the Common Stock, the Committee shall, in order to preserve the benefits or prevent the enlargement of benefits of this Award, and in the manner it determines equitable in its sole discretion, (a) adjust the number and kind of shares subject to this Award and (b) make any other adjustments that the Committee determines to be equitable (which may include, without limitation, (i) replacement of this Award with other Awards which the Committee determines have comparable value and which are based on stock of a company resulting from the transaction, and (ii) cancellation of this Award in return for cash payment of the current value of this Award, determined as though this Award is fully vested at the time of payment).

11. Notices. Any notice required or permitted under this Agreement shall be deemed given when delivered personally, through Ambac's stock compensation administration system or when deposited in a United States Post Office, postage prepaid, addressed, as appropriate, to Ambac at its principal offices, to the Participant at the Participant's address as last known by the Company or, in either case, such other address as one party may designate in writing to the other.

12. Governing Law. The validity, construction and effect of this Agreement shall be determined in accordance with the laws of the State of New York and applicable federal law.

13. Amendments. The Board of Directors may, at any time, amend or terminate the Incentive Plan, and the Board of Directors or the Committee may amend this Agreement or the LTIP, provided that no amendment or termination may, in the absence of written consent to the change by the affected Participant (or, if the Participant is not then living, the affected beneficiary), adversely affect the rights of any Participant or beneficiary under this Agreement prior to the date such amendment or termination is adopted by the Board of Directors or the Committee, as the case may be.

14. Award Not Contract of Employment. The Award does not constitute a contract of employment or continued service, and the grant of the Award will not give the Participant the right to be retained in the employ or service of the Company, nor any right or claim to any benefit under the Incentive Plan, the LTIP or this Agreement, unless such right or claim has specifically accrued under the terms of the Incentive Plan and this Agreement.

15. Severability. If a provision of this Agreement is held invalid by a court of competent jurisdiction, the remaining provisions will nonetheless be enforceable according to their terms. Further, if any provision is held to be overbroad as written, that provision shall be amended to narrow its application to the extent necessary to make the provision enforceable according to applicable law and enforced as amended.

16. Incentive Plan and LTIP Govern. The Award evidenced by this Agreement is granted pursuant to the Incentive Plan, and the Performance Stock Units and this Agreement are in all respects governed by the Incentive Plan (including the LTIP) and subject to all of the terms and provisions thereof, whether such terms and provisions are incorporated in this Agreement by reference or are expressly cited.

17. Special Section 409A Rules. To the fullest extent possible, amounts and other benefits payable under the Agreement are intended to comply with or be exempt from the provisions of section 409A of the Code. This Agreement will be interpreted and administered to the extent possible in a manner consistent with the foregoing statement of intent; provided, however, that the Company does not guarantee the tax treatment of the Award. Notwithstanding any other provision of this Agreement to the contrary, if any payment or benefit hereunder is subject to section 409A of the Code, and if such payment or benefit is to be paid or provided on account of the Participant's termination of employment (or other separation from service):

(a) and if the Participant is a specified employee (within the meaning of section 409A(a)(2)(B) of the Code) and if any such payment or benefit is required to be made or provided prior to the first day of the seventh month following the Participant's separation from service or termination of employment, such payment or benefit shall be delayed until the first day of the seventh month following the Participant's separation from service; and

(b) the determination as to whether the Participant has had a termination of employment (or separation from service) shall be made in accordance with the provisions of section 409A of the Code and the guidance issued thereunder without application of any alternative levels of reductions of bona fide services permitted thereunder.

EXHIBIT A
PERFORMANCE GOALS

Weight of Award between AAC and AFG Performance:

AAC Percentage: 70%
AFG Percentage: 30%
Collectively ("Total Performance")

Performance Goals

The Award evidenced by the Agreement shall be earned based on the satisfaction of the Performance Goals described in this Exhibit A determined based on the rating calculated pursuant to the following table, subject to the RTSR modifier discussed below:

		AAC		AFG
Rating	Payout Multiple	Adjusted Net Asset Value ($mm)	WLACC Outstanding ($bn)	Original Cumulative EBITDA ($mm)
1	2.00	$(180)	$11.5	$35
2	1.00	$(380)	$13.5	$20
3	0.00	$(580)	$15.0	$0

With respect to the AFG Performance Goal, representing 30% of Total Performance, the applicable rating shall be determined based on Original Cumulative EBITDA, however upon the Effective Date, the applicable rating shall be determined based on a weighting of the Original Cumulative EBITDA and the Revised Cumulative EBITDA as described herein. Linear interpolation between the payout multiple of both Original Cumulative EBITDA and Revised Cumulative EBITDA will be applied to determine the respective payout multiple to be used in determining the final payout multiple. The final payout multiple will result in a proportionate number of the Target Performance Units (and associated Dividend Equivalent Units) becoming Earned Performance Units (and Earned Dividend Equivalent Units).

