AMBAC ASSURANCE CORPORATION

Statutory Financial Statements and Schedules

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Independent Auditors' Report

The Audit & Risk Assessment Committee of the Board of Directors
Ambac Assurance Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of Ambac Assurance Corporation, which comprise the statutory statements of admitted assets, liabilities, and capital and surplus as of December 31, 2016 and 2015, and the related statutory statements of operations, changes in capital and surplus, and cash flow for the years then ended, and the related notes to the statutory financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance for the State of Wisconsin. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in note 2 to the financial statements, the financial statements are prepared by Ambac Assurance Corporation using statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance for the State of Wisconsin, which is a basis of accounting other than U.S. generally accepted accounting principles. Accordingly, the financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.

The effects on the financial statements of the variances between the statutory accounting practices described in note 2 and U.S. generally accepted accounting principles, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the variances between statutory accounting practices and U.S. generally accepted accounting principles discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of Ambac Assurance Corporation as of December 31, 2016 and 2015, or the results of its operations or its cash flow for the years then ended.

Opinion on Statutory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of Ambac Assurance Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flow for the years then ended, in accordance with statutory accounting practices prescribed or permitted by the Office of the Commissioner of Insurance for the State of Wisconsin.

Emphasis of Matter

The accompanying statutory financial statements have been prepared assuming that Ambac Assurance Corporation will continue as a going concern. As discussed in note 1 to the financial statements, the significant deterioration of the guaranteed portfolio has adversely impacted the business, resulting in significant regulatory oversight by the Office of the Commissioner of Insurance for the State of Wisconsin, including the rehabilitation of a segregated account of Ambac Assurance Corporation. This raises substantial doubt about Ambac Assurance Corporation's ability to continue as a going concern. Management’s plans in regard to these matters is also described in note 1. The statutory financial statements and financial statement schedules do not include any adjustments that might result from the outcome of this uncertainty.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information included in the supplemental schedules of reinsurance interrogatories, investment risk interrogatories and investments are presented for purposes of additional analysis and are not a required part of the financial statements but is supplementary information required by the Office of the Commissioner of Insurance for the State of Wisconsin. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

May 30, 2017

AMBAC ASSURANCE CORPORATION

Statutory Statements of Admitted Assets, Liabilities and Capital and Surplus

December 31, 2016 and 2015
(Dollar amounts in thousands)

Admitted Assets	2016	2015
Cash and invested assets:		
Bonds	$ 2,376,707	$ 2,554,878
Common stocks	227,695	222,921
Short-term investments	306,180	133,023
Cash and cash equivalents	41,771	5,836
Investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account	2,317,422	1,807,302
Inter-company loans with affiliates, net of allowance	6,876	8,088
Other invested assets	136,773	7,420
Receivable for securities	1,176	43,881
Total cash and invested assets	5,414,600	4,783,349
Investment income due and accrued	22,631	24,285
Premium receivable balances	1,998	2,244
Receivable from parent, subsidiaries and affiliates	3,217	3,589
Assets of Ambac Assurance Corporation Segregated Account	8,196	10,966
Total admitted assets	$ 5,450,642	$ 4,824,433
Liabilities and Capital and Surplus		
Liabilities:		
Unearned premiums	$ 488,442	$ 647,840
Loss and loss expenses	2,440,760	1,870,840
Borrowed money and interest thereon	103,308	132,837
Surplus notes classified as debt	874,749	893,300
Mandatory contingency reserve	391,802	390,881
Estimated impairment losses on guarantees of subsidiary liabilities	25,000	—
Taxes, licenses and fees (excluding federal and foreign income taxes)	2,987	5,166
Current income taxes	28,256	75,635
Accounts payable and other liabilities	45,353	33,845
Deferred gain on investment transactions with subsidiaries	31,752	31,913
Ceded reinsurance premiums payable	673	873
Reinsurance payables on loss subrogation received	346	57
Payable to parent, subsidiaries and affiliates	805	548
Payable for securities	25	76,246
Liabilities allocated to Ambac Assurance Corporation Segregated Account	(4,568,933)	(4,615,637)
Liabilities assumed from Ambac Assurance Corporation Segregated Account	4,981,931	5,031,961
Liabilities of Ambac Assurance Corporation Segregated Account	(373,091)	(376,667)
Total liabilities	4,474,165	4,199,638
Capital and surplus:		
Common stock	82,000	82,000
Preferred stock	26,411	26,411
Additional paid-in capital	3,550,774	3,547,445
Unassigned surplus	(2,682,708)	(3,031,061)
Total capital and surplus	976,477	624,795
Total liabilities and capital and surplus	$ 5,450,642	$ 4,824,433

See accompanying Notes to Statutory Financial Statements.

AMBAC ASSURANCE CORPORATION

Statutory Statements of Operations

Years Ended December 31, 2016 and 2015
(Dollar amounts in thousands)

	2016	2015
Revenues:		
Net premiums earned	$ 204,604	$ 307,920
Net investment income	273,254	263,317
Net realized gains (net of tax of $0 and $0)	41,469	93,326
Change in net liabilities allocated to (assumed from) Segregated Account	5,702	(149,465)
Other loss	(3,075)	(18,012)
Total revenues	521,954	497,086
Expenses:		
Loss and loss expenses (benefit)	2,351	(491,882)
Other underwriting expenses incurred	93,233	79,706
Change in provision for uncollectible loan with affiliates	36,353	51,581
Total expenses	131,937	(360,595)
Net income before income taxes	390,017	857,681
Income taxes incurred	30,965	85,399
Net income	$ 359,052	$ 772,282

See accompanying Notes to Statutory Financial Statements.

AMBAC ASSURANCE CORPORATION

Statutory Statements of Changes in Capital and Surplus

Years Ended December 31, 2016 and 2015
(Dollar amounts in thousands)

	Common stock	Preferred stock	Additional paid-in capital	Unassigned surplus	Total
Balance at December 31, 2014	$ 82,000	$ 26,411	$ 3,546,554	$ (3,554,965)	$ 100,000
Net income	—	—	—	772,282	772,282
Net unrealized capital gains	—	—	—	125,487	125,487
Net unrealized foreign exchange capital losses	—	—	—	(38,147)	(38,147)
Change in nonadmitted assets	—	—	—	(148,980)	(148,980)
Change in provision for mandatory contingency reserve	—	—	—	(222,528)	(222,528)
Change in surplus of Ambac Assurance Corporation Segregated Account	—	—	—	36,477	36,477
Stock-based compensation	—	—	891	—	891
Changes to post-retirement benefits	—	—	—	(687)	(687)
Balance at December 31, 2015	82,000	26,411	3,547,445	(3,031,061)	624,795
Net income	—	—	—	359,052	359,052
Net unrealized capital gains	—	—	—	120,563	120,563
Net unrealized foreign exchange capital losses	—	—	—	(103,212)	(103,212)
Change in nonadmitted assets	—	—	—	57,311	57,311
Change in provision for mandatory contingency reserve	—	—	—	(921)	(921)
Change in surplus of Ambac Assurance Corporation Segregated Account	—	—	—	(84,464)	(84,464)
Stock-based compensation	—	—	3,329	—	3,329
Changes to post-retirement benefits	—	—	—	24	24
Balance at December 31, 2016	$ 82,000	$ 26,411	$ 3,550,774	$ (2,682,708)	$ 976,477

See accompanying Notes to Statutory Financial Statements.

AMBAC ASSURANCE CORPORATION

Statutory Statements of Cash Flow

Years Ended December 31, 2016 and 2015
(Dollar amounts in thousands)

	2016	2015
Cash from operations:		
Premiums collected, net of reinsurance	$ 45,516	$ 53,444
Net investment income	120,317	118,527
Losses recovered, net of reinsurance	1,301,292	296,189
Payments under excess of loss reinsurance agreement with Ambac Assurance Segregated Account	(290,581)	(344,074)
Loss adjustment and operating expenses paid	(124,668)	(128,244)
Federal taxes (paid) received from affiliates, net of tax settlements paid to parent	(78,343)	(11,768)
Other	(2,076)	(18,012)
Net cash provided by (used in) operations	971,457	(33,938)
Cash from investments:		
Proceeds from investments sold, matured or repaid:		
Bonds, including Ambac Assurance insured securities	1,657,580	1,524,479
Intercompany loans with affiliates	183,771	155,390
Other invested assets	50,431	49,443
Total investment proceeds	1,891,782	1,729,312
Cost of investments acquired:		
Bonds, including Ambac Assurance insured securities	2,204,934	1,771,734
Intercompany loans with affiliates	218,912	215,059
Other invested assets	180,611	2,000
Total investments acquired	2,604,457	1,988,793
Net cash used in investments	(712,675)	(259,481)
Cash from financing and miscellaneous sources:		
Borrowed funds, net	(29,482)	132,467
Surplus notes	(19,550)	—
Net transfers from (to) affiliates	629	(1,264)
Other cash (used) provided	(1,287)	4,775
Net cash (used in) provided by financing and miscellaneous sources	(49,690)	135,978
Net change in cash, cash equivalents and short-term investments	209,092	(157,441)
Cash, cash equivalents and short-term investments, beginning of year	138,859	296,300
Cash, cash equivalents and short-term investments, end of year	$ 347,951	$ 138,859

AMBAC ASSURANCE CORPORATION

Statutory Statements of Cash Flow

Years Ended December 31, 2016 and 2015
(Dollar amounts in thousands)

	2016	2015
Supplemental disclosure of significant non-cash operating activities:		
Settlement of loss related expenses pursuant to the Reinsurance Agreement	$ 28,635	$ 129,860
Settlement of operating expenses pursuant to the Cooperation Agreement	13,175	17,996
Supplemental disclosure of significant non-cash investing activities:		
Cancellation of Ambac-insured bonds, previously purchased	394,763	—
Capital contribution of subsidiary to Phoenix Holdings Fund LLC	4,000	—

See accompanying Notes to Statutory Financial Statements.

(1) Background

Ambac Assurance Corporation (the Company or Ambac Assurance) is a subsidiary of Ambac Financial Group, Inc. (Ambac), a publicly traded financial services holding company that holds 100% of the common stock of the Company. On May 1, 2013 (the Effective Date), the Second Modified Fifth Amended Plan of Reorganization of Ambac (the Reorganization Plan) became effective and Ambac emerged from bankruptcy. Pursuant to the Reorganization Plan, Ambac issued common stock and warrants that are listed on the NASDAQ Global Select Market under the symbols "AMBC" and "AMBCW", respectively.

Ambac Assurance provides financial guarantee insurance for public and structured finance obligations solely through the insurance operations of Ambac Assurance and its wholly owned subsidiaries, Ambac Assurance UK Limited (Ambac UK) and Everspan Financial Guarantee Corp. (Everspan). Insurance policies insured by these entities guarantee payment when due of the principal and interest on the obligation guaranteed. The deterioration of Ambac Assurance's financial condition resulting from losses in its insured portfolio since 2007 has prevented Ambac Assurance from being able to write new business. An inability to write new business has and will continue to negatively impact Ambac's future operations and financial results.

On March 24, 2010, Ambac Assurance established a segregated account pursuant to Wis. Stat. Section 611.24(2) (the Segregated Account). The State of Wisconsin Office of the Commissioner of Insurance (OCI (which term shall be understood to refer to such office as regulator of Ambac Assurance and to refer as well to the Commissioner of Insurance for the State of Wisconsin as rehabilitator of the Segregated Account (the Rehabilitator), as the context requires)) commenced rehabilitation proceedings in the Dane County, Wisconsin Circuit Court (the Rehabilitation Court) with respect to the Segregated Account (the Segregated Account Rehabilitation Proceedings) in order to permit OCI to facilitate an orderly run-off and/or settlement of the liabilities allocated to the Segregated Account pursuant to the provisions of the Wisconsin Insurers Rehabilitation and Liquidation Act. Under Wisconsin insurance law, the Segregated Account is a separate insurer from Ambac Assurance for purposes of the Segregated Account Rehabilitation Proceedings. The purpose of the Segregated Account is to segregate certain liabilities of Ambac Assurance. The Rehabilitator is Theodore Nickel, the Commissioner of Insurance of the State of Wisconsin.

Ambac Assurance's principal business objective consists of actively managing its assets and liabilities with a focus on transaction terminations, policy commutations, settlements and restructurings that we believe will improve the Company risk profile (de-risking), and maximizing the risk-adjusted return on invested assets. The execution of these strategies is subject to the authority of the Rehabilitator to control the management of the Segregated Account. In exercising such authority, the Rehabilitator will act for the benefit of policyholders, and will not take into account the interests of Ambac. Similarly, by operation of the contracts executed in connection with the establishment, and subsequent rehabilitation, of the Segregated Account, the Rehabilitator retains rights to oversee and approve certain actions taken by or in respect of Ambac Assurance. Opportunities for remediating losses on poorly performing insured transactions also depend on market conditions, including the perception of Ambac Assurance's creditworthiness, the structure of the underlying risk and associated policy, as well as other counterparty specific factors. Oversight by the Rehabilitator could impair Ambac Assurance'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.

The Company owns 100% of the common stock of Ambac UK; Connie Lee Holdings, Inc. (CLHI), a financial guarantee holding company that directly owns Everspan; Ambac Japan Co. Ltd., a Japan service company; and Ambac Capital Corporation (ACC), a provider of investment agreements.

The Company is the sole member of the following limited liability corporations: Ambac Financial Services, LLC (AFS), an entity that provides interest rate swaps, Ortley Investments, LLC, an entity which can hold investment securities, and Phoenix Holdings Fund LLC, an entity that invests in residential real estate properties.

Ambac Assurance's ownership interests in additional subsidiaries were allocated to the Segregated Account in conjunction with the Segregated Account Rehabilitation Proceedings.

Ambac

Pursuant to the Mediation Agreement, dated September 21, 2011 (the Mediation Agreement) among Ambac, the statutory committee of creditors appointed by the United States Trustee on November 17, 2010 (the Creditors' Committee), Ambac Assurance, the Segregated Account, the Rehabilitator, and the OCI, the terms of which formed an integral part of the Reorganization Plan, Ambac Assurance transferred $30,000 (plus accrued interest) from an escrow account to Ambac on the Effective Date. Additionally, the Segregated Account issued a junior surplus note in the amount of $350,000 (the Junior Surplus Note) to Ambac on the Effective Date in accordance with the Mediation Agreement. No payment of interest on or principal of a Segregated Account junior surplus note may be made until all existing and future indebtedness of the Segregated Account, including Segregated Account surplus notes, policy claims and claims having statutory priority, and all surplus notes, contribution notes or similar obligations of Ambac Assurance, have been paid in full. All payments of principal and interest on Segregated Account junior surplus notes are subject to the prior approval of the OCI. If the OCI does not approve the payment of interest on the Segregated Account junior surplus notes, such interest will accrue and compound annually until paid. On August 28, 2014, Ambac deposited the Junior Surplus Note plus accrued but unpaid interest thereon, into a newly formed trust (the Trust) in exchange for cash of $224,262 and a subordinated owner trust certificate (the Owner Trust Certificate) issued by the Trust in the face amount of $74,794. The Trust funded the cash portion of its purchase of the Junior Surplus Note with proceeds of a private placement of $299,175 face amount of notes to third party investors (the Notes), which amount equates to approximately 80% of par plus accrued and unpaid interest on the Junior Surplus Note. The Notes have a final maturity of August 28, 2039. Interest on the Notes will accrue at 5.1% per annum and compound annually on June 7th of each year up to and including the maturity date. Payments on the Notes will be made when and to the extent that the Segregated Account makes payments on the Junior Surplus Note. The Notes must be paid in full before any payments will be made on the Owner Trust Certificate. The Notes and Owner Trust Certificate are non-recourse to Ambac, Ambac Assurance and the Segregated Account, but are collateralized by the Junior Surplus Note.

Also pursuant to the Mediation Agreement, (i) Ambac, Ambac Assurance and certain affiliates entered into an amended tax sharing agreement (the Amended TSA), (ii) Ambac, Ambac Assurance and certain affiliates entered into an expense sharing and cost allocation agreement (the Cost Allocation Agreement) and (iii) Ambac, Ambac Assurance, the Segregated Account and OCI entered into an amendment (the Cooperation Agreement Amendment) of the Cooperation Agreement which was entered into March 2010 by the Company and the Segregated Account (as amended, the Cooperation Agreement).

Segregated Account

The Segregated Account is operated in accordance with a plan of operation (the Plan of Operation) and certain operative documents relating thereto (which include the Secured Note, the Reinsurance Agreement, the Management Services Agreement and the Cooperation Agreement, as defined below). These operative documents provide that the Segregated Account will act exclusively through the Rehabilitator.

Pursuant to the Plan of Operation, Ambac Assurance allocated to the Segregated Account (1) certain policies insuring or relating to credit default swaps; (2) residential mortgage-backed securities (RMBS) policies; (3) certain policies insuring debt obligations backed by student loans; and (4) other policies insuring obligations with substantial projected impairments or relating to transactions which have contractual triggers based upon Ambac Assurance's financial condition or the commencement of rehabilitation, which triggers are potentially damaging (collectively, the Segregated Account Policies). The policies described in (4) above include (a) certain types of securitizations, including commercial asset-backed transactions, consumer asset-backed transactions and other types of structured transactions; (b) the policies relating to Las Vegas Monorail Company; (c) policies relating to debt securities purchased by, and the debt securities issued by, Juneau Investments, LLC (Juneau), which is a finance company owned by Ambac Assurance and allocated to the Segregated Account; (d) policies relating to leveraged lease transactions; and (e) certain policies relating to interest rate, basis, and/or currency swap or other swap transactions. Ambac Assurance also allocated the following to the Segregated Account: (i) all remediation claims, defenses, offsets, and/or credits (except with respect to recoveries arising from remediation efforts or reimbursement or collection rights), if any, in respect of the Segregated Account Policies, (ii) Ambac Assurance's limited liability interests in Ambac Credit Products, LLC (ACP), Ambac Conduit Funding LLC and Juneau and (iii) all of Ambac Assurance's liabilities as reinsurer under reinsurance agreements (except for reinsurance assumed from Everspan). At December 31, 2016 and 2015, insurance liabilities for policies allocated to the Segregated Account were $4,568,933 and $4,615,637, respectively. Net par exposure as of December 31, 2016 and 2015 for policies allocated to the Segregated Account were $11,884,751 and $15,361,202, respectively.

Policy obligations not allocated to the Segregated Account remain in the General Account of Ambac Assurance, and such policies in the General Account are not subject to and, therefore, will not be directly impacted by the Segregated Account Rehabilitation Plan (as defined below).

In 2010, Ambac Assurance issued a $2,000,000 secured note due in 2050 (the Secured Note) to the Segregated Account. Interest on the Secured Note accrued at the rate of 4.5% per annum, and accrued interest was added to principal quarterly. The Segregated Account had the ability to demand payment from time to time under the Secured Note to pay claims and other obligations. On May 20, 2014, the Secured Note was fully drawn. Following the exhaustion of the Secured Note, the Segregated Account has the ability to demand payment from time to time under an aggregate excess of loss reinsurance agreement provided by Ambac Assurance (the Reinsurance Agreement) to pay claims and other liabilities. In addition, certain operating expenses of the Segregated Account are now reimbursable by Ambac Assurance pursuant to the Cooperation Agreement. In the event that Ambac Assurance does not maintain surplus in excess of $100,000 (the Minimum Surplus Amount), the Segregated Account would experience a shortfall in funds available to pay its obligations. Ambac Assurance secured its obligations under the Reinsurance Agreement by granting to the Segregated Account a security interest in all of Ambac Assurance's right, title and interest in (i) installment premiums received in respect of the Segregated

Account Policies; (ii) reinsurance premiums received in respect of assumed reinsurance agreements with respect to which the liabilities of Ambac Assurance have been allocated to the Segregated Account; (iii) recoveries under third party reinsurance agreements in respect of the Segregated Account Policies; and (iv) any recoveries arising from remediation efforts or reimbursement or collection rights with respect to policies allocated to the Segregated Account.

During the Segregated Account Rehabilitation Proceedings, the Rehabilitator controls the management of the Segregated Account and possesses ultimate decision-making authority with respect to all matters relating to the policies allocated to the Segregated Account. Ambac Assurance provides certain management and administrative services to the Segregated Account and the Rehabilitator pursuant to a management services agreement (the Management Services Agreement), including information technology services, credit exposure management, treasury, accounting, tax, management information, risk management, loss management, internal audit services and business continuity services. Services are provided at cost, subject to mutual agreement of the Segregated Account and Ambac Assurance. Either party may terminate the Management Services Agreement for cause upon 120 days written notice (or such shorter period as the Rehabilitator may determine) and the Segregated Account may terminate without cause at any time upon at least 30 days prior notice. If the Segregated Account elects to terminate the Management Services Agreement, Ambac Assurance will not have the right to consent to the replacement services provider.

Pursuant to the Reinsurance Agreement, Ambac Assurance has made certain covenants to the Segregated Account, including covenants that Ambac Assurance will not, (i) without the Segregated Account's consent (not to be unreasonably withheld), amend its investment policies if doing so would have a material adverse effect on Ambac Assurance's ability to perform its obligations under the Reinsurance Agreement and the documents relating thereto or under any other material agreement to which it is a party, (ii) without the prior approval of the OCI, directly or indirectly make any distribution to its shareholder or redeem any of its securities and, (iii) without the Segregated Account's consent (not to be unreasonably withheld), enter into any transaction other than pursuant to the reasonable requirements of Ambac Assurance's business and which Ambac Assurance reasonably believes are fair and reasonable terms and provisions.