With respect to the AAC Performance Goal, representing 70% of Total Performance, the applicable rating shall be determined as follows: (i) 25% of Total Performance based on the Adjusted Net Asset Value and (ii) 45% of Total Performance based on WLACC Outstanding at the end of the Performance Period. Linear interpolation between payout multiples of Adjusted Net Asset Value and the WLACC Outstanding, as applicable, will result in a proportionate number of the Target Performance Units (and associated Dividend Equivalent Units) becoming Earned Performance Units (and Earned Dividend Equivalent Units).

All metrics noted in this table shall be neutral to the effects of changes to US GAAP.

All determinations as to whether the Performance Goals have been satisfied will be determined by the Committee in accordance with the provisions of the LTIP, including Section 3(f) thereof.

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(1) Upon the execution of a material transaction or acquisition by AFG, revised Cumulative EBITDA (the "Revised Cumulative EBITDA") metrics will be established by the Compensation Committee to incorporate performance goals (the "Revised Performance Metrics") for such material transaction or acquisition. Upon such event, a weighting of Original Cumulative EBITDA and Revised Cumulative EBITDA will occur as follows: (i) the performance of Original Cumulative EBITDA prior to such event shall be measured against the annual projections that derived the Original Cumulative EBITDA metrics up to, but not including, the effective date (the "Effective Date") of such Revised Performance Metrics, as determined by the Compensation Committee, with straight line recognition of the projected annual EBITDA for a partial calendar year, and (ii) the performance of the Revised Cumulative EBITDA will be measured against the Revised Performance Metrics from the Effective Date of such Revised Performance Metrics through the end of the Performance Period (and shall be inclusive of earnings on the remaining capital after a material transaction or acquisition). The projections noted in item (i) above would be equivalent to a target payout multiple of 1.00 (the "Original EBITDA target projections"). Maximum payout multiple of 2.00 would be equivalent to 1.75 times the Original EBITDA target projections and a payout multiple of 0.00 is a cumulative EBITDA of $0 million up to, but not including, the Effective Date. The results in items (i) and (ii) will be weighted as follows: (a) the number of days from the beginning of the Performance Period to but not including the Effective Date multiplied by the resulting payout multiple for (i), plus (b) number of days from and including the Effective Date through the end of the Performance Period multiplied by resulting payout multiple for (ii). The resulting final payout multiple will be weighted 30% of the Total Performance consistent with the AFG Percentage noted above.

Notwithstanding anything in this Exhibit A to the contrary, the number of Target Performance Units (and associated Dividend Equivalent Units) that become Earned Performance Units (and Earned Dividend Equivalent Units) based on the level of achievement of the metrics set forth in table above shall be adjusted, either upwards or downwards, based on AFG's RTSR Percentile Ranking for the Performance Period, in accordance with the table below, as determined by the Committee. For the avoidance of doubt, in no event shall the Participant earn more than 220% of the Target Performance Units after the RTSR modifier is applied.

RTSR Percentile Ranking	RTSR Modifier
75th percentile or above	110% of overall payout multiple
Between 25th and 75th percentile	100% of overall payout multiple
25th percentile or below	90% of overall payout multiple

For purposes of this Exhibit A, the following definitions shall apply:

AAC: Ambac Assurance Corporation.

Adjusted Net Asset Value: The value determined by reducing Assets by Liabilities, determined as of the last day of the Performance Period. Additionally, Adjusted Net Asset Value will:

- neutralize the effects of claim payments, loss expense payments, advisor payments and the establishment of loss and loss expense reserves for credits that do not have a GCL, as defined below, at the beginning of the Performance Period;
- measure AAC's foreign subsidiaries utilizing the foreign exchange rate at the beginning of the Performance Period;
- add back costs related to ongoing OCI oversight during Performance Period; and
- add back direct costs of risk remediation activities with respect to credits within WLACC.

AFG: Ambac Financial Group, Inc.