Pursuant to the Cooperation Agreement, Ambac Assurance and the Segregated Account have agreed to certain matters related to decision-making, information sharing, tax compliance and allocation of expenses, including an agreement by Ambac Assurance to reimburse the Segregated Account for specified expenses, subject to the Minimum Surplus Amount. Ambac Assurance has made certain covenants to the Segregated Account pursuant to the Cooperation Agreement, including an agreement to not enter into any transaction involving consideration or other proceeds of more than $5,000 (or such higher amount as determined by the Rehabilitator) without the Segregated Account's prior written consent (other than policy claim payments made in the ordinary course of business and investments in accordance with Ambac Assurance's investment policy), and providing the Segregated Account with an annual operating expense budget for Ambac Assurance and its subsidiaries, as well as quarterly analyses of variances. The Cooperation Agreement also addresses Ambac Assurance's rights in the event Ambac Assurance is no longer the management and administrative services provider to the Segregated Account as described above. The Cooperation Agreement Amendment made each of the Company and the Rehabilitator a party to the Cooperation Agreement and provides the Rehabilitator with certain additional approval rights with respect to (a) the tax positions taken by Ambac in its consolidated tax return; (b) the acceptance by Ambac Assurance of the repayment of intercompany loans or the modification of the terms thereof; (c) changes by Ambac Assurance in the assumptions or vendors utilized in determining loss reserves determined in accordance with Statutory Accounting Principles; and (d) changes to Ambac Assurance's investment policy and transfer of the investment management function for Ambac Assurance's investment portfolio.

On October 8, 2010, the Rehabilitator filed a plan of rehabilitation for the Segregated Account (the Segregated Account Rehabilitation Plan) in the Rehabilitation Court. The Rehabilitation Court confirmed the Segregated Account Rehabilitation Plan on January 24, 2011, although it did not become effective at such time. The confirmed Segregated Account Rehabilitation Plan also made permanent the injunctions issued by the Rehabilitation Court on March 24, 2010. On June 4, 2012, the Rehabilitation Court approved a motion made by the Rehabilitator to make partial interim policy claim payments to Segregated Account policyholders. In accordance with such approval, on August 1, 2012, the Rehabilitator promulgated Rules Governing the Submission, Processing and Partial Payment of Policy Claims in accordance with the June 4, 2012 Interim Cash Payment Order (the Policy Claim Rules). Pursuant to the Policy Claim Rules, effective from August 1, 2012, holders of policies allocated to the Segregated Account were allowed to submit policy claims for review and partial payment equating to 25% of the permitted policy claim amount, and on or about September 20, 2012, the Segregated Account commenced paying 25% of each permitted policy claim that arose since the commencement of the Segregated Account Rehabilitation Proceedings.

On July 11, 2013, the Rehabilitator filed a motion with Rehabilitation Court seeking approval from the Rehabilitation Court to make cash payments in excess of 25% of the permitted policy claim amount (the Supplemental Payments) with respect to certain policies (the SP Policies) so that cash flow in the related securitization trusts that would have been available to reimburse Ambac Assurance had it paid claims in full under such policies is not diverted to uninsured holders who would not have received such cash flow if claims had been paid in full. Without making such Supplemental Payments, Ambac Assurance would likely realize lower levels of reimbursements and subrogation recoveries as cash flow that would have been available for the benefit of Ambac Assurance in relation to the SP Policies would be lost to such uninsured holders. A hearing on such motion was held on August 2, 2013, following which the Rehabilitation Court granted such motion and entered an order permitting Supplemental Payments to be made with respect to the SP Policies. As a result, the Segregated Account has been making Supplemental Payments on SP Policies since August 2013. On February 13, 2014, the Rehabilitator also received approval from the Rehabilitation Court for the Rehabilitator and the Segregated Account to disburse settlement proceeds from RMBS remediation claims as permitted policy claim payments, with such distributions to include (i) paying claim payments in excess of the then applicable claims cash payment percentage, and/or (ii) paying all or portions of unpaid permitted policy claims (such policy claim payments, Special Policy Payments).

On June 11, 2014, the Rehabilitation Court approved amendments to the Segregated Account Rehabilitation Plan that had been proposed by the Rehabilitator, and the Segregated Account Rehabilitation Plan, as amended, became effective on June 12, 2014. The amendments to the Segregated Account Rehabilitation Plan primarily modified the mechanism for handling claims. Instead of the combination of cash payments and interest-bearing surplus notes originally contemplated by the Segregated Account Rehabilitation Plan, under the amended Segregated Account Rehabilitation Plan, holders of permitted policy claims have received and will receive an initial interim cash payment for a portion of such policy claim (the Interim Payment), together with the right to receive a deferred payment equal to the balance of the unpaid policy claim, as may be adjusted from time to time pursuant to the terms of the amended Segregated Account Rehabilitation Plan (the Deferred Amount). Payments of Deferred Amounts will be made at such times as the Rehabilitator deems appropriate in his sole discretion. The Segregated Account will also establish junior deferred amounts (the Junior Deferred Amounts) with respect to permitted general claims instead of issuing junior surplus notes to the holders of such claims as contemplated under the original Segregated Account Rehabilitation Plan.

Under the amended Segregated Account Rehabilitation Plan, Deferred Amounts and Junior Deferred Amounts generally accrue and compound interest at an annual effective rate of 5.1%. However, in the case of insured bonds whose outstanding principal balance is not reduced by the unpaid portion of permitted policy claims (such bonds, Undercollateralized Bonds), the 5.1% effective annual interest rate on the Deferred Amount will be reduced by the bond interest rate applicable to such Undercollateralized Bonds. In the case of permitted policy claims relating to transactions that pay monthly, interest will begin to accrue on Deferred Amounts from the first distribution date (under the transaction documents for the relevant bond) after the date on which the Interim Payment in respect of such permitted policy claim was made. For permitted policy claims relating to transactions that do not pay monthly, interest will begin to accrue on Deferred Amounts from the first Payment Date (as defined in the Segregated Account Rehabilitation Plan, as amended) to occur after the date on which the Interim Payment in respect of such permitted policy claim was made. If approved by the Rehabilitator, payment of Deferred Amounts, together with interest thereon, will trigger proportionate redemption payments with respect to surplus notes (other than junior surplus notes). Permitted policy claims, including payments of Deferred Amounts and interest thereon, or increases to the percentage of Interim Payments as required by the Rehabilitator will be material uses of future liquidity.

Following the effective date of the Segregated Account Rehabilitation Plan, as amended, the percentage of the initial cash Interim Payment for permitted policy claims increased from 25% to 45% with effect from July 21, 2014. As with previously permitted policy claims, the remaining portion of the unpaid permitted policy claims (in this case, 55%) will remain outstanding as Deferred Amounts and, subject to the adjustment for Undercollateralized Bonds, will accrue interest at 5.1% per annum. These Deferred Amounts, together with interest thereon, may be paid from time to time in the future at the sole discretion of the Rehabilitator. As further described in Note 8. Commitments and Contingencies, on February 10, 2016, certain investors filed a motion in the Rehabilitation Court requesting an order directing the Rehabilitator to show cause why the Interim Payment percentage should not be substantially increased. The motion was denied.

A portion of Deferred Amounts outstanding as of July 20, 2014 (the Reconciliation Date) (together with interest thereon), if still outstanding, was paid on December 22, 2014 (the Deferred Payment Date) in accordance with the Segregated Account Rehabilitation Plan, as amended, such that those policyholders that received 25% (and not 45%) cash Interim Payments in respect of their permitted policy claims were generally entitled to receive equalizing payments in cash of 26.67% of their Deferred Amounts (including accrued interest thereon) outstanding as of the Reconciliation Date. Policyholders were entitled to receive an equalizing payment of their Deferred Amounts equal to the lower of (i) their outstanding Deferred Amounts on December 22, 2014, and (ii) 26.67% of their Deferred Amounts as of the Reconciliation Date, even if they had received a Supplemental Payment and/or a Special Policy Payment. The aggregate amount of equalizing payments for Deferred Amounts (including interest thereon) paid on the Deferred Payment Date was $1,137,202.

In addition, the Segregated Account was required, pursuant to the terms of the amended Segregated Account Rehabilitation Plan, to early redeem a portion of its surplus notes (excluding junior surplus notes) on or about the Deferred Payment Date. The redemption amount of the Segregated Account surplus notes was equal to 26.67% of the sum of par and accrued interest on such Segregated Account surplus notes, in each case, outstanding as at the Reconciliation Date. Pursuant to the terms of the Settlement Agreement, Ambac Assurance is also required to make a proportionate redemption of its surplus notes when the Segregated Account redeems Segregated Account surplus notes (excluding junior surplus notes). Therefore, the Segregated Account and Ambac Assurance were both required to make redemptions of the surplus notes (excluding junior surplus notes) on or about the Deferred Payment Date in an amount equal to 26.67% of the sum of par and accrued interest outstanding on such surplus notes as at the Reconciliation Date, which were $17,220 and $396,367 for the Segregated Account and Ambac Assurance surplus notes, respectively, owned by the third parties. Ambac Assurance, for and on behalf of itself and as the management services provider for the Segregated Account, sought and received the approval of OCI to effect these redemptions of surplus notes on November 20, 2014, rather than the Deferred Payment Date, to save interest expense. Such approval was granted on October 13, 2014.

Ambac Assurance is evaluating the possibility of entering into, and may seek to enter into, one or more transactions to improve the financial condition of Ambac Assurance which may, subject to OCI approval, lead to the conclusion of the Segregated Account Rehabilitation Proceedings. In pursuing this objective, Ambac Assurance may seek to monetize certain assets, restructure, purchase, modify or exchange certain outstanding obligations, extinguish or modify certain contractual restrictions, and/or commute or reduce insured exposures, and is also discussing with OCI potential options for addressing outstanding Segregated Account and other obligations. Separately from or in connection with any such transaction Ambac Assurance may seek to further optimize its capital and corporate structure to unlock shareholder value.

While the terms, conditions, and timing of a potential conclusion of the Segregated Account Rehabilitation Proceedings are in the sole discretion of the OCI, and subject to the approval of the Rehabilitation Court, Ambac Assurance has discussed, and is currently engaged in discussing, with counterparty creditors and OCI a potential transaction pursuant to which outstanding Deferred Amounts and surplus notes, in each case including accrued interest, would be exchanged for or satisfied with cash, securities, or other instruments, assets or means. No assurance can be given that an agreement with respect to any such potential transaction will be reached or consummated.

On July, 12, 2016, the Special Deputy Commissioner (SDC) for the Segregated Account met with policy beneficiaries and holders of surplus notes of Ambac Assurance and the Segregated Account during which the SDC stated (i) that at present, the Rehabilitator does not have any plans to increase the Interim Payment percentage on Segregated Account policy claims, commenting that the Rehabilitator and his advisors would need to feel highly confident that any change to the Interim Payment percentage would be sustainable and fair to all policyholders; (ii) that the Rehabilitator reserves the right to amend the Segregated Account Rehabilitation Plan or take such other action as he deems necessary or appropriate to adjust the rate of accretion on Deferred Amounts from time to time based on such factors as he considers relevant and, as such, the accretion rate remains under review; and (iii) his objective of seeking an exit of the Segregated Account from rehabilitation, and further stated that although his preferred goal would be to achieve an exit from rehabilitation through a consensual plan, he would advise the Rehabilitator to use all tools available to accomplish a successful and durable conclusion that enhances Ambac Assurance's long-term claims-paying ability.

On December 16, 2016, the Rehabilitator filed with the Rehabilitation Court a supplement to his 2016 Annual Report dated June 1, 2016 relating to the Segregated Account Rehabilitation Proceedings (the Supplement). In the Supplement, the Rehabilitator reiterated his goal of achieving a successful and durable conclusion to the Segregated Account Rehabilitation Proceedings. The Rehabilitator also stated in the Supplement that at the present time and absent further actions, Ambac Assurance has insufficient capital to demonstrate to the satisfaction of the Rehabilitator that the Segregated Account Rehabilitation Proceedings could be concluded and leave Ambac Assurance with sufficient financial resources to meet all policy obligations, as projected by the Rehabilitator (in his sole discretion) under a varying range of base and stress case scenarios. The Rehabilitator further stated in the Supplement that given such requirements, any transaction facilitating the conclusion of the Segregated Account Rehabilitation Proceedings will need to provide for an increase in Ambac Assurance's existing surplus capital, as determined and defined by OCI in its sole discretion. We cannot provide assurance that the terms of any possible transaction will satisfy OCI or the Rehabilitator that Ambac Assurance has, or will have, sufficient capital to meet all policy obligations after the conclusion of the Segregated Account Rehabilitation Proceedings.

On April 10, 2017, the Rehabilitator issued a statement indicating that the SDC has engaged in discussions with Ambac Assurance, policy beneficiaries, and other stakeholders to advance the goal of achieving a durable exit from Rehabilitation by the Segregated Account and, as a result, the SDC has recommended to the Rehabilitator that Ambac Assurance be allowed to further engage with stakeholders in an effort to reach a comprehensive consensual agreement for a durable plan of exit from Rehabilitation by the Segregated Account. According to the statement, the Rehabilitator agreed with such recommendation recognizing that any such plan is subject to further review and that it will need to be approved by the Rehabilitator as well as the Rehabilitation Court. In his April 10th statement, the Rehabilitator also indicated that if a consensual plan acceptable to the Rehabilitator is not developed within the next sixty days from that time, the Rehabilitator may pursue a plan that he believes will provide for a durable exit and that is protective of policyholders. OCI has not specified a course of action to address Segregated Account or other obligations or to conclude the Segregated Account Rehabilitation Proceedings.

The Rehabilitator further indicated in the April 10, 2017 statement that he and the SDC are supportive of Ambac Assurance's efforts to continue, over sixty days from that time, to work diligently to reach an agreement for a durable plan which will enable the Segregated Account to exit from Rehabilitation. The SDC is continuing to monitor this process closely and the Rehabilitator reserves the right to take all actions allowed or required under applicable law with respect to the Segregated Account, including the pursuit of the Rehabilitator's own aforementioned exit plan.

Ambac Assurance has not reached any agreement on the terms of a potential transaction, and we cannot provide assurance that any such transaction will be entered into by Ambac Assurance within the timeframe allowed by OCI, or if it is, as to the ultimate timing, terms or conditions of any such transaction, or as to whether it could lead to the conclusion of the Segregated Account Rehabilitation Proceedings. Any such transaction would remain subject to the prior approval of the board of Ambac Assurance, OCI and the Rehabilitation Court and may require third party consents, which may not be obtained. OCI retains the authority, subject to the approval of the Rehabilitation Court, to address Segregated Account obligations without the agreement of Ambac Assurance or its board of directors. Moreover, even if the Segregated Account Rehabilitation Proceedings could be brought to a successful conclusion, there can be no assurance that any level of capital deemed sufficient by OCI to permit such conclusion will be sufficient to cover all future losses, whether currently anticipated or unanticipated.

The execution of Ambac's strategy to increase the value of its investment in Ambac Assurance is subject to the authority of the Rehabilitator to control the management of the Segregated Account. In exercising such authority, the Rehabilitator will act for the benefit of policyholders, and will not take into account the interests of Ambac. The Rehabilitator's authority includes, but is not limited to, sole discretion over the rate at which the Segregated Account pays claims and the accretion rate on Deferred Amounts. Similarly, by operation of the contracts executed in connection with the establishment, and subsequent rehabilitation, of the Segregated Account, the Rehabilitator retains rights to oversee and approve certain actions taken by or in respect of Ambac Assurance. Opportunities for remediating losses on poorly performing insured transactions also depend on market conditions, including the perception of Ambac Assurance's creditworthiness, the structure of the underlying risk and associated policy as well as other counterparty specific factors. Oversight by the Rehabilitator 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.

Going Concern Matters

The Company's financial statements as of and for the periods ending December 31, 2016 and 2015, respectively, are prepared assuming the Company continues as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. As a result of uncertainties associated with the aforementioned oversight by the Rehabilitator of the Segregated Account, management has concluded that there is substantial doubt about Ambac Assurance's ability to continue as a going concern within one year after the date the financial statements are issued. The statutory basis financial statements do not include any adjustment that might result from its inability to continue as a going concern.

(2) Significant Accounting Policies

The accompanying financial statements of Ambac Assurance have been 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 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.

Prescribed Practices

OCI has prescribed an accounting practice that differs from NAIC SAP. Paragraph 8 of Statement of Statutory Accounting Principles No. 60 *Financial Guaranty Insurance* (SSAP 60) allows for a deduction from loss reserves for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the financial guaranty insurer as of the date of the computation of the reserve. The discount rate shall be adjusted at the end of each calendar year. Additionally, in accordance with paragraph 13.e of Statutory Accounting Principles No. 5R *Liabilities, Contingencies and Impairments of Assets – Revised*, Ambac Assurance records probable losses on its subsidiaries for which it guarantees their obligations, Ambac Assurance also discounts probable losses on guarantees of subsidiary obligations using a discount rate equal to the average rate of return on its admitted assets. The Company's average rate of return on its admitted assets for the year ended December 31, 2016 and 2015 were 6.98% and 8.07%, respectively. OCI has directed the Company to utilize a prescribed discount rate of 5.10% for the purpose of discounting both its loss reserves and its probable losses on subsidiary guarantees. Statutory surplus at December 31, 2016 and 2015, was lower by $104,603 and $140,699, respectively, than if the Company had reported such amounts in accordance with NAIC SAP. Net income for the year ended December 31, 2016 and 2015 was higher by $36,096 and lower by $2,892, respectively than if the Company had reported such amounts in accordance with NAIC SAP. This prescribed practice would impact the loss and loss expenses and the estimated impairment losses on guarantees of subsidiary liabilities on the Statutory Statements of Admitted Assets, Liabilities and Capital and Surplus and the loss and loss expenses (benefit) and net realized gains on the Statutory Statements of Operations if the Company had reported such amounts in accordance with NAIC SAP.

OCI has prescribed an additional accounting practice that differs from NAIC SAP. Paragraph 4 of Statement of Statutory Accounting Principles No. 41 *Surplus Notes* (SSAP 41) states that proceeds received by the issuer of surplus notes must be in the form of cash or other admitted assets having readily determinable values and liquidity satisfactory to the commissioner of the state of domicile. Under statutory accounting principles, surplus notes issued in conjunction with commutations or the settlement of claims would be valued at zero upon issuance pursuant to paragraph 4 of SSAP 41. OCI has directed the Company to record surplus notes issued in settlement of liabilities at full par value upon issuance as in these instances the surplus notes do not represent a contribution of capital, but rather a distribution of value from the common and preferred shareholders of the Company. The surplus notes issued in connection with commutations or settlement of liabilities have a claim against surplus senior to the preferred and common shareholders. In 2016 and 2015, the Company did not issue surplus notes and accordingly the statutory surplus and net income were not impacted.

OCI has extended the preceding prescribed practice related to surplus notes to the evaluation of other-than-temporary impairments for Ambac Assurance guaranteed securities held in the investment portfolio. Paragraph 35 of Statement of Statutory Accounting Principles No. 43R *Loan-backed and Structured Securities* states that when an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the loan-backed or structured security's effective interest rate. Under NAIC SAP, the present value of cash flows expected to be collected should include the fair value of surplus notes received from the Segregated Account, as required under the originally confirmed Segregated Account Rehabilitation Plan. OCI had prescribed an accounting practice that differed from NAIC SAP and has directed the Company to utilize par value rather than fair value of these surplus notes in this computation. As a result of the amended Segregated Account Rehabilitation Plan becoming effective June 12, 2014, the previously disclosed OCI prescribed practice relating to other-than-temporary impaired investment securities is no longer applicable. Ambac Assurance received a new prescribed practice from OCI with regard to the carrying value of investments in Ambac Assurance insured securities with policies that were allocated to the Segregated Account. The new prescribed practice, effective beginning June 11, 2014, exempts Ambac Assurance from evaluating such investments for other-than-temporary impairments and requires all such investments be reported at amortized cost regardless of its NAIC risk designation. This accounting determination is intended to recognize that Ambac Assurance continues to maintain statutory loss reserves without adjustment for the economic effects of its ownership of the insured investment securities, improve transparency to the users of the statutory financial statements and to minimize operational risks. Statutory surplus at years ended December 31, 2016 and 2015 is greater by $141,734 and $161,959, respectively, and net income for the years ended December 31, 2016 and 2015 was lower by $14,204 and $24,447, respectively, than if the Company had reported such amounts in accordance with NAIC SAP. This prescribed practice would impact the investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account on the Statutory Statements of Admitted Assets, Liabilities and Capital and Surplus and net investment income and net realized gains on the Statutory Statements of Operations if the Company had reported such amounts in accordance with NAIC SAP.

OCI has prescribed an additional accounting practice related to the total liabilities and total surplus of the Segregated Account that are reported as discrete components of Ambac Assurance's liabilities and surplus reported in Ambac Assurance's statutory basis financial statements. Pursuant to this prescribed practice, the results of the Segregated Account are not included in Ambac Assurance's financial statements if Ambac Assurance's surplus is (or would be) less than the Minimum Surplus Amount. Statutory surplus at December 31, 2016 and December 31, 2015 was not impacted by this prescribed practice due to statutory surplus being greater than the Minimum Surplus Amount.

Permitted Practice

Wisconsin accounting practices for changes to contingency reserves differ from NAIC SAP. Under NAIC SAP, contributions to and releases from the contingency reserve are recorded via a direct charge or credit to surplus. Under Section 3.08(7)(b) of the Wisconsin Administrative Code, contributions to and releases from the contingency reserve are to be recorded through underwriting income. The Company received permission of the OCI on December 13, 2003 to record contributions to and releases from the contingency reserve and the related tax and loss bond impact, in accordance with NAIC SAP. Statutory surplus is the same using each of these accounting practices. Net income for the years ended December 31, 2016 and 2015 is greater by $921 and $222,528, respectively, than if the Company had reported the contributions to the contingency reserve in accordance with the Wisconsin Administrative Code.

Ambac Assurance received permission from OCI to report investment holdings of Ambac Assurance insured securities, with coverage under financial guaranty policies that have been allocated to the Segregated Account, as a separate invested asset on the balance sheet rather than combined with other bond investments. This permitted practice only impacts the balance sheet line items and has no impact on the valuation of the securities to which it applies or to statutory surplus.

(Dollar amounts in thousands, except share and per share data)

The following reconciles statutory net income and statutory surplus determined in accordance with prescribed and permitted practices by the OCI to NAIC SAP:

	State of Domicile	2016	2015
Net income:			
1. Net income per statement of operations	WI	$ 359,052	$ 772,282
2. State prescribed practices that increase (decrease) NAIC SAP:			
Prescribed discount rate effect		36,096	(2,892)
Prescribed OTTI on investments		(14,204)	(24,447)
		21,892	(27,339)
3. State permitted practices that increase (decrease) NAIC SAP		—	—
4. Net income per NAIC SAP (1-2-3 = 4)	WI	$ 337,160	$ 799,621
Surplus:			
5. Statutory surplus per statement of admitted assets, liabilities and capital and surplus	WI	$ 976,477	$ 624,795
6. State prescribed practices that increase (decrease) NAIC SAP:			
Prescribed discount rate effect		(104,603)	(140,699)
Prescribed OTTI on investments		141,734	161,959
		37,131	21,260
7. State permitted practices that increase (decrease) NAIC SAP		—	—
8. Statutory surplus per NAIC SAP (5-6-7 = 8)	WI	$ 939,346	$ 603,535

The preparation of financial statements in conformity with statutory accounting practices prescribed or permitted by the State of Wisconsin 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 statutory financial statements, and the reported revenues and expenses during the reporting period. Such estimates are used in connection with certain fair value measurements, the evaluation of other-than-temporary impairments on investments and case basis loss reserves. Actual results could differ from those estimates.

(a) Differences between U.S. GAAP and NAIC SAP

The significant differences from U.S. GAAP are that under NAIC SAP:

- Case basis loss reserves are established for losses on defaulted obligations in an amount that is sufficient to cover the present value of management's best estimate of future claim payments, including potential commutation settlements and estimated expenses associated with settling the claims, less estimated recoveries under subrogation rights (5.1% as prescribed by OCI). Additionally, case basis loss reserves are established for potential commutation settlements for non-defaulted guaranteed obligations when a binding contract is signed by the counterparty. Under U.S. GAAP, in addition to the establishment of case basis loss reserves for defaulted obligations, reserves are established for obligations that have experienced credit deterioration, but have not yet defaulted. Furthermore, U.S. GAAP loss reserves are established considering a probability weighted of all possible outcomes (discounted using the risk free rate). The claim reserve established under U.S. GAAP is equal to the excess, if any, of the reserve over the policy's unearned premium reserves;

- Mandatory contingency reserves are required based upon the type of obligation insured, whereas GAAP does not require such a reserve. Releases of the contingency reserves are generally subject to OCI approval and relate to a determination that the held reserves are deemed excessive;

- Bonds that have an NAIC designation of 1 or 2 are stated at amortized cost; bonds that have an NAIC designation of 3 to 6 are reported at the lower of amortized cost or fair value. Under U.S. GAAP, all bonds are reported at fair value;

- Wholly owned subsidiaries are not consolidated; rather they are carried under the equity basis of accounting and are subject to admissibility tests. Additionally, when the Company's share of losses exceeds the carrying amount of a wholly owned subsidiary, the Company discontinues applying the equity method when the investment is reduced to zero. For those subsidiaries that have obligations guaranteed by Ambac Assurance and have insufficient claims paying resources, the Company records probable losses in excess of the subsidiaries' claims paying resources. Under U.S. GAAP wholly owned subsidiaries are consolidated;

- Variable interest entities (VIE) are not required to be assessed for consolidation. Under U.S. GAAP, a reporting entity that has both of the following characteristics is required to consolidate the VIE: a) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance; and b) 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. Ambac generally has the obligation to absorb losses of VIEs that could potentially be significant to the VIE as the result of its guarantee of insured obligations issued by VIEs. For certain VIEs Ambac Assurance has the power to direct the most significant activities of the VIE and accordingly consolidates the related VIEs under U.S. GAAP;

- All payments of principal and interest on the surplus notes are subject to the approval of the OCI. Unpaid interest due on surplus notes is expensed when the approval for payment of interest has been granted by the OCI. Under GAAP, interest on surplus notes is accrued regardless of OCI approval;

- Upfront premiums written are earned on a basis proportionate to the remaining scheduled debt service to the original total principal and interest insured. Installment premiums are reflected in income pro-rata over the period covered by the premium payment. Under U.S. GAAP, the premiums are earned pro rata over the life of the financial guarantee contract in proportion to the insured principal outstanding;

- Unearned premiums and loss reserves are reflected net of ceded amounts, while under U.S. GAAP, they are reflected gross of ceded amounts;

- Assets must be included in the statutory statements of admitted assets, liabilities and capital and surplus at "admitted asset value", and "non-admitted assets" are excluded through a charge against capital and surplus. Under U.S. GAAP, an allowance is recorded only if the realization of asset value is doubtful;

- Under U.S. GAAP, the Company would be required to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. Statutory accounting principles do not require such presentation of other comprehensive income as such items captured within this U.S. GAAP component are generally reflected as unassigned surplus.

(b) Investments

Short-term investments, consisting primarily of money market instruments and other debt issues purchased with a remaining maturity of less than one year, are stated at amortized cost, which approximates fair value.

Investments in long-term bonds that have an NAIC designation of 1 or 2 that are not backed by loans are reported at amortized cost; which is computed via the effective interest method. For bonds purchased at a price below par value, discounts are accreted over the remaining term of the bond. For bonds purchased at a price above par value, which have call features, premiums are amortized to the call date that produces the lowest yield. For premium bonds that do not have call features, such premiums are amortized over the remaining term of the bond. Bonds with a NAIC designation of 1 or 2 are generally rated investment grade by a nationally recognized statistical rating organization.

Investments in long-term bonds that have an NAIC designation of 3 to 6 that are not backed by other loans are reported at the lower of amortized cost or fair value as determined by using independent market sources, when available, and appropriate valuation methodologies when market quotes are not available. In cases where specific market quotes are unavailable, or cannot be reasonably corroborated, interpreting market data and estimating market values require considerable judgment by management. Accordingly, the estimates presented are not necessarily indicative of the amount Ambac Assurance could realize in the market.

Non-agency residential mortgage-backed securities (RMBS), other loan-backed and structured securities, including beneficial interests in securitizations and investments in Ambac Assurance-insured securities with policies allocated to the Segregated Account (collectively "loaned-backed" securities) with a NAIC designation of 1 or 2 are reported at amortized cost. Loan-backed securities with a NAIC designation of 3 to 6 are reported at the lower of amortized cost or fair value. For loan-backed securities subject to multiple designations by the NAIC's Securities Valuation Office ("SVO"), the current amortized cost is compared to the range of values assigned to the six NAIC designations for each CUSIP to determine the initial NAIC designation. This initial NAIC designation is used to determine the carrying value of such loaned-backed securities.

For loan-backed securities where the collection of all contractual cash flows is not certain, Ambac Assurance shall recognize the excess of all cash flows expected at acquisition over the initial purchase price of the loan-backed security as the accretable yield. If there is a favorable change in estimated cash flows from the cash flows previously projected, the Company will recalculate the accretable yield. If the fair value of the loan-backed security has declined below its amortized cost basis, the Company shall determine whether the decline is other-than-temporary. If there has been an adverse change in estimated cash flows then an other-than-temporary impairment will be considered to have occurred and the loan-backed security will be written down to the current estimate of cash flows discounted at a rate equal to the current accretable yield with the resulting change being recognized as a realized loss. Determining whether there has been a favorable or adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of the remaining cash flows as estimated at the previous reporting date against the present value of the cash flows estimated at the current reporting date.

Changes in currently estimated cash flows, including the effect of prepayment assumptions, on loan-backed securities are reviewed periodically. Prepayment assumptions are applied consistently across portfolios to all securities backed by similar collateral. The Company uses the retrospective method to revalue loan-backed securities that have not been other-than-temporarily impaired using current prepayment assumptions. Once a bond has been other-than-temporarily impaired the prospective method is used. Prepayment assumptions for single class and multi-class loan-backed securities were obtained from publicly available sources.

As a result of the prescribed practice described above, Ambac Assurance-insured securities guaranteed under policies that have been allocated to the Segregated Account are exempt from being evaluated for other-then-temporary impairments. With the exception of these securities, Ambac Assurance has a formal impairment review process for all other securities in its investment portfolio, including a review for impairment losses. Ambac Assurance conducts a review each quarter to identify and evaluate investments that have indications of possible impairment that is other-than-temporary. Factors considered when assessing impairment include: (i) securities whose fair values have declined by 20% or more below amortized cost; (ii) securities whose fair values have declined by 5% or more but less than 20% below amortized cost for a continuous period of at least six months; (iii) recent downgrades by a nationally recognized statistical rating organization; (iv) the financial condition of the issuer and financial guarantor, if applicable, and analysis of projected defaults on the underlying collateral; (v) whether scheduled interest payments are past due; and (vi) whether Ambac Assurance has the ability and intent to hold the security for a sufficient period of time to allow for anticipated recoveries in fair value. If the Company believes the decline is “other-than-temporary”, the Company will write down the carrying value of the investment to the present value of the cash flows expected to be received and record a realized loss in the Statement of Operations (regardless of the NAIC designation). In addition, if management either: (i) has the intent to sell its bond investment or (ii) determines that the Company more likely than not will be required to sell the bond investment before its anticipated recovery of the amortized cost basis less any current period credit impairment, then the Company will write-down the carrying value of the investment to fair value and an other-than-temporary impairment charge is recorded as a realized loss in the Statement of Operations. Ambac’s assessment of a decline in value includes management’s current judgment of the factors noted above. If that judgment changes in the future, Ambac may ultimately record a loss after having originally concluded that the decline in value was temporary.

Investments in insurance subsidiaries domiciled in the United States are reported at their audited statutory book values, in accordance with the statutory equity method. Investments in foreign insurance subsidiaries are reported at their audited U.S. GAAP equity value adjusted to a statutory basis of accounting as provided for in paragraph 9 of SSAP 97, *Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP 88*. Investments in unaudited foreign insurance subsidiaries are non-admitted. Admitted investments are included in common stocks in the statutory statement of admitted assets, liabilities and capital and surplus.

Investments in non-insurance limited liability companies (LLCs) and non-insurance subsidiaries are recorded based on the audited U.S. GAAP equity of the investee. Investments in unaudited companies are non-admitted.

Ambac Assurance is party to Insurance and Indemnity agreements whereby it guarantees timely payment of obligations of certain non-insurance subsidiaries. For subsidiaries, when the Company’s share of losses exceeds the carrying amount of the investment, the Company discontinues applying the equity method when the investment is reduced to zero. For subsidiaries where Ambac Assurance guarantees the obligations of the subsidiary that have insufficient claims paying resources, the Company records an estimated impairment loss for probable losses which are in excess of the subsidiary’s claims paying resources and are included within net realized losses in the statements of operations. Ambac Assurance's estimated impairment losses are $25,000 and $0 at December 31, 2016 and 2015, respectively.

(c) Premium Revenue Recognition

Up-front written premiums are earned on a basis proportionate to the remaining scheduled periodic maturity of principal and payment of interest (debt service) to the original total principal and interest insured. Installment premiums are reflected in income pro-rata over the installment period covered. Unearned premiums represent the portion of premium written that relate to unexpired risk. When an issue insured by Ambac Assurance has been refunded or called, the remaining unrecognized premium is earned at that time.

Premiums ceded to reinsurers reduce the amount of premiums earned Ambac Assurance will recognize from its insurance policies. For both up-front and installment premiums, ceded premiums written are primarily recognized in earnings in proportion to and at the same time the related gross premium revenue is recognized.

When the anticipated future losses, loss expenses, and maintenance costs, discounted at the rate of return on the Company's invested assets, exceed the recorded unearned premium reserve and contingency reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to the Statement of Operations.

(d) Reserve for Loss and Loss Expenses

Case basis loss reserves are only established for losses on defaulted obligations in an amount that is sufficient to cover the present value of management's best estimate of future claim payments, including potential commutation settlements and estimated expenses associated with settling the claims, less estimated recoveries under subrogation rights. Additionally, case basis loss reserves are established for potential commutation settlements for non-defaulted guaranteed obligations when a binding contract is signed by the counterparty. At December 31, 2016 and 2015, case basis loss reserves were discounted using a discount rate of 5.1%, as prescribed by the OCI. The amount of the discount as of December 31, 2016 and 2015 was $543,453 and $803,493, respectively. Loss expense reserves are established for costs incurred to mitigate losses on defaulted policies and policies expected to default in the future. As these costs are generally imminent, the established loss expense reserve is not discounted. For assumed transactions, the Company considers the information provided by the ceding reinsurer to evaluate whether a loss reserve should be established.

Ambac Assurance's loss reserves are based on management's on-going review of the non-derivative financial guarantee credit portfolio. Active surveillance of the insured portfolio enables Ambac Assurance's Portfolio Risk Management group to track credit migration of insured obligations from period to period and update internal classifications and credit ratings for each transaction. Non-adversely classified credits are assigned a Class I or Survey List rating while adversely classified credits are assigned a rating of Class IA through Class V. The criteria for an exposure to be assigned an adversely classified credit rating includes the deterioration of an issuer's financial condition, underperformance of the underlying collateral (for collateral dependent transactions such as mortgage-backed securitizations and student loans), poor performance by the servicer of the underlying collateral and other adverse economic events or trends. The servicer of the underlying collateral of an insured securitization transaction is a consideration in assessing credit quality because the servicer's performance can directly impact the performance of the related issue. For example, a servicer of a mortgage-backed securitization that does not remain current in its collection loss mitigation efforts could cause an increase in the delinquency and potential default of the underlying obligation. Similarly, loss severities increase when a servicer does not effectively handle loss mitigation activities such as (i) the advancing of delinquent principal and interest of default related expenses which are deemed to be recoverable by the servicer, (ii) pursuit of loan charge-offs which maximize cash flows from the mortgage loan pool, and (iii) foreclosure and real estate owned disposition strategies and timelines.

One of two approaches is generally utilized to estimate case basis loss reserves. The first approach is a statistical expected loss approach, which considers the likelihood of all possible outcomes. The "base case" statistical expected loss is the product of: (i) the par outstanding on the credit; (ii) internally developed historical default percentages (taking into consideration internal ratings and average life of an obligation); (iii) internally developed loss severities; and (iv) a discount factor. The loss severities and default information are based on rating agency information, are specific to each bond type and are established and approved by the Company's senior management. For certain credit exposures, Ambac Assurance's additional monitoring and loss remediation efforts may provide information relevant to adjust this estimate of "base case" statistical expected losses. As such, analysts may utilize the "base case" statistical expected loss as the best estimate of expected loss or determine an adjusted statistical expected loss that better reflects management's view of a given transaction's expected loss.

The second approach entails the use of more precise estimates of expected net cash flows (future claim payments, net of potential recoveries, expected to be paid to the holder of the insured financial obligation). This approach can include the utilization of market accepted software models to develop net claim payment estimates. The Company has utilized such models for residential mortgage-backed and student loan exposures. These models, in conjunction with detailed data of the historical performance of the collateral pools, assist Ambac Assurance in the determination of certain assumptions, such as default and voluntary prepayment rates, which are needed in order to estimate expected future net claim payments. Ambac Assurance's Risk Management Group will consider the likelihood of all possible outcomes and develop cash flow scenarios. In this approach, the scenario with the highest probability is utilized to develop loss reserves. For certain policies, estimated potential recoveries exceed estimated future claim payments because all or a portion of such recoveries relate to claim payments previously paid.

Additional remediation activities can include various actions by Ambac Assurance. The most common actions include obtaining detailed appraisal information on collateral, more frequent meetings with the issuer's or servicer's management to review operations, financial condition and financial forecasts and more frequent analysis of the issuer's financial statements. Senior management meets at least quarterly with the Risk Management Group to review the status of their work to determine the adequacy of Ambac Assurance's case basis loss reserves and make any necessary adjustments.

All credits are assigned risk classifications by the Risk Management Group using the following guidelines:

CLASS I – "Fully Performing – Meets Ambac Criteria with Remote Probability of Claim"

Credits that demonstrate adequate security and structural protection with a strong capacity to pay interest, repay principal and perform as underwritten. Factors supporting debt service payment and performance are considered unlikely to change and any such change would not have a negative impact upon the fundamental credit quality.

SURVEY LIST (SL) – "Investigation of Specific Condition or Weakness Underway"

Credits that require additional analysis to determine if adverse classification is warranted. These credits may lack information or demonstrate a weakness but further deterioration is not expected.

CLASS IA – "Potential Problem with Risks to be Dimensioned"

Credits that are fully current and monetary default or claims payment are not anticipated. The payor's or issuer's financial condition may be deteriorating or the credits may lack adequate collateral. While these credits may still retain an investment grade rating, they usually have experienced or are vulnerable to a ratings downgrade. Further investigation is required to dimension and correct any deficiencies. A complete legal review of documents may be required. An action plan should be developed with triggers for future classification changes upward or downward.

CLASS II – "Substandard Requiring Intervention"

Credits whose fundamental credit quality has deteriorated to the point that timely payment of debt service may be jeopardized by adversely developing trends of a financial, economic, structural, managerial or political nature. No claim payment is currently foreseen but the probability of loss or claim payment over the life of the transaction is now existent (generally 10% or greater probability). Class II credits may be borderline or below investment grade (BBB – to B). Prompt and sustained action must be taken to execute a comprehensive loss mitigation plan and correct deficiencies.

CLASS III – "Doubtful with Clear Potential for Loss"

Credits whose fundamental credit quality has deteriorated to the point that timely payment of debt service has been or will be jeopardized by adverse trends of a financial, economic, structural, managerial or political nature which, in the absence of positive change or corrective action, are likely to result in a loss. The probability of monetary default or claims paying over the life of the transaction is generally 50% or greater. Full exercise of all available remedial actions is required to avert or minimize losses. Class III credits will generally be rated below investment grade (B to CCC).

CLASS IV – "Imminent Default or Defaulted"

Monetary default or claims payment has occurred or is expected imminently. Class IV credits are generally rated D.

CLASS V – "Fully Reserved"

The credit has defaulted and payments have occurred. The claim payments are scheduled and known, reserves have been established to fully cover such claims, and no claim volatility is expected.

Management believes that the reserves for losses and loss expenses are adequate to cover the ultimate cost of claims arising from issues currently in default, but the reserves are necessarily based on estimates and there can be no assurance that the ultimate liability will not exceed such estimates.

(e) Mandatory Contingency Reserve

The Company is required to establish a mandatory contingency reserve in accordance with the NAIC Accounting Practices and Procedures manual and the Wisconsin Administrative Code. The mandatory contingency reserve is an additional liability established to protect policyholders against the effect of adverse economic developments or cycles or other unforeseen circumstances. Under NAIC SAP, financial guarantors are required to establish a contingency reserve equal to the greater of 50% of premiums written or a stated percentage of the principal guaranteed depending on the category of obligation insured. NAIC SAP contributions are required to be made in equal quarterly installments over a period of 20 years for municipal bonds and 15 years for all other obligations. Such contributions may be discontinued if the total reserve established for all categories exceeds the sum of the stated percentages contained therein multiplied by the unpaid principal balance. This reserve must be maintained for the periods specified above, except that the guarantor may be permitted to release reserves under specified circumstances in the event that actual loss experience exceeds certain thresholds or if the reserve accumulated is deemed excessive in relation to the guarantor's outstanding guaranteed obligations, with notice to or approval by the insurance commissioner. Under the Wisconsin Administrative Code, a municipal bond insurer is required to establish a contingency reserve consisting of 50% of earned premiums on policies of municipal bond insurance. The only exemption is when another jurisdiction in which the insurer is licensed requires a larger contingency reserve than required by the Wisconsin Administrative Code. Accordingly, Ambac Assurance calculates contingency reserves, net of releases discussed below, based on the above noted rules as well as other jurisdictions that have contingency reserve regulations, such as California, and records the highest amount.