ART Transactions: Alternative Risk Transfer transactions executed by the Company that reduce/eliminate portfolio risk, including by way of proportional reinsurance (e.g. quota share) or other alternative hedging or risk transfer strategies (e.g. excess of loss reinsurance) the impact of which has been approved by the Committee for purposes of reducing WLACC Outstanding. For purposes of this definition, (i) the impact of an ART transaction whereby net par is not reduced but a portion of the risk related to a WLACC is defeased or reduced for some or all of the remaining life of the insured exposure shall count towards calculating the reduction in WLACC Outstanding and (ii) the measure of benefit for the risk retention metric for an ART Transaction will be calculated as follows (a) the net par balance of the portion of the WLACC exposure affected by the ART multiplied by (b) the quotient of the ART coverage period and the remaining expected life of the exposure. To the extent an ART transaction is executed that does not conform to the aforementioned example management will propose an alternative calculation to the Committee to measure the WLACC reduction.

Assets: The sum of the following relating to the Included Entities: cash, invested assets at fair value (except for Ambac-insured investments which will be measured at amortized cost and excluding the Secured Note issued in 2018 in connection with AAC's restructuring as it is included below in liabilities), loans, investment income due and accrued, net receivables (payables) for security sales (purchases), tax tolling payments or dividends made by AAC to AFG, cash, cash equivalents and securities pledged as collateral to counterparties and other receivables.

Included Entities: AAC and its subsidiaries, and may include any other entities that the Committee shall determine.

Liabilities: The sum of the following relating to the Included Entities: the present value of future probability weighted financial guarantee claims and CDS payments reduced by recoveries, including probability weighted estimated subrogation recoveries and reinsurance recoverables, using discount rates in accordance with GAAP ("GCL"), fair value of interest rate derivatives (prior to any AAC credit valuation adjustments), par value and accrued interest on all outstanding surplus notes of AAC (including junior surplus notes), par value and accrued interest on the Ambac Note and Tier 2 Notes issued in 2018 in connection with the Segregated Account rehabilitation exit transactions (net of par value and accrued interest on AAC's holdings of the Secured Note), the liquidation value of outstanding preferred stock and the GAAP carrying value of RMBS secured borrowings, if any. Liabilities will also include the par and accrued interest on any new debt obligations issued in the future.

Original Cumulative EBITDA: AFG's earnings before interest, taxes, depreciation, amortization, and non-controlling interests (as determined under current US GAAP) through the Performance Period. This includes all of AFG's subsidiaries excluding AAC and AAC's subsidiaries. Original Cumulative EBITDA shall be adjusted for the effects of:

- advisor and deal/transaction related costs related to AFG and AAC capital and/or M&A transactions above or below budgeted amounts[2];
- cost of post-employment guarantees;

(2) Revised Cumulative EBITDA from Revised Performance Metrics during the Performance Period will be recognized net of any excluded advisor and/or deal costs incurred during such period.

- cost and impact of AAC and AFG share repurchase (direct and synthetic)[3];
- changes to Board fees and Board imposed expenses;
- litigation and defense costs and any potential litigation gains in excess of damages incurred;
- (cost)/benefit of performance based compensation (above) or below target amounts; and
- any other costs as determined in the sole discretion of the Board.

Peer Group: The entities set forth on Exhibit B hereto. However, in the event that, prior to the end of the Performance Period, there occurs: (i) a merger, acquisition or business combination transaction of a Peer Group member with or by another Peer Group member, only the surviving entity shall remain a member of the Peer Group; (ii) a merger, acquisition or business combination of a Peer Group member with an entity that is not a Peer Group member, or the acquisition or business combination transaction by or with a Peer Group member, where such Peer Group member is the surviving entity and remains publicly traded, such Peer Group member shall remain a member of the Peer Group; (iii) a merger or acquisition or business combination transaction of a Peer Group member by or with an entity that is not a Peer Group member or a "going private" transaction involving a Peer Group member where such Peer Group member is not the surviving entity or is otherwise no longer publicly traded, such Peer Group member shall no longer be a member of the Peer Group; (iv) a stock distribution from a Peer Group member consisting of the shares of a new publicly traded company (a "spin-off"), such Peer Group member shall remain a member of the Peer Group, such distribution shall be treated as a dividend from such Peer Group member based on the closing price of the shares of the spun-off company on its first day of trading and the performance of the shares of the spun-off company shall not thereafter be tracked for purposes of calculating Total Shareholder Return; or (v) a bankruptcy or liquidation of a Peer Group member, such Peer Group member will remain a member of the Peer Group and the Total Shareholder Return of such Peer Group member shall equal -100%.

Relative Total Shareholder Return, or **RTSR**: The percentile rank of the Company's Total Shareholder Return as compared to the Total Shareholder Returns of all members of the Peer Group, ranked in descending order (including the Company), at the end of the Performance Period.