The NAIC SAP mandatory contingency reserve may be released on a first-in, first-out basis through unassigned surplus in the following circumstances:

- For contingency reserves required to be maintained for 15 or 20 years, any year in which actual incurred losses exceed 65% or 35%, respectively, of the corresponding earned premiums, with commissioner approval;
- For contingency reserves required to be maintained for 15 or 20 years, if the reserve has been in existence less than 30 quarters or 40 quarters, respectively, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, with commissioner approval;
- For contingency reserves required to be maintained for 15 or 20 years, if the reserve has been in existence more than 30 quarters or 40 quarters, respectively, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer's financial guarantees, upon 30 days prior written notice to the commissioner.

Contingency reserves established in accordance with Wisconsin Administrative Code may be released on a first-in, first-out basis through unassigned surplus in the following circumstances:

- Contingency reserves established and maintained for more than 20 years shall be released and may no longer constitute part of the contingency reserve;
- Subject to the approval of the commissioner, withdrawals may be made from the contingency reserve in any year in which the actual incurred losses on municipal bond insurance policies exceed 35% of the earned premiums on municipal bonds insurance.

Ambac Assurance computes expected losses on non-defaulted financial guaranty insurance policies that are not allocated to the Segregated Account. In the event that these expected losses exceed contingency reserves as determined in the methods discussed above., Ambac Assurance record the higher amount.

(f) Income Taxes

Pursuant to the Amended TSA approved by both the OCI and Ambac Assurance's Board of Directors, Ambac Assurance and its subsidiaries/members, ACC, Ambac Investments Inc. (AII), Ambac Capital Funding, Inc. (ACFI), Connie Lee Holdings Inc., and Everspan, which constitute a separate sub-group (the Ambac Sub-group), are included in Ambac's consolidated federal income tax return with Ambac Asset Management, Inc.

(Dollar amounts in thousands, except share and per share data)

The Amended TSA provides the method of allocations between the entities in the Ambac Sub-group. Amounts assessed/reimbursed under the Amended TSA are based upon separate tax return calculations made as if Ambac Assurance, including the operations of Ambac Assurance and its subsidiaries, had filed its own federal income tax return for each taxable period.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The change in deferred tax assets and liabilities is charged directly to unassigned surplus. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

Pursuant to the TSA, to the extent the Ambac Sub-group generates taxable income after September 30, 2011, 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:

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%

A credit is available to offset the first $5,000 of payments due under each of the NOL usage Tiers A, B and C. Pursuant to the Closing Agreement between Ambac and the Internal Revenue Service (the IRS), the IRS will receive 12.5% of Tier C and 17.5% of Tier D payments, if made.

To the extent the Ambac Sub-group utilizes Allocated NOLs generated prior to September 30, 2011 greater than $3,650,000 (or the proportionate amount of AMT NOLs), the Company is obligated to pay Ambac 25% of the federal income tax liability that would have been paid if the NOLs were not available.

For the period from September 30, 2011 through December 31, 2016, the Ambac Sub-group has generated cumulative taxable income of $1,086,124, utilizing all of the $10,000 Tier A and B NOL credit, resulting in tolling tax payments of $71,454 in 2016 and an accrual of $28,691 in 2017. As of December 31, 2016 and December 31, 2015, $2,563,876 and $2,768,808, respectively, of the allocated $3,650,000 NOL subject to Tolling Payments remains.

(g) Foreign Currency Transactions

Transactions denominated in foreign currencies are recorded at their U.S. dollar equivalent value based on the foreign currency exchange rate as of the transaction date. Foreign assets and liabilities are translated to U.S. dollars using exchange rates at the balance sheet date. Changes in balance sheet asset and liability values resulting from fluctuations in foreign currency exchange rates are recorded as unrealized capital gains and losses (a component of surplus) until the asset is sold or exchanged or the liability is settled. Upon settlement, the previously recorded unrealized capital gains and losses are reversed and recognized in the statutory statement of operations.

(h) Reclassifications

Certain reclassifications have been made to prior year's amounts to conform to the current year's presentation.

(3) Investments

The following disclosures include investments in bonds and investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account which are reported separately on the balance sheet with a carrying value of $2,376,707 and $2,317,422, respectively as of December 31, 2016 and $2,554,878 and $1,807,302, respectively as of December 31, 2015.

(Dollar amounts in thousands, except share and per share data)

The admitted value and estimated fair value of investments in bonds and investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account at December 31, 2016 and 2015 are as follows:

	Admitted value	Unrealized gains	Unrealized losses	Estimated fair value
2016:				
U.S. government	$ 72,108	$ 119	$ —	$ 72,227
All other governments	4,004	54	—	4,058
States, territories and possessions (direct and guaranteed)	22,150	1,263	—	23,413
Political subdivisions of states, territories and possessions (direct and guaranteed)	49,346	1,031	—	50,377
Special revenue and special assessment obligations and all non-guaranteed obligations of agencies and authorities of governments and their political subdivisions	189,261	19,663	1	208,923
Industrial and miscellaneous (unaffiliated)	4,357,260	196,993	98,095	4,456,158
	$ 4,694,129	$ 219,123	$ 98,096	$ 4,815,156
2015:				
U.S. government	$ 71,893	$ 113	$ 57	$ 71,949
All other governments	4,007	53	—	4,060
States, territories and possessions (direct and guaranteed)	22,143	1,578	—	23,721
Political subdivisions of states, territories and possessions (direct and guaranteed)	61,899	2,460	3	64,356
Special revenue and special assessment obligations and all non-guaranteed obligations of agencies and authorities of governments and their political subdivisions	211,018	25,929	—	236,947
Industrial and miscellaneous (unaffiliated)	3,991,220	201,258	99,399	4,093,079
	$ 4,362,180	$ 231,391	$ 99,459	$ 4,494,112

Of the $98,096 of gross unrealized losses at December 31, 2016, $67,514 has been in an unrealized loss position for more than one year. At December 31, 2016, the fair value of securities in an unrealized loss position for less than one year and more than one year is $1,113,975 and $770,186, respectively. Of the $99,459 of gross unrealized losses at December 31, 2015, $25,659 has been in an unrealized loss position for more than one year. At December 31, 2015, the fair value of securities in an unrealized loss position for less than one year and more than one year is $1,634,283 and $289,966, respectively. Management has determined that the unrealized losses reflected in the table above are temporary in nature based upon (i) the absence of 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) Ambac Assurance has no intent to sell these investments in debt securities; and (iv) it is not more likely than not that Ambac Assurance 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 unaffiliated invested assets plus the projected principal 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. For purposes of this analysis, residual cash flows are projected to be invested at current reinvestment rates consistent with existing fixed income portfolio holdings. 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 before the recovery of their amortized cost basis.For Ambac Assurance-insured bonds in the investment portfolio, Ambac Assurance estimates the timing of claim payment receipts but the actual timing of such amounts are at the sole discretion of the Rehabilitator. Further modifications to the Segregated Account Rehabilitation Plan or to the rules and guidelines promulgated thereunder, orders from the Rehabilitation Court or actions by the Rehabilitator with respect to the form, amount and timing of satisfying permitted policy claims, or making payments on Deferred Amounts or surplus notes may require Ambac Assurance to sell such securities before the anticipated recovery of its amortized cost basis. As of December 31, 2016, 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, 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. Declines in the fair value of investment securities or changes in management's intent to sell securities could result in future recognition of other-than-temporary impairments.

(Dollar amounts in thousands, except share and per share data)

The proceeds from the sale of bonds in 2016 and 2015 were $576,471 and $701,974, respectively. Net pre-tax realized investment gains were $41,469 and $93,326 in 2016 and 2015, respectively. The following table details amounts included in net realized gains and (losses):

	2016	2015
Estimated impairment (losses) gains on guarantees of subsidiary liabilities (discussed in Note 7)	$ (25,000)	$ 4,900
Gross realized gains on sales of securities	21,267	100,116
Gross realized losses on sales of securities	(4,729)	(5,755)
Gross realized gains on maturities, calls and redemptions	50,587	1,894
Gross realized losses on maturities, calls and redemptions	(523)	(868)
Other-than-temporary impairments on securities [1]	(52)	(6,935)
Foreign exchange (losses) on investments	(81)	(26)
Net pre-tax realized gains	$ 41,469	$ 93,326

(1) For the years ended December 31, 2016 and 2015, the Company recognized these other-than-temporary impairment losses as a result of the Company having an intent to sell certain securities that were in an unrealized loss position as of the impairment evaluation dates.

The admitted value and estimated fair value of bonds and investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account at December 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Admitted value	Estimated fair value
Due in one year or less	$ 163,454	$ 163,990
Due after one year through five years	1,138,439	1,159,942
Due after five years through ten years	796,717	797,250
Due after ten years	2,595,519	2,693,974
Total	$ 4,694,129	$ 4,815,156

The invested assets include bonds having an amortized cost of: i) $3,506 and $3,507 on deposit with state regulatory authorities as required by law, ii) $64,833 and $64,612 that were loaned to AFS, and iii) $370,661 and $388,446 that were collateral for a secured borrowing transaction, at December 31, 2016 and 2015, respectively.

Ambac Assurance's fixed income portfolio included securities covered by guarantees issued by Ambac Assurance and other financial guarantors (insured securities). The published 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 generally do not publish separate underlying ratings (those ratings excluding the insurance by the financial guarantor) because the insurance cannot be legally separated from the underlying security by the insurer. In the event these underlying ratings are not available from the rating agencies, Ambac Assurance will assign an internal rating.

(Dollar amounts in thousands, except share and per share data)

The following table represents the carrying amount, including the value of the financial guaranty, and weighted average underlying rating, excluding the financial guarantee, of the insured securities at December 31, 2016 and 2015, respectively:

	Municipal obligations	Corporate obligations	Mortgage and asset backed securities	Total	Weighted average underlying rating (1)
2016:					
Ambac Assurance Corporation	$ 64,057	$ —	$ 2,455,804	$ 2,519,861	CC
National Public Finance Guarantee Corporation	27,812	—	—	27,812	A
Assured Guaranty Municipal Corporation	16,675	—	—	16,675	AA+
MBIA Insurance Corporation	—	2,594	—	2,594	BBB+
Total	$ 108,544	$ 2,594	$ 2,455,804	$ 2,566,942	CC
2015:					
Ambac Assurance Corporation	$ 40,892	$ —	$ 2,122,935	$ 2,163,827	CC
National Public Finance Guarantee Corporation	35,044	—	—	35,044	A-
Assured Guaranty Municipal Corporation	47,380	—	—	47,380	A+
MBIA Insurance Corporation	—	16,254	—	16,254	A+
Total	$ 123,316	$ 16,254	$ 2,122,935	$ 2,262,505	CCC-

(1) Ratings represent the lower underlying rating assigned by S&P or Moody's. If unavailable, Ambac Assurance's internal rating is used.

The following table represents structured notes by CUSIP in accordance with SSAP 26 at December 31, 2016 and 2015, respectively:

2016:	CUSIP identification	Actual cost	Fair value	Book/adjusted carrying value	Mortgage-reference security (YES/NO)
	251093 S8 4	$ 899	$ 584	$ 584	NO
	251093 S9 2	285	187	187	NO
	62718Q AA3	4,157	4,020	4,007	NO
	Total	$ 5,341	$ 4,791	$ 4,778	

2015:	CUSIP identification	Actual cost	Fair value	Book/adjusted carrying value	Mortgage-reference security (YES/NO)
	233048 AC 1	$ 2,710	$ 2,683	$ 2,710	NO
	251093 S8 4	899	824	825	NO
	251093 S9 2	285	217	217	NO
	62718Q AA3	4,157	4,125	4,044	NO
	Total	$ 8,051	$ 7,849	$ 7,796	

(4) Financial Guarantee Contracts

Premiums

For financial guarantee insurance contracts where premiums are received as installment payments over the period of the contract rather than at inception, if the installment premiums had all been recorded at inception in accordance with ASC Topic 944, *Financial Services — Insurance*, and amortized in proportion to the amount and period of coverage, the unearned premium revenue (net of reinsurance) would have been $428,800 at December 31, 2016 as compared to the recorded amount of $2,960.

(Dollar amounts in thousands, except share and per share data)

The table below summaries the expected future gross undiscounted premiums to be collected at December 31, 2016:

	Amount
Three months ended:	
March 31, 2017	$ 11,596
June 30, 2017	10,190
September 30, 2017	10,205
December 31, 2017	9,708
Twelve months ended:	
December 31, 2018	38,254
December 31, 2019	35,861
December 31, 2020	33,785
December 31, 2021	31,054
Five years ended:	
December 31, 2026	133,405
December 31, 2031	107,186
December 31, 2036	66,236
December 31, 2041	29,348
December 31, 2046	15,448
December 31, 2051	5,294
December 31, 2056	242
Total	**$ 537,812**

If installment paying policies are retired or prepay early, premiums reflected in the above table for such policies may not be collected. Below are the expected future gross undiscounted premiums roll-forward for the periods ended December 31, 2016 and 2015:

	2016	2015
Expected future premiums at January 1	$ 676,435	$ 825,854
Premium payments received	(50,143)	(58,815)
Adjustments to expected future premium payment (1)	(88,480)	(90,604)
Expected future premiums at December 31	$ 537,812	$ 676,435

(1) Adjustments to expected future premium payments represent policies that have retired or terminated early that were not factored into the previous period's expected future premiums.

Total accelerated revenue recognition for non-installment contracts during 2016 and 2015 were $114,771 and $200,621, respectively. Accelerations of upfront paying transactions resulting from the legal defeasance of Ambac Assurance insured obligations whereby government securities are purchased by the issuer with the proceeds of a new bond issuance, or less frequently with other funds of the issuer, and held in escrow (a pre-refunding) during 2016 and 2015 were $42,046 and $56,538, respectively. Accelerations during 2016 and 2015 due to Ambac Assurance insured obligations being either called or terminated were $72,725 and $144,083, respectively.

(Dollar amounts in thousands, except share and per share data)

The table below summarizes the expected future expected premiums earned, net of reinsurance on non-installment contracts at December 31, 2016:

	Amount
Three months ended:	
March 31, 2017	$ 7,236
June 30, 2017	9,149
September 30, 2017	11,130
December 31, 2017	8,952
Twelve months ended:	
December 31, 2018	34,094
December 31, 2019	27,783
December 31, 2020	26,049
December 31, 2021	27,411
Five years ended:	
December 31, 2026	110,276
December 31, 2031	103,851
December 31, 2036	52,227
December 31, 2041	20,181
December 31, 2046	6,555
December 31, 2051	24,162
December 31, 2056	16,426
Total	**$ 485,482**

In addition, net unearned premium reserves at December 31, 2016 include $2,960 of future expected premiums earned, net of reinsurance, on installment paying contracts.

Loss and Loss Expenses

As discussed in note 2(d), the Company's liability for loss and loss expenses consists of case basis loss reserves including related loss expense reserves. Following is a summary of the activity in the case basis loss and loss expense reserve accounts:

	2016	2015
Net loss and loss expense reserves at January 1	$ 1,870,840	$ 2,459,952
Loss and loss expenses incurred (benefit) related to:		
Current year	207,706	123,033
Prior years	(205,355)	(614,915)
Total loss and loss expenses (benefit)	2,351	(491,882)
Paid (recovered) losses and loss expenses related to:		
Current year	159,363	105,174
Prior years	(726,932)	(7,944)
Total paid losses and loss expenses	(567,569)	97,230
Net loss and loss expense reserves at December 31	$ 2,440,760	$ 1,870,840

The terms "current year" and "prior years" in the foregoing table refer to the year in which case basis loss reserves were initially established.

(Dollar amounts in thousands, except share and per share data)

For the years ended December 31, 2016 and 2015, the positive development in loss reserves established in respective prior years was primarily due to improved performance of the RMBS insured portfolio, including an increase in representation and warranty subrogation recoveries.

Pursuant to the injunctions issued by the Rehabilitation Court, claims on policies allocated to the Segregated Account were not paid from the commencement of the Segregated Account Rehabilitation Proceedings until the third quarter of 2012. Pursuant to the Policy Claim Rules, effective from August 1, 2012, holders of policies allocated to the Segregated Account were allowed to submit policy claims for review and partial payment equating to 25% of the permitted policy claim amount, and on or about September 20, 2012, the Segregated Account commenced paying 25% of each permitted policy claim that arose since the commencement of the Segregated Account Rehabilitation Proceedings. As described in note 1, following the effective date of the Segregated Account Rehabilitation Plan, as amended, the percentage of the initial cash Interim Payment for permitted policy claims increased from 25% to 45% with effect from July 21, 2014. As with previously permitted policy claims, the remaining portion of the unpaid permitted policy claims (in this case, 55%) will remain outstanding as Deferred Amounts and, subject to the adjustment for Undercollateralized Bonds, will accrue interest at 5.1% per annum. These Deferred Amounts, together with interest thereon, may be paid from time to time in the future at the sole discretion of the Rehabilitator. Partial interim policy claim payments for the Segregated Account were $206,076 and $240,080 for the years ended December 31, 2016 and 2015, respectively.

Loss reserves include insurance claims presented and not paid of $3,655,989 and $3,458,771 (including accrued interest on Deferred Amounts of $661,842 and $491,017) for policies allocated to the Segregated Account as of December 31, 2016 and 2015, respectively.

The Company's average rate of return on its admitted assets for the year ended December 31, 2016 and 2015 was 6.98% and 8.06%, respectively. OCI has directed the Company to utilize a prescribed discount rate of 5.10% for the purpose of discounting its December 31, 2016 and 2015 loss reserves.

Below are the significant components of the change in claim liability for the periods ended December 31, 2016 and 2015:

	2016	2015
Accretion of the discount	$ 316,958	$ (77,499)
Changes in timing	204,619	(529,472)
New reserves for defaults of insured contracts [1]	48,343	17,859
Total	$ 569,920	$ (589,112)

[1] Includes loss reserves of $27,159 and loss expense reserves of $21,184 for the year ended December 31, 2016. Includes loss reserves of $2,950 and loss expense reserves of $14,909 for the year ended December 31, 2015. Loss expense reserves for new defaults of insured contracts includes reserves on current year defaulted policies and on policies which have not yet defaulted.

(Dollar amounts in thousands, except share and per share data)

Below are the insured financial obligations with a gross claim liability and/or loss expense reserve at the period ended December 31, 2016 and 2015:

	Surveillance Categories			
	I-III	**IV**	**V**	**Total**
December 31, 2016:				
Number of policies	63	168	3	234
Remaining weighted average contract period (in years)	17	6	5	10
Gross insured contractual payments outstanding:				
Principal	$ 4,036,912	$ 7,057,746	$ 49,247	$ 11,143,905
Interest	8,278,075	1,914,131	14,185	10,206,391
Total	$ 12,314,987	$ 8,971,877	$ 63,432	$ 21,350,296
Gross claim liability and loss expense reserves	$ 22,279	$ 5,537,441	$ 63,431	$ 5,623,151
Less:				
Gross potential recoveries	56,119	2,589,274	14,148	2,659,541
Discount on gross claim liability, net of recoveries	(15,158)	555,752	6,579	547,173
Claim liability, including loss expense reserves, reported in the balance sheet, excluding reinsurance	$ (18,682)	$ 2,392,415	$ 42,704	$ 2,416,437
Gross unearned premium revenue	$ 68,063	$ 23,941	$ 654	$ 92,658
Reinsurance recoverables (payables) on loss and loss expense reserves	$ (3,135)	$ (21,188)	$ —	$ (24,323)
December 31, 2015:				
Number of policies	49	157	3	209
Remaining weighted average contract period (in years)	19	7	6	11
Gross insured contractual payments outstanding:				
Principal	$ 4,321,874	$ 8,576,841	$ 54,590	$ 12,953,305
Interest	8,360,630	2,632,137	16,791	11,009,558
Total	$ 12,682,504	$ 11,208,978	$ 71,381	$ 23,962,863
Gross claim liability and loss expense reserves	$ 21,895	$ 6,048,330	$ 71,381	$ 6,141,606
Less:				
Gross potential recoveries	49,112	3,412,588	14,467	3,476,167
Discount on gross claim liability, net of recoveries	(13,605)	815,668	8,772	810,835
Claim liability, including loss expense reserves, reported in the balance sheet, excluding reinsurance	$ (13,612)	$ 1,820,074	$ 48,142	$ 1,854,604
Gross unearned premium revenue	$ 70,330	$ 21,451	$ 733	$ 92,514
Reinsurance recoverables (payables) on loss and loss expense reserves	$ (2,345)	$ (13,891)	$ —	$ (16,236)

Puerto Rico

On March 13, 2017, the Financial Management and Oversight Board for Puerto Rico (the "Oversight Board") certified the 10-year Fiscal and Economic Growth Plan ("FEGP") for the Commonwealth of Puerto Rico (the “Commonwealth"). The certified FEGP, among other things, was intended to provide Commonwealth creditors a base from which to progress consensual negotiations under Title VI of the Puerto Rico Oversight, Management and Economic Stability Act ("PROMESA"). However, the certified FEGP implied a 77% discount to all debt service due to be paid by the Commonwealth and its instrumentalities covered by the FEGP over the ten-years of the plan (FY2017-2026). The FEGP did not provide details regarding its underlying assumptions and data, expense definitions, cause of expense growth or accounting adjustments and did not include any restructuring proposals. These deficiencies of the FEGP, when combined with the absence of sufficient projected cash flows for debt service, increased the uncertainty of whether successful consensual negotiations can be reached.

On April 28, 2017, the Fiscal Agency and Financial Advisory Authority of Puerto Rico (“FAFAA”) released a restructuring proposal covering General Obligation (“GO”), GO-guaranteed, Puerto Rico Sales Tax Financing Corporations ("COFINA"), Puerto Rico Highway and Transportation Authority ("HTA"), Puerto Rico Infrastructure Financing Authority ("PRIFA") and Puerto Rico Convention Center District Authority ("CCDA") bonds. Under the proposal, bondholders would receive a “senior bond” based on amounts expected to be available for debt service under the FEGP and a “cash flow bond” that would allow for additional payments if amounts available for debt service exceeded FEGP forecasts. FAFAA’s proposal further provides that GO and GO-guaranteed bondholders would receive a maximum recovery of 77% (52% senior bond, 25% cash flow bond), COFINA bondholders would receive a maximum recovery of 58% (39% senior bond, 19% cash flow bond), and HTA, CCDA, PRIFA, and Metropolitan Bus Authority bondholders would receive a maximum recovery of 30% (0% senior bond, 30% cash flow bond). Recoveries relating to the cash flow bond component could be lower depending upon future surpluses at the General Fund and future new money GO bond issuances. The proposal was premised only on the cash available for debt service included in the certified FEGP, despite challenges from creditors and repeated calls for a review and adjustment of the assumptions underlying such Plan. Among other infirmities, the proposal lacks any textured narrative or economic or financial logic for treating Senior and Junior tranches within the COFINA structure as pari passu obligations and fails to explain how the allocation of cashflow between GO and GO-guaranteed bonds and COFINA bonds was derived. The proposal was summarily rejected by affected bondholders.

On April 29, 2017, the Commonwealth enacted the Fiscal Plan Compliance Act, also known as Act No. 26 (the “Fiscal Plan Compliance Act” or “Act 26-2017”). Articles 4.01 and 4.02 of Chapter 4 of the Fiscal Plan Compliance Act order all public corporations, agencies and instrumentalities of the Government of Puerto Rico to transfer their revenue surplus to the Commonwealth Treasury, after covering operational expenses and obligations, as per the expense budget recommended by the Office of Management and Budget of Puerto Rico for each fiscal year. Article 4.01 further states that such funds would be considered “available resources” for the Commonwealth and would be deposited in the Commonwealth’s General Fund to meet the liquidity requirements contemplated in the FEGP. Article 4.02 empowers a committee composed of the Executive Director of the Fiscal Agency and Financial Advisory Authority of Puerto Rico, the Secretary of the Puerto Rico Treasury Department and the Executive Director of the Office of Management and Budget of Puerto Rico to determine the amount each public corporation and instrumentality would contribute. Such committee is also empowered to revise the sources of revenue of the public corporations, agencies and instrumentalities and adjust, increase or reduce any of their charges, fees, tariffs and similar revenues, with the objective of complying with the metrics stated in the FEGP.

Article 4.03 of Chapter 4 of Act 26-2017, “Exclusions”, explicitly excludes certain entities from coverage of Articles 4.01 and 4.02, including the University of Puerto Rico, the Public Corporation for the Supervision and Insurance of Cooperatives (COSSEC), and funds from public corporations and entities received by private entities for community-related objectives.

While Article 4.03 does not explicitly exclude COFINA from coverage of such Articles 4.01 and 4.02, as it does with other entities, it does state that the Executive Branch shall be authorized to use the COFINA funds, occasionally, solely as a last alternative, and subject to the filing of a sworn certification before the Legislative Assembly. Such sworn certification, which, according to Article 4.03 shall not be interpreted to give the Executive Branch indefinite use of the COFINA funds, must establish the need, term and amount of funds that will be used to cover significant occasional cash flow deficits to comply with the FEGP. An Explicative Declaration of Act 26-2017 signed by the Governor of Puerto Rico on April 29, 2017, however, states that because COFINA does not generate surpluses, the dispositions of Chapter 4 are not applicable to COFINA. Moreover, the Explicative Declaration states that the Fiscal Plan Compliance Act does not refer to other revenues from public corporations except for those determined by fee adjustments of the corporations specifically included in the FEGP. Given that the statements in the Explicative Declaration seem to contradict the statutory language of Articles 4.01, 4.02 and 4.03, it is not clear how some of the provisions of Fiscal Plan Compliance Act will be implemented.

In its Chapter 6, the Fiscal Plan Compliance Act also requires that, commencing July 1, 2017, all special funds and other revenues of dependencies and public corporations must be deposited with the Puerto Rico Treasury. The Puerto Rico Secretary of Treasury is authorized to establish the order of priority for the disbursement of payments chargeable to the special funds and other revenues, in accordance with the approved budget and the Fiscal Plan.

On May 1, 2017, Ambac Assurance sent COFINA a notice of failures to comply with covenants and events of default under COFINA’s bond resolution and enabling legislation. Among other things, Ambac Assurance stated that the Commonwealth had violated its covenant not to interfere with COFINA’s ability to meet its obligations to its bondholders by enacting the Fiscal Plan Compliance Act;

that COFINA had violated its covenant to defend, preserve, and protect the COFINA structure and the rights of COFINA's bondholders; and that both covenant violations were incurable and therefore constituted immediate Events of Default under the COFINA resolution. Also on May 1, 2017, the COFINA trustee, Bank of New York Mellon ("BNY"), sent a letter to COFINA and the Puerto Rico Fiscal Agency and Financial Advisory Authority stating that the Fiscal Plan Compliance Act was inconsistent with COFINA's and the Commonwealth's covenants under COFINA's resolution and enabling legislation, and seeking a response detailing any curative action either intended to take. On May 4, 2017, BNY sent COFINA a notice of default arising out of the Fiscal Plan Compliance Act, and stated that the defaults by COFINA and the Commonwealth would be deemed Events of Default under the COFINA resolution if left uncured within 30 days of Ambac's May 1, 2017 letter noticing the defaults. Later on May 4, 2017, Ambac Assurance, together with certain holders of senior COFINA bonds, sent a letter to BNY demanding immediate acceleration of all senior bonds issued by COFINA.

In response to letter requests from Governor Rossello, the Oversight Board commenced a Title III proceeding for the Commonwealth of Puerto Rico on May 3, 2017 and for COFINA on May 5, 2017. It is currently unclear which additional Commonwealth entities and instrumentalities, if any, will pursue a plan of adjustment of their debts under Title III or continue to pursue consensual debt restructuring pursuant to Title VI of PROMESA. As part of the Title III filings for the Commonwealth and COFINA, the Oversight Board noted that the Oversight Board and the Commonwealth intend to continue pursuing consensual negotiations under the protection of the Title III automatic stay. No assurances can be given that consensual resolutions will be achieved with respect to the Commonwealth's or COFINA's obligations or those of any other Puerto Rico instrumentality. In addition, given that the Title III filings are the first two under PROMESA, Ambac is uncertain how the Title III process will be implemented and to what extent the rights of Ambac Assurance will be respected as part of that process.

Ambac Assurance is party to seven litigations related to its Puerto Rico exposures, including two litigations challenging the constitutionality and legality of the FEGP and the Fiscal Plan Compliance Act, discussed in Note 14 "Contingencies". Ambac Assurance filed several of those cases to protect and assert its rights under transaction documents and applicable law. Ambac Assurance has also intervened in the Lex Claims litigation to defend the COFINA structure against a challenge by certain GO bondholders. Some or all of the claims asserted in the cases against the Commonwealth or its officials or instrumentalities may be stayed under Title III of PROMESA. Accordingly, Ambac is unable to predict when and how the issues raised in those cases will be resolved. If we are unsuccessful with any of these challenges, Ambac's financial condition, including liquidity, loss reserves and capital resources may suffer a material negative impact.

Ambac has considered these developments and other factors in evaluating its Puerto Rico case basis loss and loss expense reserves. While management believes its reserves are adequate to cover losses for claims that are currently in default, 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.

Representation and Warranty Subrogation Receivables:

Loss reserves are reduced by estimated recoveries under subrogation rights for breaches of representations and warranties by sponsors in insured RMBS transactions at December 31, 2016 and 2015 of $1,813,377 and $2,646,123, respectively, discounted at 5.1% (RMBS subrogation). In an effort to better understand the unprecedented levels of delinquencies and defaults, Ambac Assurance or its counsel engaged consultants with significant mortgage underwriting experience to review the underwriting documentation for mortgage loans underlying certain insured RMBS transactions. Transactions which exhibited exceptionally poor performance were chosen for further examination of the underwriting documentation supporting the underlying loans. Factors which Ambac Assurance believes to be indicative of poor performance include (i) high levels of early payment defaults, (ii) significant number of loan liquidations or charge-offs and resulting high level of losses, and (iii) rapid elimination of credit protections inherent in the transactions' structures. With respect to item (ii), "loan liquidations" refers to loans for which the servicer has liquidated the related collateral and the securitization has realized losses on the loan; "charge-offs" refers to loans which have been written off as uncollectible by the servicer, thereby generating no recoveries to the securitization, and may also refer to the unrecovered balance of liquidated loans. In either case, the servicer has taken actions as it has deemed viable to recover against the collateral, and the securitization has incurred losses to the extent such actions did not fully repay the borrower's obligations. Generally, the sponsor of the transaction provided representations and warranties with respect to the securitized loans, including representations with respect to the loan characteristics, the absence of fraud or other misconduct in the origination process, and attesting to the compliance of loans with the prevailing underwriting policies. Per the underlying transaction documents, the sponsor of the transaction is contractually obligated to repurchase, cure or substitute collateral for any loan that breaches the representations and warranties.

Subsequent to the forensic exercise of examining loan files to ascertain whether the loans conformed to the representations and warranties, we submit nonconforming loans to the sponsor for repurchase. To effect a repurchase, depending on the transaction, the sponsor is obligated to repurchase the loan (a) for loans which have not been liquidated or charged off, either at (i) the current unpaid principal balance of the loan, (ii) the current unpaid principal balance plus accrued unpaid interest, or (iii) the current unpaid principal balance plus accrued unpaid interest plus unreimbursed servicer advances/expenses and/or trustee expenses resulting from the breach of representations and warranties that trigger the repurchase, and (b) for a loan that has already been liquidated or charged-off, the amount of the realized loss.

In cases where loans are repurchased by a sponsor, the effect is typically to offset current period losses and then to increase the over-collateralization of the securitization, depending on the extent of loan repurchases and the structure of the securitization. Specifically, the repurchase price is paid by the sponsor to the securitization trust which holds the loan. The cash becomes an asset of the trust, replacing the loan that was repurchased by the sponsor. On a monthly basis the cash received related to loan repurchases by the sponsor is aggregated with cash collections from the underlying mortgages and applied in accordance with the trust indenture payment waterfall. This payment waterfall typically includes principal and interest payments to the note holders, various expenses of the trust and reimbursements to Ambac Assurance, as financial guarantor, for claim payments made in previous months. Notwithstanding the reimbursement of previous monthly claim payments, to the extent there continues to be insufficient cash in the waterfall in the current month to make scheduled principal and interest payments to the note holders, Ambac Assurance is required to make additional claim payments to cover this shortfall. Ambac may also receive payments directly from transaction sponsors in settlement of their repurchase obligations pursuant to negotiated settlement agreements or otherwise as a result of related litigation. Ambac Assurance alleges claims for fraudulent inducement in certain cases in connection with Ambac Assurance's issuance of certain insurance policies. Ambac's estimated representation and warranty subrogation recoveries do not include potential recoveries attributed solely to the fraudulent inducement claims.

While the obligation by sponsors to repurchase loans with material breaches is clear, generally the sponsors have not yet honored those obligations without actual or threatened litigation. Ambac Assurance's approach to resolving these disputes has included negotiating with individual sponsors at the transaction level and in some cases at the individual loan level and has resulted in the repurchase of some loans. Ambac Assurance has utilized the results of the above described loan file examinations to make demands for loan repurchases from sponsors or their successors and, in certain instances, as a part of the basis for litigation filings. Ambac Assurance has initiated and will continue to initiate lawsuits seeking compliance with the repurchase obligations in the securitization documents.

Ambac Assurance has performed the above-mentioned, detailed examinations on a variety of second-lien and first-lien transactions that have experienced exceptionally poor performance. However, the loan file examinations and related estimated recoveries we have reviewed and recorded to date have been limited to only those transactions whose sponsors (or their successors) are subsidiaries of large financial institutions, all of which carry an investment grade rating from at least one nationally recognized rating agency, or otherwise deemed to have the financial wherewithal to live up to their repurchase obligations. While our contractual recourse is generally to the sponsor/subsidiary, rather than to the financial institutional parent, each of these financial institutions has significant financial resources and may have an ongoing interest in mortgage finance, and we therefore believe that the financial institution/parent would ultimately assume financial responsibility for these obligations if the sponsor/subsidiary is unable to honor its contractual obligations or pay a judgment that we may obtain in litigation. Additionally, in the case of successor institutions, we are not aware of any provisions that explicitly preclude or limit the successors' ability to honor the obligations of the original sponsor. Certain successor financial institutions have made significant payments to certain claimants to settle breaches of representations and warranties perpetrated by sponsors that have been acquired by such financial institutions. As a result, we did not make any significant adjustments to our estimated subrogation recoveries with respect to the credit risk of these sponsors or their successors. We believe that focusing our loan remediation efforts on large financial institutions first will provide the greatest economic benefit to Ambac Assurance. Ambac Assurance retains the right to review other RMBS transactions for representations and warranties breaches, and management continues to review transactions for inclusion in this effort. There have been limited cases for certain smaller transactions where Ambac has successfully negotiated recoveries for breaches of representations and warranties without a detailed examination of the respective loan files.

Our ability to recover the RMBS subrogation 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, regulatory intervention which could impede our ability to take actions required to realize such recoveries and uncertainty inherent in the assumptions used in estimating such recoveries. In January 2016, Ambac Assurance settled its RMBS-related disputes and litigation against JP Morgan Chase & Co. and certain of its affiliates (collectively JP Morgan). Pursuant to the settlement, JP Morgan paid Ambac Assurance $995,000 ($992,778 net of reinsurance) in cash in return for releases of all of Ambac Assurance's claims against JP Morgan arising from certain RMBS transactions insured by Ambac Assurance.

(Dollar amounts in thousands, except share and per share data)

Reinsurance

Selected information regarding reinsurance is as follows:

	2016		2015	
	Written	Earned	Written	Earned
Direct	$ 49,631	$ 225,522	$ 58,457	$ 334,643
Assumed	1	49	2	74
Ceded	(4,426)	(20,967)	(5,264)	(26,797)
Net premiums	$ 45,206	$ 204,604	$ 53,195	$ 307,920

There are neither unearned premium reserves nor commission equity related to affiliated entities at December 31, 2016. The following table summarizes assumed and ceded unearned premiums and the related commission equity for non-affiliated assumed and ceded reinsurance contracts at December 31, 2016.

	Assumed		Ceded		Assumed less ceded	
	Unearned premiums	Commission equity	Unearned premiums	Commission equity	Unearned premiums	Commission equity
Non-affiliated	$ 1,125	$ 107	$ 30,694	$ 5,832	$ (29,569)	$ (5,725)

The direct unearned premium reserves at December 31, 2016 and 2015 were $518,011 and $693,902, respectively.

Ceded Reinsurance

Ambac Assurance has reinsurance in place pursuant to surplus share treaty and facultative reinsurance agreements. The reinsurance of risk does not relieve Ambac Assurance of its original liability to its policyholders. In the event that any of Ambac Assurance's reinsurers are unable to meet their obligations under reinsurance contracts, Ambac Assurance would, nonetheless, be liable to its policyholders for the full amount of its policy. To minimize its credit exposure to losses from reinsurer insolvencies, Ambac Assurance (i) is entitled to receive collateral from its reinsurance counterparties in certain reinsurance contracts; and (ii) 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).

At December 31, 2016, and 2015 the Company held letters of credit and collateral amounting to approximately $122,912 and $136,167, respectively, from its reinsurers to cover liabilities ceded under the aforementioned reinsurance contracts. At December 31, 2016 and 2015, Ambac Assurance did not have any unsecured reinsurance balances in excess of 3% of policyholders' surplus.

Ceded unearned premiums were $30,694 and $47,235 at December 31, 2016 and 2015, respectively. Ceded loss and loss expense reserves at December 31, 2016 and 2015, were ($24,323) and ($16,236), respectively.

For the years ended December 31, 2016 and 2015, reinsurance recoveries (payables), which reduced (increased) loss and loss expenses incurred, amounted to $5,991 and ($1,844), respectively. Contingent commission ceded during 2016 and 2015 was $3.

Assumed Reinsurance

On March 24, 2010, all assumed reinsurance agreements with third parties were allocated to the Segregated Account, which will not allow for cancellations without the approval of the Rehabilitator. Assumed exposure at December 31, 2016 and 2015 are $243,703 and $243,645 of net par outstanding, respectively.

Retroactive Reinsurance

Ambac Assurance provides aggregate excess of loss reinsurance to the Segregated Account pursuant to the Reinsurance Agreement whereby the Segregated Account has the ability to demand payment from time to time under the Reinsurance Agreement to pay claims and other obligations. Ambac Assurance is not obligated to make payments under the Reinsurance Agreement if its surplus as regards to policyholders is (or would be) less than the Minimum Surplus Amount. As long as the surplus as regards to policyholders is not less than the Minimum Surplus Amount, payments by Ambac Assurance to the Segregated Account under the Reinsurance Agreement are not capped. As of December 31, 2016 and 2015, Ambac Assurance's surplus exceeds the Minimum Surplus Amount.

(Dollar amounts in thousands, except share and per share data)

Pursuant to Statement of Statutory Accounting Principles No. 62 – *Revised, Property and Casualty Reinsurance of SSAP 62R* (SSAP 62R), the allocation of insurance policies to the Segregated Account as well as the Reinsurance Agreement has been recorded as retroactive reinsurance since these contracts were executed in connection with a court-ordered rehabilitation of the Segregated Account. The liabilities allocated to the Segregated Account from Ambac Assurance consist of loss reserves and loss expenses, excluding remediation and reinsurance.

Below is a table reflecting ever-to-date activity for liabilities allocated to the Segregated Account and liabilities assumed from the Segregated Account:

	Liabilities allocated to Segregated Account	Liabilities assumed from Segregated Account	Net liabilities assumed from Segregated Account
Initial allocation and assumption of assets (liabilities)	$ 3,639,973	$ (1,639,973)	$ 2,000,000
Changes in prior years	975,664	(3,391,988)	(2,416,324)
Changes in current year	(46,704)	50,030	3,326
Assets (liabilities) at December 31, 2016	$ 4,568,933	$ (4,981,931)	$ (412,998)

	Liabilities allocated to Segregated Account	Liabilities assumed from Segregated Account	Impact to Surplus
Assets (liabilities) at December 31, 2016	$ 4,568,933	$ (4,981,931)	
Consideration provided to Segregated Account	(2,000,000)	—	
Payments in prior years	3,819,376	(1,789,330)	
Payments in current year	320,917	(318,541)	
Ever-to-date surplus impact at December 31, 2016	$ 6,709,226	$ (7,089,802)	$ (380,576)

The current and prior years payments for liabilities allocated to the Segregated Account consist of the following:

	Current year	Prior years
Partial payments of permitted claims and commutations in the form of surplus notes issued by and cash settlements paid by the Segregated Account	$ 292,282	$ 3,486,435
Loss related and loss expense payments	28,635	332,941
Total loss and loss expense payments	$ 320,917	$ 3,819,376

(5) Capital and Surplus

The Company is authorized to issue 40,000,000 shares of common stock, par value $2.50 per share and 285,000 shares of serial auction rate preferred stock, par value $1,000 per share. Issued and outstanding common stock shares were 32,800,000 at December 31, 2016 and 2015. Issued and outstanding preferred stock shares were 26,411 at December 31, 2016 and 2015, respectively.

Unassigned surplus included net unrealized losses of $66,674 and $84,025 as of December 31, 2016 and 2015, respectively.

(6) Insurance Regulatory Restrictions

Ambac Assurance (exclusive of the Segregated Account which is under the control of OCI via the Segregated Account Rehabilitation Proceedings) is subject to the insurance laws and regulations of each jurisdiction in which it is licensed, some of which are described below. Failure to comply with applicable insurance laws and regulations (including, without limitation, minimum surplus requirements, aggregate risk limits and single risk limits) could expose Ambac Assurance to fines, the loss or suspension of insurance licenses in certain jurisdictions, the imposition of orders by regulators with respect to the conduct of business by Ambac Assurance and/or the inability of Ambac Assurance to dividend monies to Ambac.

Section 3.08 of the Wisconsin Administrative Code prohibits the Company from having total net liability in respect of any one issue of municipal bonds in excess of an amount representing 10% of its policyholders' surplus. Total net liability, as defined by the Wisconsin Administrative Code, means the average annual amount due, net of reinsurance, for principal and interest on the insured amount of any one issue of municipal bonds. Additionally, Section 3.08 of the Wisconsin Administrative Code prohibits the Company from having outstanding cumulative net liability, under inforce policies of municipal bond insurance in an amount which exceeds the sum of the Company's: (i) capital and surplus, plus (ii) contingency reserves. Cumulative net liability, as defined by the Wisconsin Administrative Code, means one-third of one percent of the insured unpaid principal and insured unpaid interest covered by inforce policies of municipal bond insurance.