Revised Cumulative EBITDA: For all of AFG's subsidiaries (excluding AAC and AAC's subsidiaries), including any new subsidiary or affiliate resulting from the execution of a material transaction or acquisition by AFG, earnings before interest, taxes, depreciation, amortization, and non-controlling interests (as determined under current US GAAP) as of the Effective Date through the Performance Period that will be measured against Revised Performance Metrics as of the Effective Date.

Revised Performance Metrics: Revised Cumulative EBITDA metrics established as of the Effective Date by the AFG Board and Compensation Committee to incorporate performance goals for a material transaction or acquisition by AFG.

Total Shareholder Return: With respect to each of the Common Stock and the common stock of each of the members of the Peer Group, a rate of return reflecting stock price appreciation, plus the reinvestment of dividends in additional shares of stock, from the beginning of the Performance Period through the end of the Performance Period. For purposes of calculating Total Shareholder Return for each of AFG and the members of the Peer Group, (i) the beginning stock price will be based on the average of the twenty (20) trading days immediately prior to the first day of the Performance Period on the principal stock exchange on which the stock is then listed or admitted to trading and the ending stock price will be based on the average of the last twenty (20) trading days of the Performance Period on the principal stock exchange on which the stock is then listed or admitted to trading and (ii) reinvestment of dividends shall be assumed to be reinvested on the ex-dividend date using the closing stock price on the ex-dividend date.

WLACC Outstanding: The remaining net par outstanding, inclusive of the impact of any ART Transactions executed by the Company during the Performance Period, for watch list and adversely classified credits as identified at the beginning of the Performance Period ("WLACC") by AFG and its subsidiaries, including AAC and Ambac Assurance UK Limited ("Ambac UK"). For purposes of this award, WLACC amounts will exclude new credits added during the Performance Period[4], including credits added through reinsurance recaptures. Additionally, the WLACC net par outstanding at the beginning of performance period shall incorporate accreted par outstanding at the beginning of the performance period for the following three capital appreciation bond exposures:

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(3) Cost to be calculated based on (i) the amount of capital allocated to share repurchase multiplied by (ii) LIBOR + the average spread earned on AFG investments from the time of such allocation through the end of the Performance Period. For the avoidance of doubt, gains or losses from repurchases are also excluded from the Original Cumulative EBITDA and, to the extent applicable, the Revised Cumulative EDITDA calculation.

(4) Beginning WLACC Outstanding for this award will include the net par outstanding as of December 31, 2018 related to credits added to the watch list in January 2019.

- Single Risk ID: 239961 PHILADELPHIA PA GO
- Single Risk ID: 4224 NEW JERSEY TSP TRT FND-TRS SYS
- Single Risk ID: 813506 ALAMEDA CA CORRID TRAN ATH

Any reductions to WLACC net par outstanding for the above specified exposures will be based on the accreted par outstanding at the beginning of the Performance Period.

For non-U.S. exposures, the currency exchange rates to be used shall be those beginning on the first day of the Performance Period.

EXHIBIT B

PEER GROUP

Assured Guaranty Ltd. (AGO)
MBIA Inc. (MBI)
Syncora Holdings Ltd. (SYCRF)
MGIC Investment Corporation (MTG)
The Navigators Group, Inc. (NAVG)
Radian Group Inc. (RDN)
Mr. Cooper Group (COOP)
ECN Capital Corp. (TSX:ECN)
Element Fleet Management Corp. (TSX:EFN)
Navient Corporation (NAVI)
Enstar Group Limited (ESGR)

EXHIBIT 31.1

Ambac Financial Group, Inc.
Certifications

I, Claude LeBlanc, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ambac Financial Group, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a—15(e) and 15d—15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 8, 2019

By: /s/ Claude LeBlanc

Claude LeBlanc
President and Chief Executive Officer

EXHIBIT 31.2

Ambac Financial Group, Inc.
Certifications

I, David Trick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ambac Financial Group, Inc. (the"registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a—15(e) and 15d—15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 8, 2019

By: /s/ David Trick
David Trick
Chief Financial Officer and Treasurer

EXHIBIT 32

Certification of Chief Executive Officer and Chief Financial Officer
Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Ambac Financial Group, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Claude LeBlanc, Chief Executive Officer of the Company, and David Trick, Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of their knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Claude LeBlanc

Name: Claude LeBlanc
Title: President and Chief Executive Officer

By: /s/ David Trick

Name: David Trick
Title: Chief Financial Officer and Treasurer

Dated: August 8, 2019