The New York financial guarantee insurance law establishes single risk limits applicable to obligations insured by financial guarantee insurers. The single risk limits are specific to the type of insured obligation (for example, municipal or asset-backed). The limits compare the insured net par outstanding and average annual debt service, net of reinsurance and collateral, for a single risk to the insurer's qualified statutory capital, which is defined as the sum of the insurer's policyholders' surplus and contingency reserves. New York law also establishes aggregate risk limits on the basis of aggregate net liability and policyholders' surplus requirements. Aggregate net liability is defined as the aggregate of the outstanding insured principal, interest and other payments of guaranteed obligations, net of reinsurance and collateral. Under these limits, surplus to policyholders plus contingency reserves must at least equal a percentage of aggregate net liability that is equal to the sum of various percentages of aggregate net liability for various categories of specified obligations. The percentage varies from 0.33% for municipal bonds to 4.00% for certain non-investment grade obligations.

At December 31, 2016, Ambac Assurance is in compliance with the aggregate risk limits but not in compliance with the single risk limits. Through run-off of the portfolio, Ambac Assurance will seek to reduce its exposure to comply with applicable single and aggregate risk limits, but may not be able to do so.

Pursuant to the Wisconsin Insurance Laws, Ambac Assurance may declare dividends, subject to restrictions in its articles of incorporation, provided that, after giving effect to the distribution, such dividends would not violate certain statutory equity, solvency, income and asset tests. Ambac Assurance's ability to pay dividends is restricted by the OCI. Board action authorizing a shareholder distribution by Ambac Assurance (other than stock dividends) must be reported to the OCI at least 30 days prior to payment. Additionally, no quarterly dividend may exceed the dividend paid in the corresponding quarter of the preceding year by more than 15% without notifying the OCI 30 days in advance of payment. Wisconsin insurance law restricts the payment of dividends in any 12-month period without regulatory approval to the lesser of (a) 10% of policyholders' surplus as of the preceding December 31, and (b) the greater of (i) statutory net income (loss) for the calendar year preceding the date of the dividend, minus realized capital gains for that calendar year or (ii) the aggregate of statutory net income (loss) for three calendar years preceding the date of the dividend, minus realized capital gains for those calendar years and minus dividends paid or credited within the first two of the three preceding calendar years. Extraordinary dividends must be reported prior to payment and are subject to disapproval by the OCI. Based upon these restrictions, Ambac Assurance will not be able to pay dividends during 2016, without regulatory approval. In addition, pursuant to Section 3.04(h) of the Settlement Agreement, Ambac Assurance may not make any Restricted Payment (as defined therein), including dividends from Ambac Assurance to Ambac in excess of $5,000 in the aggregate per annum, other than Restricted Payments from Ambac Assurance to Ambac in an amount up to $7,500 per annum solely to pay operating expenses of Ambac. Concurrent with making any such Restricted Payment, the Surplus Notes issued by Ambac Assurance pursuant to the Settlement Agreement would also need to be proportionately redeemed. Ambac Assurance did not pay ordinary cash dividends on common stock in 2016 and 2015.

Under the terms of Ambac Assurance's preferred stock, dividends may not be paid on the common stock of Ambac Assurance unless all accrued and unpaid dividends on the preferred stock 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 as provided in the prior sentence, dividends on the preferred stock become cumulative until the date that all accumulated and unpaid dividends have been paid on the preferred stock. Ambac Assurance paid ordinary dividends of $0 on preferred stock in 2016 and 2015.

Under New York law, a financial guarantee insurer must have at least $75,000 paid of paid-in capital and surplus and maintain thereafter at least $65,000 of policyholders' surplus. A similar law in California imposes a $100,000 minimum capital and surplus requirement, with a maintenance requirement thereafter of $75,000.

(7) Related Party Transactions

As per the plan of operation for the Segregated Account, the Segregated Account retroactively assumed liabilities from Ambac Assurance which consists of loss and loss expense reserves related to policies allocated to the Segregated Account. In addition, the Segregated Account retroactively ceded obligations to Ambac Assurance pursuant to the Reinsurance Agreement.

During 2015, Ambac Assurance sold one investment security for an amount equal to $4,009 to Everspan. The deferred gain of $3 was recognized in 2015 upon the sale of the investment to Everspan.

During 2015, Ambac Assurance sold certain investment securities for an amount equal to $63,039 to Ambac UK. This transaction resulted in gains of $27,675 which have been deferred in accordance with SSAP 25.

The Company loaned cash to ACFI pursuant to a Credit Agreement, dated November 12, 2008, by and between ACFI, as borrower, and Ambac Assurance, as lender (the ACF Credit Facility). During 2016 and 2015, ACFI had additional borrowings of $2,512 and $17,259, respectively. During 2016 and 2015, ACFI had repayments of $1,250 and $0, respectively. There were outstanding cash loans of $196,396 and $195,134 to ACFI at December 31, 2016 and 2015, respectively. A portion of the loans, ($189,520) and ($187,046) was deemed uncollectible at December 31, 2016 and 2015, respectively.

The Company loaned cash and securities to AFS pursuant to a revolving credit facility approved by the OCI. During 2016, the loans to AFS had additional borrowings of $216,400 and repayments of $182,521. During 2015, the loans to AFS had additional borrowings of $197,800 and repayments of $155,390. There was outstanding cash loan of $714,489 and $680,610 to AFS at December 31, 2016 and 2015, respectively. The loan is deemed uncollectible at December 31, 2016 and 2015. At December 31, 2016 and 2015, securities loaned by Ambac Assurance to AFS, which were classified as investments, had an admitted carrying value of $64,833 and $64,612, respectively.

The Company is party to a reinsurance agreement with Everspan whereby the Company provides excess of loss reinsurance for the aggregate of all incurred losses of Everspan in excess of an attachment point. The attachment point is defined as an amount which would provide for the surplus of Everspan to not fall below $75,000. Premiums assumed under this agreement were $1 in 2016 and 2015. No losses were incurred under this agreement during 2016 and 2015.

During 2016 and 2015, Ambac Assurance guaranteed the timely payment of principal and interest on obligations under investment agreements issued by its affiliates. As of December 31, 2016 and 2015, the principal amount of investment agreements insured was $82,386 and $100,376, respectively, including accrued interest. The insurance policies are collateralized by investment securities, accrued interest receivable, securities purchased under agreements to resell, cash and cash equivalents, and other financial assets which as of December 31, 2016 and 2015 had an aggregate fair value of $89,014 and $109,200 respectively. During 2016 and 2015, Ambac Assurance recorded gross premiums written of $90 and $109 and gross premiums earned of $90 and $161, respectively, related to these agreements. There were no losses incurred under these agreements during 2016 and 2015.

Pursuant to Insurance and Indemnity agreements between AFS and Ambac Assurance, AFS' swap agreements are guaranteed by Ambac Assurance. During 2016 and 2015, Ambac Assurance recorded gross premiums written and earned of $153 and $144 respectively, related to these agreements. The total notional amount under these agreements was $3,042,808 and $2,341,681 at December 31, 2016 and 2015, respectively. The estimated impairment on Ambac Assurance's guarantees of AFS's swap agreements was $25,000 and $0 as of December 31, 2016 and 2015, respectively.

Ambac Assurance is party to Insurance and Indemnity agreements with the swap counterparties of ACP, whereby the Company guarantees timely payment of ACP's obligations under credit default swaps. The total notional amount of these credit default swaps was $737,380 and $970,883 at December 31, 2016 and 2015, respectively. During 2016 and 2015, Ambac Assurance recorded gross premiums written of $845 and $1,578 and gross premiums earned of $1,372 and $1,578, respectively, related to these agreements. There were no losses incurred under these agreements during 2016 and 2015.

Ambac Assurance issued policies of financial guaranty insurance insuring the financial obligations of its affiliate Juneau under its assets, note obligations and swap agreements. Gross premiums written and earned by Ambac Assurance relating to policies with Juneau in 2016 and 2015 were $83 and $96, respectively. There were no losses incurred under these agreements during 2016 and 2015.

In 2015, Ambac Assurance created subsidiaries to invest in residential real estate owned properties sourced from Ambac Assurance insured transactions. As a result, on February 19, 2016, Phoenix Holdings Fund LLC (Phoenix) was formed. On February 25, 2016, certain existing entities (Osprey Holding I LLC and Triton Real Estate Holdings I LLC) were contributed to Phoenix by Ambac Assurance with a value of $4,000. Phoenix received a $3,000 cash capital contribution from Ambac Assurance in 2016. Osprey Holding

(Dollar amounts in thousands, except share and per share data)

I LLC received a $2,000 cash capital contribution from Ambac Assurance in 2015. Phoenix is an unaudited limited liability company and is therefore a non-admitted investment.

Ambac Assurance made the following capital contributions and received the following dividends and capital distributions during 2016 and 2015:

	2016			2015		
	Capital contributions	Dividends	Capital distributions	Capital contributions	Dividends	Capital distributions
Affiliate:						
Osprey	$ —	$ —	$ —	$ 2,000	$ —	$ —
Phoenix	3,000	—	—	—	—	—
Orient Bay	—	168	—			
	$ 3,000	$ 168	$ —	$ 2,000	$ —	$ —

The Amended TSA addresses certain issues including, but not limited to, the allocation and use of NOLs by Ambac, Ambac Assurance and their respective subsidiaries. Pursuant to the Amended TSA, Ambac Assurance received $2,115 and $2,980 from Everspan for the years ended December 31, 2016 and 2015, respectively.

Pursuant to various agreements with affiliates, including the Cost Allocation Agreement, the Management Services Agreement with the Segregated Account, and separate management services agreements with Ambac UK and Orient Bay, (i) $19,448 was either paid or to be paid to third-parties by Ambac Assurance on behalf of its affiliates in 2016; and (ii) $14,154 was charged to affiliates for services provided by Ambac Assurance during 2016. Such amounts in 2015 were $22,470 and $18,444, respectively. Following the exhaustion of the Secured Note, costs and expenses of the Segregated Account were reimbursable by Ambac Assurance pursuant to the Cooperation Agreement. The amounts charged back to Ambac Assurance and recorded in underwriting expenses via the Cooperation Agreement were $13,432 and $17,888 during 2016 and 2015, respectively.

Amounts due from (to) related parties as of December 31, 2016 and 2015 are as follows:

	December 31, 2016	December 31, 2015
Ambac	$ 2,014	$ 2,292
Ambac UK	300	574
AFS	395	439
ACC	165	159
ACP	103	54
Everspan	89	69
Orient Bay	—	2
Phoenix	137	—
Osprey Holding I, LLC	7	—
Triton Real Estate Holdings I, LLC	7	—
Segregated Account	(805)	(548)
Total	$ 2,412	$ 3,041

Net amounts due from (to) related parties are settled net in cash where the right of offset exists.

(8) Commitments and Contingencies

Ambac Assurance's headquarters lease in New York, NY was modified and extended in 2015 to allow Ambac Assurance to remain in the same office space at its current location through September 2019 and on one floor through the end of 2029, with an option to continue to occupy other currently leased floors through the end of 2029. Rent payment under this lease made through September 2019 will result in periodic reduction of the Segregated Account Junior Surplus Notes ($13,056 par value) that were previously issued to the landlord; $4,002 par reduction occurred during 2016. Ambac Assurance leases additional space for its data center and disaster recovery sites. Rental expense for the years ended December 31, 2016 and 2015 was $2,171 and $5,305, respectively. An estimate of future net minimum lease payments in each of the next five years ending December 31, and the periods thereafter, is as follows:

(Dollar amounts in thousands, except share and per share data)

Year	Amount
2017	$ 6,576
2018	6,597
2019	5,319
2020	1,624
2021	1,630
Subtotal	21,746
Thereafter	14,019
Total	$ 35,765

Regulatory Matters

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 Segregated Account and Wisconsin Rehabilitation Proceedings

On March 24, 2010, Ambac Assurance established the Segregated Account and allocated to the Segregated Account certain financial guaranty insurance policies and other contingent liabilities, certain claims and other rights, and certain equity interests in subsidiaries. The Rehabilitation Proceeding was commenced with respect to the Segregated Account in the Rehabilitation Court on March 24, 2010 by OCI and the Rehabilitation Court entered an order of rehabilitation for the Segregated Account, appointing the Commissioner as Rehabilitator, and entered orders enjoining certain actions that could have an adverse effect on the financial condition of the Segregated Account.

Various third parties filed motions or objections in the Rehabilitation Court and/or moved to intervene in the Segregated Account Rehabilitation Proceeding. On January 24, 2011, the Rehabilitation Court issued its Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation, with Findings of Fact and Conclusions of Law (the Confirmation Order). Notices of appeal from the Confirmation Order were filed by various parties, including policyholders. These appeals challenged various provisions of the Segregated Account Rehabilitation Plan and actions the Rehabilitator or the Wisconsin Commissioner of Insurance had taken in formulating the Segregated Account Rehabilitation Plan. These appeals from the Confirmation Order were consolidated with earlier-filed appeals challenging, among other things, the issuance of injunctive relief and a settlement between Ambac Assurance and various financial institutions. On October 24, 2013, the Wisconsin Court of Appeals affirmed the Confirmation Order and the Rehabilitation Court's rejection of the objections filed by various third parties before entry of the Confirmation Order. On November 22, 2013, petitions seeking discretionary review of this ruling by the Wisconsin Supreme Court were filed by various parties. The Rehabilitator responded by opposing further review by the Wisconsin Supreme Court. On March 17, 2014, the Supreme Court of Wisconsin denied the petitions for review making the decision by the Wisconsin Court of Appeals final and controlling law.

On June 9, 2014, the Rehabilitator filed in the Rehabilitation Court a motion to confirm and declare the reimbursement amounts due with respect to cash claim payments made by Ambac Assurance and the Segregated Account on two policies. Certain investors filed objections to the motion on July 2, 2014. On July 7, 2014, after a hearing on the motion, the Rehabilitation Court granted the Rehabilitator's motion. On August 20, 2014, a group of investors filed a notice of appeal. On March 4, 2016, the Wisconsin Court of Appeals affirmed the Rehabilitation Court's ruling. On March 24, 2016, a group of investors filed a motion for reconsideration asking the Wisconsin Court of Appeals to reverse its decision. The motion for reconsideration was denied on March 30, 2016.

On February 10, 2016, certain investors filed a motion in the Rehabilitation Court requesting an order directing the Rehabilitator to show cause why the Interim Payment Percentage as set forth in the Segregated Account Rehabilitation Plan, as amended, should not be substantially increased and distributions promptly made to all holders. A hearing on the motion was held on March 29, 2016. On April 5, 2016, the Rehabilitation Court entered an order denying the motion, granting the Rehabilitator's motion to quash a related deposition notice, and requiring interested parties in the proceedings to obtain leave of court before seeking any discovery.

On July 15, 2016, the Rehabilitator filed a motion to confirm and declare the nature of the Segregated Account Rehabilitation Proceedings in order to avoid misunderstandings that may arise in litigation involving Ambac Assurance concerning certain military housing projects. Certain parties to these military housing litigations filed an opposition to the Rehabilitator's motion on September 30, 2016. On October 11, 2016 the Rehabilitation Court held a hearing on the motion and on October 24, 2016, the Rehabilitation Court entered an order granting the Rehabilitator's motion. On November 7, 2016, the interested parties that had opposed the Rehabilitator's motion filed a notice of appeal from the October 24 order, and filed their opening brief in support of this appeal on January 17, 2017. The Rehabilitator filed a response brief in the Wisconsin Court of Appeals on February 15, 2017. On November 21, 2016, the Rehabilitator filed a motion to quash a subpoena served on the Wisconsin Commissioner of Insurance by certain parties to the military housing litigations. The Rehabilitation Court granted the Rehabilitator's motion to quash on November 23, 2016. The interested parties that had served the subpoena filed an opposition to the Rehabilitator's motion to quash on November 23, 2016, and filed on November 28, 2016 a motion to reconsider the November 23 order, which the Rehabilitator opposed on December 6, 2016. The Rehabilitation Court held a hearing on January 6, 2017 and entered an order on January 20, 2017 denying the motion to reconsider and clarifying procedures for discovery relating to the Segregated Account Rehabilitation Proceedings.

Litigation Against Ambac Assurance

County of Alameda et al. v. Ambac Assurance Corporation et al. (Superior Court of the State of California, County of San Francisco, second amended complaint filed on or about August 23, 2011) (the Alameda Complaint); Contra Costa County et al. v. Ambac Assurance Corporation et al. (Superior Court of the State of California, County of San Francisco, third amended complaint filed on or about October 21, 2011) (the Contra Costa Complaint); The Olympic Club v. Ambac Assurance Corporation et al. (Superior Court of the State of California, County of San Francisco, fourth amended complaint filed on or about October 21, 2011) (the Olympic Club Complaint). The Contra Costa Complaint was brought on behalf of five California municipal entities and the non-profit Jewish Community Center of San Francisco. The Alameda Complaint was brought on behalf of nineteen California municipal entities. The Olympic Club Complaint was brought on behalf of the non-profit Olympic Club. The three actions make similar allegations against Ambac Assurance, various other financial guarantee insurance companies and employees thereof (collectively with Ambac Assurance, the "Bond Insurer Defendants"), and, in the case of the Contra Costa Complaint and the Olympic Club Complaint, the major credit rating agencies (the "Rating Agencies"). The actions allege that (1) Ambac Assurance and the other Bond Insurer Defendants colluded with the Rating Agencies to perpetuate a "dual rating system" pursuant to which the Rating Agencies rated the debt obligations of municipal issuers differently from corporate debt obligations, thereby keeping municipal ratings artificially low relative to corporate ratings; (2) Ambac Assurance and the other Bond Insurer Defendants issued false and misleading financial statements and failed to disclose the extent of the insurers' respective exposures to mortgage-backed securities and collateralized debt obligations; and (3) as a result of these actions, plaintiffs incurred higher interest costs and bond insurance premiums in respect of their respective bond issues. Ambac Financial Group was originally a defendant in each of these actions, but on November 22, 2010, Ambac Financial Group was dismissed without prejudice as a defendant by the plaintiffs in each of these actions. Ambac Assurance and the other Bond Insurer Defendants filed a demurrer seeking dismissal of the current amended complaints on September 21, 2011, which was denied on October 20, 2011. On December 2, 2011, Ambac Assurance and the other Bond Insurer Defendants filed a special motion to strike the current amended complaints under California's Anti-SLAPP statute (Calif. Code of Civ. Proc. Section 425.16). A hearing on the motion was held on March 23, 2012. On May 1, 2012, the Court ruled that the complaints were governed by the Anti-SLAPP statute to the extent they alleged conspiracy to influence the rating agencies' rating methodologies, but not to the extent that the complaints alleged false or misleading statements or nondisclosures. After oral argument on March 21, 2013, the court dismissed claims related to the conspiracy branch of the complaint under the California Antitrust Law (the Cartwright Act) and after oral argument on April 22, 2013 denied defendants' motion to dismiss claims under the California Unfair Competition Law. The court entered an order to this effect on July 9, 2013. On February 18, 2016 the California Court of Appeal, First District, issued a decision reversing the lower court's dismissal of Cartwright Act claim as against Ambac Assurance and otherwise affirming the lower court's decision as to Ambac Assurance. In 2017, Ambac Assurance and representatives of the plaintiffs reached a preliminary agreement to settle these litigations, subject to the receipt of required approvals and execution of a formal settlement agreement.

Ambac Assurance is defending several lawsuits in which borrowers have brought declaratory judgment actions claiming, among other things, that Ambac Assurance's claims for specific performance related to the construction and development of housing at various military bases to replace or cash-fund a debt-service-reserve surety bond, as required under the applicable loan documents (see Litigation Filed or Joined by Ambac Assurance), are time-barred or are barred by the doctrine of laches, that Ambac lacks standing on the basis that there has been an "Ambac Default," and that Ambac is not entitled to specific performance pursuant to the terms of the loan documents. Specifically, Ambac Assurance is a defendant in the following actions:

- Meade Communities LLC v. Ambac Assurance Corporation (Circuit Court, Anne Arundel County, Maryland, Case No. C-02-CV-15-003745). Plaintiff filed this action on December 2, 2015. Ambac Assurance's answer was served on February 16, 2016. On April 28, 2017, Ambac Assurance filed a motion for summary judgment on all counts of the Meade complaint. On April 28, 2017, Meade filed a motion for partial summary judgment on two counts of the complaint and certain Ambac Assurance affirmative defenses. The parties' opposition briefs are due on June 2, 2017.

- Bragg Communities, LLC v. Ambac Assurance Corporation (General Court of Justice, Cumberland county, North Carolina, Case No. 15-CVS-9013). Plaintiff filed this action on December 4, 2015. Ambac Assurance filed a motion to dismiss on February 5, 2016, which was granted on June 14, 2016. The court entered the dismissal of plaintiff's complaint on June 24, 2016. Plaintiff's time to appeal the dismissal has expired.

- Monterey Bay Military Housing LLC and Monterey Bay Land LLC v. Ambac Assurance Corporation (Superior Court, Monterey County, California, Case No. 15CV000599). Plaintiff filed this action on December 4, 2015. Ambac Assurance filed an answer on January 19, 2016. On March 30, 2017, Ambac Assurance filed a motion for summary judgment on all counts of the Monterey Bay complaint. On March 30, 2017, Monterey Bay filed a motion for partial summary judgment on two counts of the complaint and certain Ambac Assurance affirmative defenses. The parties' opposition briefs are due on June 2, 2017.

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. It is not possible to predict whether disputes will arise, nor the outcomes of any potential litigation. It is possible that there could be unfavorable outcomes in any dispute or proceeding and that our interpretations may prove to be incorrect, which could lead to changes to our estimate of loss reserves.

Ambac Assurance is involved from time to time in various routine legal proceedings, including proceedings related to litigation with present or former employees. Although Ambac'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 Ambac Assurance 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 Ambac Assurance 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 but, 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 Assurance

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.

Erste Europäische Pfandbriefund Kommunalkreditbank AG In Luxemburg and Ambac Assurance Corporation v. City of San Bernardino, California (United States Bankruptcy Court, Central District of California, Riverside Division, Docket No. 15-1185, filed on January 7, 2015). Plaintiffs commenced this adversary proceeding, which relates to the Debtor's obligations under the Public Employees Retirement Law, California Government Code Section 20000 et seq. (the Retirement Law), in connection with the City of San Bernardino's bankruptcy proceeding. In the complaint, plaintiffs seek a declaratory judgment that the Debtor is obligated to make equivalent payments to both the holders of certain pension obligation bonds (the "Bonds"), a portion of which are insured by Ambac, and the California Public Employees Retirement Systems (CalPERS) to fund pension and other retirement benefits. It is the plaintiffs' position that they are entitled to declaratory judgment because (i) when the City issue the Bonds, the City argued and a California court found, that the obligations under the Bonds were of the same legal character as the City's obligations to CalPERS and (ii) the amounts owed to the bondholders and to CalPERS are merely separate portions of a single obligation owed by the Debtor under the Retirement Law. Plaintiffs therefore seek equivalent payment as to CalPERS, whether such payment takes for the form of current payments during the bankruptcy proceeding and thereafter, payments otherwise made in connection with the Retirement Law or any agreements entered into in accordance therewith, or distributions under a plan of adjustment. On March 13, 2015, the City filed a motion to dismiss the complaint, which plaintiffs opposed. On May 11, 2015, the court heard oral argument and granted the City's motion to dismiss. On

June 8, 2015, plaintiffs filed a notice of appeal of the court's order granting the City's motion to dismiss with the Bankruptcy Appellate Panel for the Ninth Circuit and filed their appellate brief on January 5, 2016. The parties have reached a settlement and pursuant to the settlement agreement dated March 28, 2016, the plaintiffs have agreed to dismiss the appeal with prejudice upon confirmation of the City's plan of adjustment by the bankruptcy judge and the plan of adjustment becoming effective.

Ambac UK v. J.P. Morgan Investment Management (Supreme Court of the State of New York, County of New York, filed May 4, 2009, No. 650259/2009). Ambac UK commenced this action against J.P. Morgan Investment Management asserting claims for breach of contract, breach of fiduciary duty and gross negligence relating to defendant's mismanagement of assets supporting bonds issued by Ballantyne Plc and insured by Ambac UK that funded excess reserves for term life insurance required by regulation. Pursuant to an agreement with Ballantyne Plc, Ambac UK was given the authority to prosecute Ballantyne plc's claims against J.P. Morgan Investment Management. On March 24, 2010, the court granted defendant's motion to dismiss the complaint. Ambac UK appealed the March 2010 decision and on July 14, 2011, the Appellate Division for the First Department reversed the decision and reinstated Ambac UK's claims in their entirety. Fact and expert discovery have been completed. On January 22, 2016, Ambac UK filed a motion for partial summary judgment seeking a ruling that defendant breached the Investment Management Agreement between JPMIM and Ballantyne plc under one of the asserted theories of liability. On February 21, 2017, the court issued a decision that JPMIM had not complied with the contractual provision at issue in the motion, but also decided that an issue of fact remained as to whether such breach violated the standard of care set forth in the investment management agreement. Trial commenced in March 2017. On March 25, 2017 the parties reached a confidential settlement in principle and on April 11, 2017 executed a settlement agreement memorializing the terms of the agreement.

Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Ambac Assurance Corporation v. Alejandro Garcia Padilla, et al. (United States District Court, District of Puerto Rico No. 3:16-cv-01037, filed on January 7, 2016). Ambac Assurance, along with co-plaintiffs Assured Guaranty Corp. and Assured Guaranty Municipal Corp., filed a complaint for declaratory and injunctive relief to protect its rights against the illegal clawback of certain revenue by the Commonwealth of Puerto Rico. Defendants (including the Government Development Bank (GDB) President but solely in her capacity as a member of the Working Group For The Fiscal and Economic Restoration of Puerto Rico) filed a motion to dismiss for lack of subject matter jurisdiction on January 29, 2016. The GDB President, in her official capacity, moved to dismiss for failure to state a claim upon which relief can be granted on January 29, 2016. Plaintiffs filed their oppositions to the motions on February 16, 2016 and defendants filed replies on February 23, 2016. This case was administratively consolidated with a similar case before the same judge, Financial Guaranty Insurance Company v. Alejandro Garcia Padilla, et al. (United States District Court, District of Puerto Rico No. 3:16- cv-01095). On October 4, 2016, the court denied the Defendants' and GDB President's motions to dismiss with respect to all claims asserted by Ambac Assurance and Assured. On October 14, 2016, Defendants filed a Notice of Automatic Stay, asserting that Plaintiffs' claims have been rendered moot and further asserting that the case is automatically stayed under section 405 of the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA). On October 28, 2016, Plaintiffs informed the court that neither party was currently challenging the stay, and expressly reserved their right to seek to lift the stay at any time. Plaintiffs also objected to Defendants' assertion that the case should be dismissed as moot. PROMESA's litigation stay expired on May 2, 2017. On May 3, 2017, a petition under Title III of PROMESA was filed on behalf of the Commonwealth of Puerto Rico. On May 16, 2017, Defendants filed a statement requesting that the court take notice of the stay resulting from the Commonwealth's Title III filing. On May 17, 2017, the court issued an order staying this case until further order of the court.

Ambac Assurance Corporation v. Puerto Rico Highways and Transportation Authority (United States District Court, District of Puerto Rico, No. 16-cv-1893, filed May 10, 2016). Ambac Assurance filed a complaint against the Puerto Rico Highways and Transportation Authority (PRHTA) on May 10, 2016, alleging breach of fiduciary duty and breach of contract in connection with PRHTA's extension of an existing toll road concession agreement. The complaint alleges that it was inappropriate for PRHTA to enter into the extension agreement in its current state of financial distress because PRHTA has no control over, and is unlikely to receive, the proceeds of the transaction. The complaint also seeks specific performance of PRHTA's contractual duty to provide information requested by Ambac Assurance under documents related to PRHTA bonds insured by Ambac Assurance. Ambac Assurance filed related motions seeking the appointment of a provisional receiver for PRHTA and expedited discovery. In addition to those remedies, Ambac Assurance seeks an order of the court that would, among other things, compel PRHTA to allow Ambac Assurance to inspect PRHTA's financial records on an ongoing basis and permanently enjoin PRHTA from committing further breaches of its fiduciary and contractual duties. On July 1, 2016, PRHTA filed an Emergency Notice of Stay, asserting that the case was automatically stayed under section 405 of PROMESA. Ambac Assurance filed a response on July 11, 2016, disagreeing that the PROMESA stay applies but electing not to contest the stay at such time and reserving the right to challenge it or to seek to lift the stay in the future. Ambac Assurance also asserted that PRHTA still is obligated to make available to Ambac Assurance certain information, notwithstanding the stay on litigation and provided a proposed order for the court to issue. PRHTA filed a reply on July 18, 2016, contesting Ambac Assurance's characterization, and provided an alternative order for the court to issue. Ambac Assurance's response was filed July 25, 2016. PRHTA also filed an Urgent Motion to Exempt PRHTA from Outstanding Filings in the case during the pendency of the stay, which was granted. On August 23, 2016 the court issued an order staying the case. PROMESA's litigation stay expired on May 2, 2017. The Commonwealth and Oversight Board have stated to Ambac Assurance that they believe this action is stayed due to the Commonwealth's Title III filing. Subsequent to that statement, on May 21, 2017, a petition under Title III of PROMESA was filed on behalf of PRHTA. Lex Claims, LLC et al. v. Alejandro Garcia Padilla et al. (United States District Court, District of Puerto Rico, No. 16-2374). On October 7, 2016, certain General Obligation bondholder plaintiffs in an action to which Ambac Assurance is not currently a party filed a motion for leave to amend their complaint and for partial relief from the PROMESA stay. Plaintiffs' proposed second amended complaint adds the Puerto Rico Sales Tax Financing Corporation (COFINA), COFINA's executive director, and the trustee for the COFINA bonds as defendants, and asserts numerous claims that challenge the legal validity of the COFINA structure and seek injunctive relief requiring the sales and use tax proceeds securing COFINA's bonds to be transferred to the Puerto Rico Treasury. The plaintiffs contend that many of the claims challenging COFINA are not subject to PROMESA's litigation stay provisions. On October 24, 2016, the defendants filed an opposition to the motion for leave to amend, arguing that the entire action is subject to the PROMESA stay. On October 26, 2016, Ambac Assurance filed a motion for leave to intervene and in support of the PROMESA stay. Ambac Assurance seeks to intervene principally to argue that the claims challenging COFINA are stayed by PROMESA, but also reserves the right to move to dismiss or otherwise defend against those claims should the court determine they are not stayed. The court has not ruled yet on plaintiffs' motion for leave to amend or Ambac Assurance's motion to intervene. On November 4, 2016, the Court granted Plaintiffs' motion for leave to amend. Plaintiffs filed their second amended complaint that same day. On November 7, 2016, the government defendants sought to stay the case. On November 29, 2016, the parties' briefing on Ambac Assurance's motion to intervene was complete. Other putative intervenors have filed motions to intervene. On February 17, 2017, the court granted the motions to intervene by Ambac Assurance and some of the other movants. The court also denied the motion to stay by defendants and the arguments in support of the stay filed by the intervenors, including Ambac Assurance. On March 20, 2017, Ambac Assurance filed in the district court an answer to the second amended complaint and a motion to dismiss plaintiffs' claim against COFINA, to strike certain portions of the second amended complaint, or, in the alternative, to certify the question of COFINA's constitutionality to the Supreme Court of Puerto Rico. Certain other intervenors also filed answers and various motions in the district court. On April 4, 2017, the U.S. Court of Appeals for the First Circuit reversed the district court's decision concerning the application of the PROMESA stay, which had the effect of reinstating the stay. PROMESA's litigation stay expired on May 2, 2017. On May 3, 2017, a petition under Title III of PROMESA was filed on behalf of the Commonwealth of Puerto Rico. On May 16, 2017, Defendants filed a statement requesting that the court take notice of the stay resulting from the Commonwealth's Title III filing. On May 17, 2017, the court issued an order staying this case until further order of the court. .

Ambac Assurance Corporation v. Puerto Rico, et al. (United States District Court, District of Puerto Rico, No. 17-1567, filed May 2, 2017). On May 2, 2017, Ambac Assurance filed a complaint seeking a declaration that the FEGP and a recently enacted statute called the "Fiscal Plan Compliance Law" are unconstitutional and unlawful because they violate the Contracts, Takings, and Due Process Clauses of the U.S. Constitution; are preempted by PROMESA; and are unlawful transfers of property from COFINA to the Commonwealth in violation of PROMESA. The complaint further seeks an injunction against the filing of any Title III petitions, or the enactment or enforcement of any future legislation, rules, budgets, or restructuring plans premised on the FEGP, and a declaration that the Commonwealth is liable for any funds unlawfully transferred to it from COFINA. The complaint also seeks a declaration that the FEGP and Fiscal Plan Compliance Law each violate covenants made by the Commonwealth and COFINA in the COFINA Resolution, which constitute Events of Default under the COFINA Resolution. On May 3, 2017, a petition under Title III of PROMESA was filed on behalf of the Commonwealth of Puerto Rico, and on May 5, 2017, a petition under Title III of PROMESA was filed on behalf of COFINA. On May 15, 2017, the Oversight Board filed a statement requesting that the court take notice of the stays resulting from these Title III filings. On May 17, 2017, the court issued an order staying this case until further order of the court.

Ambac Assurance Corporation v. Puerto Rico, et al. (United States District Court, District of Puerto Rico, No. 17-1568, filed May 2, 2017). On May 2, 2017, Ambac Assurance filed a complaint alleging that various moratorium laws and executive orders enacted by the Commonwealth to claw back funds from the PRIFA, PRHTA, and PRCCDA bonds violate the Contracts, Takings, and Due Process Clauses of the U.S. Constitution; are preempted by PROMESA; and unlawfully transfer PRHTA, PRCCDA, and PRIFA property to the Commonwealth. The complaint further seeks a declaration that the Commonwealth is liable for any funds unlawfully transferred to it from COFINA; an injunction against enforcement of the moratorium laws and executive orders; and an injunction against the filing of any Title III petitions, or the enactment or enforcement of any future legislation, rules, budgets, or restructuring plans premised on the FEGP. On May 3, 2017, a petition under Title III of PROMESA was filed on behalf of the Commonwealth of Puerto Rico. On May 15, 2017, the Oversight Board filed a statement requesting that the court take notice of the stay resulting from the Commonwealth's Title III filing. On May 17, 2017, the court issued an order staying this case until further order of the court.

Ambac Assurance Corporation v. U.S. Department of Treasury et al. (United States District Court, District of Columbia, No. 17-809, filed May 2, 2017). On May 2, 2017, Ambac Assurance filed a complaint against the U.S. Department of Treasury and Steven Mnuchin, in his official capacity as Secretary of the Treasury, alleging that Puerto Rico's ongoing diversion of rum taxes from PRIFA violates the Contracts, Takings, and Due Process Clauses of the U.S. Constitution, and seeking an equitable lien on all rum taxes possessed by the U.S. Treasury, and an injunction preventing their transfer to the Commonwealth, in order to prevent further dissipation of those funds by the Commonwealth. The Commonwealth and Oversight Board have stated to Ambac Assurance that they believe this action is stayed due to the Commonwealth's Title III filing.

Ambac Assurance Corporation v. Bank of New York Mellon (United States District Court, Southern District of New York. No. 1:17-cv-03804). On May 2, 2017, Ambac Assurance filed a complaint in New York State Supreme Court, New York County, against the trustee for the COFINA bonds, Bank of New York Mellon (BNY), alleging breach of fiduciary, contractual, and other duties for failing to adequately and appropriately protect the holders of certain Ambac-insured senior COFINA bonds. The complaint seeks money damages; a declaration that BONY breached its fiduciary, contractual, and other duties; a declaration compelling BNY to recognize an event of default under the COFINA Resolution and accelerate the COFINA debt; an injunction to prevent BNY from making payments to holders of subordinate COFINA bonds; and forced replacement of BNY as trustee. The Commonwealth and Oversight Board have not stated to Ambac Assurance that they believe this action is stayed due to the Commonwealth's and/or COFINA's Title III filings. However, on May 16, 2017, BNY filed an adversary complaint in COFINA's Title III case for an order to show cause why the court should not: (i) grant an interpleader of funds that BNY is holding for future interest payments to holders of COFINA bonds; (ii) stay this action by Ambac Assurance against BNY; and (iii) discharge BNY from any liability in association with the interpleaded funds. The Title III court will hear argument on BNY's order to show cause on May 30, 2017. On May 19, 2017, BNY filed a notice of removal of this action from New York state court to the United States District Court for the Southern District of New York. On May 22, 2017, this action was referred to a another lawsuit in the United States District Court for the Southern District of New York brought against BNY by holders of COFINA bonds on related issues. That case, Whitebox Multi-Strategy Partners, L.P., et al. v. Bank of New York Mellon (United States District Court, Southern District of New York, No. 1:17-cv-03750), was itself referred to the docket of the COFINA Title III case on May 18, 2017.

Ambac Assurance has filed various lawsuits seeking specific performance of obligations of borrowers on loans related to the construction and development of housing at various military bases to replace or cash-fund a debt-service-reserve surety bond provided by Ambac Assurance, as required under the applicable loan documents. Specifically, Ambac Assurance has instituted the following actions:

- Ambac Assurance Corporation v. Riley Communities, LLC (District Court, Shawnee County Kansas, No. 2016-CV-00026). Ambac Assurance filed this action on January 8, 2016. On February 2, 2016, defendant served its answer.
- Ambac Assurance Corporation v. Fort Leavenworth Frontier Heritage Communities, II, LLC (U.S. District Court, District of Kansas, Index No. 15-CV-9596). Ambac Assurance filed this action on November 19, 2015. On January 4, 2016, defendant moved to dismiss for failure to join an indispensable party, which Ambac Assurance opposed on January 25, 2016. Defendant filed its reply on February 8, 2016. On June 29, 2016, the court denied defendant's motion to dismiss and granted Ambac Assurance leave to file an amended complaint, which was filed on July 13, 2016. On August 1, 2016, Defendant filed a motion to dismiss the amended complaint for lack of subject matter jurisdiction. Ambac Assurance opposed the motion. On March 17, 2017, the court granted Fort Leavenworth's motion to dismiss for lack of subject matter jurisdiction. On March 28, 2017, Ambac Assurance re-filed the case in state court in Shawnee County, Kansas. The re-filed case is styled Ambac Assurance Corporation v. Fort Leavenworth Frontier Heritage Communities II, LLC (District Court, Shawnee County, Kansas, No. 2017-cv-000216).
- Ambac Assurance Corporation v. Carlisle/ Picatinny Family Housing Limited Partnership (Court of Common Pleas, Cumberland County, Pennsylvania, No. 2015-6348). Ambac Assurance filed a summons on December 15, 2015 and a complaint on January 11, 2016. On February 1, 2016, defendant served its answer.
- Ambac Assurance Corporation v. Fort Lee Commonwealth Communities, LLC (Circuit Court, Roanoke City, Virginia, No. CL16000072-00). Ambac Assurance filed this action on January 7, 2016. Defendant served its answer on February 9, 2016.
- Ambac Assurance Corporation v. Fort Bliss/White Sands Missile Range Housing LP (District Court, El Paso County, Texas, Cause No. 2016DCV0094). Ambac Assurance filed this action on January 8, 2016. Defendant served its answer on February 11, 2016.

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 (and, in some cases, the Segregated Account) has filed the following lawsuits:

- Ambac Assurance Corporation v. EMC Mortgage LLC (formerly known as EMC Mortgage Corporation), J.P. Morgan Securities, Inc. (formerly known as Bear, Stearns & Co. Inc.), and JP Morgan Chase Bank, N.A. (Supreme Court of the State of New York, County of New York, filed February 17, 2011). This case is the continuation of a case that was originally filed on November 5, 2008 in the U.S. District Court for the Southern District of New York but that was dismissed from federal court after Ambac Assurance was granted leave to amend its complaint to add certain new claims (but not others) and a new party, which deprived the federal court of jurisdiction over the litigation. After the decision by the federal judge, dated February 8, 2011, Ambac Assurance re-filed the suit in New York state court on February 17, 2011. On July 18, 2011, Ambac Assurance filed a First Amended Complaint in its state-court litigation. In its state-court action, Ambac Assurance asserts claims for breach of contract, indemnification and reimbursement against EMC, as well as claims of fraudulent conduct by EMC and J. P. Morgan Securities Inc. In its First Amended Complaint, Ambac Assurance asserts an additional claim for breach of contract against EMC and a claim for successor liability against a new defendant, JP Morgan Chase Bank, N.A. The Defendants filed their answer to the First Amended Complaint on August 30, 2011, and the parties engaged in discovery. On December 18, 2014, defendants filed a motion for partial summary judgment seeking to dismiss the plaintiffs' claim for fraudulent inducement arguing that as a matter of law, plaintiffs cannot prove justifiable reliance. Ambac Assurance opposed the motion and the court heard oral argument on July 14, 2015. No decision was issued. On January 25, 2016, the parties reached an agreement to settle the litigation and on January 29, 2016, filed a stipulation voluntarily discontinuing the litigation.

- Ambac Assurance Corporation and the Segregated Account of Ambac Assurance Corporation v. EMC Mortgage LLC (formerly known as EMC Mortgage Corporation), J.P. Morgan Securities, Inc. (formerly known as Bear, Stearns & Co. Inc.), and JP Morgan Chase Bank, N.A. (Supreme Court of the State of New York, County of New York, filed March 30, 2012 and amended on August 14, 2012). Ambac Assurance alleges claims for fraudulent inducement and breaches of contract against EMC and J.P. Morgan Securities Inc., as well as claims against JP Morgan Chase Bank, N.A. as EMC's successor in interest, arising from the defendants' misrepresentations and breaches of contractual warranties regarding certain transactions that are not the subject of Ambac Assurance's previously filed lawsuit against the same defendants (described above). Defendants filed a motion to dismiss the amended complaint on September 28, 2012, which Ambac Assurance opposed on October 26, 2012. Oral argument was held on February 21, 2013. On June 13, 2013, the court dismissed Ambac Assurance's contractual claims but not its claims for fraudulent inducement or successor liability. Ambac Assurance appealed the trial court's decision. On October 16, 2014, the Appellate Division for the First Department affirmed the trial court's dismissal. In November 2014, Ambac Assurance filed for leave to re-argue, or in the alternative to appeal, the decision. Defendants opposed the motion. On May 14, 2015, the First Department denied the motion. On January 25, 2016, the parties reached an agreement to settle the litigation and on January 29, 2016, filed a stipulation voluntarily discontinuing the litigation.

- Ambac Assurance and The Segregated Account of Ambac Assurance Corporation v. First Franklin Financial Corporation, Bank of America, N.A., Merrill Lynch, Pierce, Fenner & Smith Inc., Merrill Lynch Mortgage Lending, Inc., and Merrill Lynch Mortgage Investors, Inc. (Supreme Court of the State of New York, County of New York, Case No. 651217/2012, filed April 16, 2012). Ambac Assurance alleges breach of contract, fraudulent inducement, indemnification, reimbursement and requested the repurchase of loans that breach representations and warranties as required under the contracts, as well as damages. Defendants filed a motion to dismiss on July 13, 2012, which Ambac opposed on September 21, 2012. Oral argument was held on May 6, 2013. On July 18, 2013 the court dismissed Ambac Assurance's claims for indemnification and limited Ambac Assurance's claim for breach of loan-level warranties to the repurchase protocol, but did not dismiss Ambac Assurance's other contractual claims or fraudulent inducement claim. On August 21, 2013, defendants filed a notice of appeal, and on August 30, 2013, Ambac Assurance filed a notice of cross-appeal. On April 22, 2014, the parties filed a stipulation withdrawing defendants' appeal and Ambac Assurance's cross-appeal of the court's July 18, 2013 decision. Discovery is ongoing.

- 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). Ambac Assurance filed an Amended Complaint on September 8, 2011. Ambac Assurance alleged breach of contract, fraudulent inducement, indemnification and reimbursement, and breach of representations and warranties, requested the repurchase of loans that breach representations and warranties as required under the contracts, as well as damages, and asserted a successor liability claim against Bank of America. On May 28, 2013, Ambac Assurance filed a Second Amended Complaint adding an alter ego claim against Bank of America alleging that, because Bank of America and Countrywide are alter egos of one another, Bank of America is responsible for Countrywide's liabilities to Ambac. The defendants served their answers on July 31, 2013. Fact and expert discovery has ended. On May 1, 2015, Ambac Assurance filed motions for partial summary judgment, which defendants opposed. Defendants also each filed motions for summary judgment, which Ambac Assurance opposed. The court heard oral argument on July 15, 2015. On October 27, 2015, the court issued a decision dated October 22, 2015 granting in part and denying in part the parties' respective summary judgment motions regarding Ambac Assurance's claims against Countrywide (primary-liability claims), and issued a second decision granting Ambac Assurance's partial motion for summary judgment and denying Bank of America's motion for summary judgment regarding Ambac Assurance's secondary-liability claims against Bank of America. Ambac Assurance and Countrywide filed notices of appeal of the October 22, 2015 decision relating to primary liability and Bank of America filed a notice of appeal of the October 27, 2015 decision relating to its secondary-liability to the New York Appellate Division, First

Department. The First Department held oral argument on January 26, 2017. On May 16, 2017, the First Department issued rulings in both appeals, reversing a number of rulings that the trial court had made and affirming other rulings.

- Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. Nomura Credit & Capital, Inc. and Nomura Holding America Inc. (Supreme Court of the State of New York, County of New York, Case No. 651359/2013, filed on April 15, 2013). Ambac Assurance alleges claims for material breach of contract and for the repurchase of loans that breach representations and warranties under the contracts, as well as damages. Ambac Assurance has also asserted alter ego claims against Nomura Holding America, Inc. Defendants filed a motion to dismiss on July 12, 2013, which Ambac Assurance opposed. The court held oral argument on November 13, 2013. On September 22, 2014, plaintiffs filed an amended complaint alleging claims for fraudulent inducement, material breach of contract and for the repurchase of loans that breach representations and warranties under the contracts, as well as damages. On October 31, 2014 defendants filed a motion to strike the amended complaint. Ambac Assurance opposed that motion and at the court's recommendation also filed a cross motion for leave to amend the complaint on November 14, 2014, which the defendants opposed. Defendants filed a motion to dismiss the fraudulent inducement claim, which Ambac Assurance opposed. The court heard oral argument on the defendants' motion to dismiss the fraudulent inducement claim on April 14, 2015. On June 3, 2015, the court denied defendants' July 2013 motion to dismiss Ambac's claim for breaches of representations and warranties, but granted the defendants' motion to dismiss Ambac's claims for breach of the repurchase protocol and for alter ego liability against Nomura Holding. On December 29, 2016, the court issued a decision denying Nomura's motion to strike Ambac's amended complaint and its motion to dismiss the fraudulent inducement claim. On January 31, 2017, Nomura filed a notice of appeal from that decision. On March 27, 2017, Nomura appealed the June 2015 decision to the extent it denied its motion to dismiss and filed its opening appellate brief. Discovery is ongoing.

- The Segregated Account of Ambac Assurance Corporation and Ambac Assurance Corporation v. Countrywide Home Loans, Inc. (Wisconsin Circuit Court for Dane County, Case No 14 CV 3511, filed on December 30, 2014). Ambac Assurance alleges a claim for fraudulent inducement in connection with Ambac Assurance's issuance of insurance policies relating to five residential mortgage-backed securitizations that are not the subject of Ambac Assurance's previously filed lawsuit against the same defendant. Defendant filed a motion to dismiss the complaint on February 20, 2015, which Ambac Assurance opposed. The court heard oral argument on two of Countrywide's grounds for dismissal on June 23, 2015, and indicated that it would dismiss the Wisconsin Action without prejudice for lack of personal jurisdiction. The court issued an order to that effect on July 2, 2015. Ambac Assurance appealed the July 2, 2015 order. On June 23, 2016, the Wisconsin Court of Appeals reversed the trial court's prior dismissal of the complaint, and on October 11, 2016, the Wisconsin Supreme Court granted Countrywide's petition for review of the June 23 decision by the Wisconsin Court of Appeals. The Wisconsin Supreme Court appeal was argued on February 28, 2017. On June 30, 2015, plaintiffs filed a Summons with Notice in the Supreme Court of the State of New York, County of New York, No. 652321/15 (the "2015 New York Action"), alleging claims identical to the Wisconsin Action. On July 21, 2015, plaintiffs filed a complaint in the 2015 New York Action and a motion to stay the 2015 New York Action pending appeal and litigation of the Wisconsin Action. On August 5, 2015, Countrywide filed its opposition to plaintiffs' motion to stay and on August 10, 2015, Countrywide filed a motion to dismiss the complaint, which Ambac opposed. The court held oral argument in November 2015 and on September 20, 2016 granted Ambac Assurance's motion to stay. Countrywide's motion to dismiss the complaint is held in abeyance pending resolution of the Wisconsin Action.

- 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). Ambac Assurance alleges a claim for fraudulent inducement in connection with Ambac Assurance's issuance of insurance policies relating to eight residential mortgage-backed securitizations that are not the subject of Ambac Assurance's previously filed lawsuits against the same defendants. On February 20, 2015, the Countrywide defendants filed a motion to dismiss the complaint, which Bank of America joined on February 23, 2015. Ambac Assurance opposed the motion. On December 20, 2016, the court issued a decision denying the defendants' motion to dismiss. Discovery is ongoing.

- Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. U.S. Bank National Association (United States District Court, Southern District of New York, Docket No. 17-cv-00446 (SHS), filed January 20, 2017). Ambac Assurance commenced this action to enjoin the defendant from accepting a proposed settlement in a separate litigation that the defendant is prosecuting, as trustee, in connection with a residential mortgage-backed securitization for which Ambac Assurance issued an insurance policy. Ambac Assurance alleges claims for declaratory judgment, breach of contract, breach of fiduciary duty, and violation of the Streit Act. On February 14, 2017, plaintiffs filed an amended complaint asserting additional claims for declaratory judgment and breach of contract related to the defendant's treatment of trust recoveries. The defendant has not yet responded to Ambac Assurance's amended complaint. On February 23, 2017, plaintiffs filed a second amended complaint to reflect a revised settlement offer, and also filed a motion for a preliminary injunction, which U.S. Bank opposed. On March 9, 2017, U.S. Bank filed a motion to dismiss the second amended complaint, which plaintiffs opposed. The court heard oral argument on plaintiffs' motion for a preliminary injunction and U.S. Bank's motion to dismiss on April 24, 2017. On March 6, 2017, U.S. Bank filed a trust instruction proceeding in Minnesota state court concerning the proposed settlement, which is captioned, In the matter of HarborView Mortgage Loan Trust 2005-10, No. 27-TR-CV-17-32 (the Minnesota Action). On April 5, 2017, Ambac Assurance filed a motion to dismiss the Minnesota Action.

(Dollar amounts in thousands, except share and per share data)

- Ambac Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. U.S. Bank National Association (United States District Court, Southern District of New York, Docket No. 17-cv-02614, filed April 11, 2017). Ambac alleges claims for breach of contract, breach of fiduciary duty, declaratory judgment, and violation of the Streit Act in connection with defendant's failure to enforce rights and remedies and defendant's treatment of trust recoveries, as trustee of five residential mortgage-backed securitizations for which Ambac Assurance issued insurance policies.

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, filed in October of 2011). This suit related to a collateralized debt obligation transaction arranged by Citigroup where Ambac Credit Products, LLC (insured by Ambac Assurance) provided credit protection through a credit default swap to a bank counterparty that was exposed to the transaction. The SEC and Citigroup reached a settlement of this action for $285,000. Judge Rakoff, the presiding judge, approved the settlement in August of 2014. We have been informed by the SEC that they intend to make a motion to Judge Rakoff for approval of the distribution of the funds to aggrieved parties. Judge Rakoff must approve the SEC's proposed allocation. While there can be no assurance as what the SEC's proposed allocation will be or the timing or substance of what Judge Rakoff will decide, Ambac Assurance expects to receive a significant portion of the settlement funds. Ambac Assurance has not recorded any receivable for its estimated portion of these settlement funds.

(9) Income Taxes

The net deferred tax asset/(liability) at December 31 and the change from the prior year are comprised of the following components:

	December 31, 2016			December 31, 2015			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Total gross deferred tax assets	$ 1,103,973	$ 25,933	$ 1,129,906	$ 1,176,254	$ 45,167	$ 1,221,421	$ (72,281)	$ (19,234)	$ (91,515)
Valuation allowance adjustment	(907,799)	(25,933)	(933,732)	(1,041,003)	(45,167)	(1,086,170)	133,204	19,234	152,438
Adjusted gross deferred tax assets	196,174	—	196,174	135,251	—	135,251	60,923	—	60,923
Deferred tax nonadmitted	—	—	—	—	—	—	—	—	—
Subtotal net admitted deferred tax assets	196,174	—	196,174	135,251	—	135,251	60,923	—	60,923
Deferred tax liabilities	(196,174)	—	(196,174)	(135,251)	—	(135,251)	(60,923)	—	(60,923)
Net admitted deferred tax assets/ (liabilities)	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —

(Dollar amounts in thousands, except share and per share data)

The admission calculation is comprised of the following components:

		December 31, 2016			December 31, 2015			Change		
		Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
(a)	Federal income taxes paid in prior years recoverable through loss carrybacks	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
(b)	Adjusted gross deferred tax assets expected to be realized (excluding the amount of deferred tax assets from (a) above) after application of the threshold limitation (The lesser of (b)1 and (b)2 below:	—	—	—	—	—	—	—	—	—
	(1) Adjusted gross deferred tax assets expected to be realized following the balance sheet date	—	—	—	—	—	—	—	—	—
	(2) Adjusted gross deferred tax assets allowed per limitation threshold	—	—	—	—	—	—	—	—	—
(c)	Adjusted gross deferred tax assets (excluding the amount of deferred tax assets from (a) and (b) above) offset by gross deferred tax liabilities	196,174	—	196,174	135,251	—	135,251	60,923	—	60,923
(d)	Deferred tax assets admitted as the result of application of SSAP 101. Total (a)+(b)+(c)	$ 196,174	$ —	$ 196,174	$ 135,251	$ —	$ 135,251	$ 60,923	$ —	$ 60,923

Other Admissibility Criteria

		2016	2015
(a)	Ratio of percentage used to determine recovery period and threshold amount in (b)1 above	—%	—%
(b)	Amount of adjusted capital and surplus used to determine recovery period and threshold limitation in (b)2 above	$ 976,477	$ 624,795

Impact of Tax Planning Strategies

		December 31, 2016		December 31, 2015		Change	
		Ordinary	Capital	Ordinary	Capital	Ordinary	Capital
(a)	Adjusted Gross Deferred Tax Assets	$ 196,174	$ —	$ 135,251	$ —	$ 60,923	$ —
(b)	Percentage of adjusted gross deferred tax assets by tax character attributable to the impact of tax planning strategies	—%	—%	—%	—%	—%	—%
(c)	Net admitted adjusted gross deferred tax assets	196,174	—	135,251	—	60,923	—
(d)	Percentage of net admitted adjusted gross deferred tax assets by tax character admitted because of the impact of tax planning strategies	—%	—%	—%	—%	—%	—%

The Company does not utilize any tax planning strategies.

Current income taxes incurred consist of the following major components:

	2016	2015
Federal income taxes	$ 30,965	$ 85,399
Foreign income taxes	—	—
Current income taxes incurred	$ 30,965	$ 85,399

(Dollar amounts in thousands, except share and per share data)

The net deferred tax asset/(liability) at December 31 and the change from the prior year are comprised of the following components:

	December 31, 2016			December 31, 2015			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Deferred tax assets:									
Net operating loss carry-forward	$ 897,356	$ —	$ 897,356	$ 970,437	$ —	$ 970,437	$ (73,081)	$ —	$ (73,081)
Tax credit carry-forward	31,889	—	31,889	27,334	—	27,334	4,555	—	4,555
Unearned premium reserve	20,395	—	20,395	26,838	—	26,838	(6,443)	—	(6,443)
Contingency reserve	137,131	—	137,131	136,808	—	136,808	323	—	323
Investments	—	—	—	7,580	—	7,580	(7,580)	—	(7,580)
Capital loss carry-forward	—	25,933	25,933	—	45,167	45,167	—	(19,234)	(19,234)
Other	17,202		17,202	7,257		7,257	9,945	—	9,945
Total gross assets	1,103,973	25,933	1,129,906	1,176,254	45,167	1,221,421	(72,281)	(19,234)	(91,515)
Valuation allowance adjustment	(907,799)	(25,933)	(933,732)	(1,041,003)	(45,167)	(1,086,170)	133,204	19,234	152,438
Total adjusted gross deferred tax assets	196,174	—	196,174	135,251	—	135,251	60,923	—	60,923
Nonadmitted deferred tax assets	—	—	—	—	—	—	—	—	—
Admitted deferred tax assets	196,174	—	196,174	135,251	—	135,251	60,923	—	60,923
Deferred tax liabilities:									
Surplus notes	(133,527)	—	(133,527)	(110,281)	—	(110,281)	(23,246)	—	(23,246)
Unremitted foreign earning	(30,699)	—	(30,699)	—	—	—	(30,699)	—	(30,699)
Other	(31,948)	—	(31,948)	(24,970)	—	(24,970)	(6,978)	—	(6,978)
Total deferred tax liabilities	(196,174)	—	(196,174)	(135,251)	—	(135,251)	(60,923)	—	(60,923)
Net admitted deferred tax asset (liabilities)	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —

The valuation allowance adjustments at 2016 and 2015 relates to the uncertainty of Ambac Assurance's ability to utilize the NOL carry forward. The realization of the deferred tax asset is dependent upon the Company's ability to generate sufficient taxable income in the future periods. As a result of Ambac Assurance's history of operating losses as well as the risks and uncertainties associated with future operating results, management anticipates that it is more likely than not that future taxable income will not be sufficient for the realization of the remaining deferred tax assets.

The change in deferred income taxes reported in surplus before consideration of non-admitted assets is comprised of the following components:

	2016	2015	Change
Total deferred tax assets	$ 1,129,906	$ 1,221,421	$ (91,515)
Total deferred tax liabilities	(196,174)	(135,251)	(60,923)
Net deferred tax assets/liabilities	933,732	1,086,170	(152,438)
Valuation allowance adjustment	(933,732)	(1,086,170)	152,438
Net deferred tax assets/ liabilities after valuation allowance adjustment	$ —	$ —	$ —
Change in deferred income tax			$ —

(Dollar amounts in thousands, except share and per share data)

The Company's income tax incurred and change in deferred income tax differs from the amount obtained by applying the federal statutory rate of 35% to income before taxes as follows:

	2016	2015
Current income tax incurred	$ 30,965	$ 85,399
Change in deferred income tax	—	—
Total income tax reported	$ 30,965	$ 85,399
Income (loss) before taxes	$ 390,017	$ 857,681
	35%	35%
Expected income tax expense at 35% statutory rate	$ 136,506	$ 300,188
Increase (decrease) in actual tax reported resulting from:		
Tax-exempt income	(1,434)	(1,326)
Change in contingency reserves	(323)	(77,885)
Net income from subsidiaries	10,738	14,998
Unremitted foreign earnings	33,009	—
Segregated Account in Rehabilitation	—	52,319
Everspan Tax Settlements	(2,415)	(2,487)
Accrued tolling payment	29,234	70,911
Utilization of Capital Loss Carryforward	(3,887)	(18,229)
Change in valuation allowance	(152,438)	(268,542)
Return Filing and Provision Adjustments	(18,862)	11,780
Other	837	3,672
Total income tax reported	$ 30,965	$ 85,399

At December 31, 2016, Ambac Assurance has the following net operating loss carryforwards available to offset any actual separate company tax liability due under the tax sharing agreement:

Origination year	Expiration year	Amount
2009	2030	$ 548,690
2010	2031	1,078,921
2011	2032	712,293
2012	2033	223,972
Total		$ 2,563,876

At December 31, 2016 and 2015, Ambac Assurance has a capital loss carryforward of $74,094 and $129,048, respectively, available to offset future capital gains which will expire in 2016 through 2018. At December 31, 2016 and 2015, there are no amounts available for recoupment in the event of future net losses. The Company has no deposits admitted under Section 6603 of the Internal Revenue Code.

The Company does not have any unrecognized tax benefits for the two years ended December 31, 2016.

The Company does not have any tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within twelve months of the reporting date.

(Dollar amounts in thousands, except share and per share data)

(10) Employee Benefits

Postretirement Health Care and Other Benefits:

Ambac Assurance provides postretirement and postemployment benefits, including health and life benefits for certain employees who meet certain age and service requirements. None of the plans are currently funded. In addition, Ambac provides severance benefits. Postretirement and postemployment benefits expenses, including severance benefits paid was $7,898 and $2,464 during 2016 and 2015, respectively.

Effective August 1, 2005, new employees were not eligible for postretirement benefits. In 2013, postretirement benefits offered to retirees were amended such that Ambac would no longer sponsor a health plan beginning in 2014. This required retirees to purchase their own insurance policy with a portion of their premium being reimbursed by Ambac. The unfunded accumulated postretirement benefit obligation was $9,958 and $10,427 as of December 31, 2016 and 2015, respectively. The assumed health care cost trend rates range from 5.8% in 2017, decreasing ratably to 4.5% in 2023. Increasing the assumed health care cost trend rate by one percentage point in each future year would increase the accumulated postretirement benefit obligation at December 31, 2016, by $187 and the 2016 benefit expense by $13. Decreasing the assumed health care cost trend rate by one percentage point in each future year would decrease the accumulated postretirement benefit obligation at December 31, 2016 by $260 and the 2016 benefit expense by $19.

The following table sets forth projected benefit payments from Ambac Assurance's postretirement plan and reflects expected future service where appropriate:

	Amount
2017	$ 270
2018	295
2019	318
2020	332
2021	353
All later years	2,269
	$ 3,837

The discount rate used in determining the projected benefit obligations for the postretirement plan is selected by reference to the year-end Citigroup pension liability index with similar duration to that of the benefit plans. The rate used for the projected plan benefit obligations at the measurement date for December 31, 2016 and 2015 was 4.00% and 4.25%, respectively.

Savings Incentive Plan:

Ambac Assurance is the sponsor of a defined contribution plan. Ambac Assurance makes an employer matching contribution subject to limits set by the Internal Revenue Code. Matching contributions will equal 100% of the employees' contribution, up to 3% of such participants' base salary, plus 50% of contributions up to an additional 2% of base salary. The total cost to the Company was $911 and $1,042 in 2016 and 2015, respectively. No Basic Profit-Sharing contributions or Supplemental Profit-Sharing contributions were made to the Plan in 2016 and 2015.

Incentive Compensation:

Incentive compensation is a key component of our compensation strategy. Incentive compensation payouts can be highly variable from year to year and are generally based on the execution of our strategies at Ambac, as well as business unit and individual performance. In January of each year a determination is made as to the total amount of incentive compensation to be awarded. Employees, directors and consultants of Ambac Assurance may be eligible to participate in Ambac's 2013 Incentive Compensation Plan (the 2013 Plan) subject to the discretion of the compensation committee of Ambac's Board of Directors. The 2013 Plan provides for incentives and rewards that are valued or determined by reference to Ambac common stock as traded on the NASDAQ exchange (listed as AMBC). There are 4,000,000 shares of Ambac's common stock authorized for awards under the 2013 Plan of which 3,004,639 shares are available for future grant at December 31, 2016. During 2016, 2015, 2014 and 2013, certain stock grants were awarded to directors, the former Chief Executive Officer of Ambac and certain executives of Ambac under the 2013 Plan. However, because those awards were granted for purposes other than compensation for services provided to Ambac Assurance, they are not subject to the statutory reporting requirements of Statement of Statutory Accounting Principles No. 104 – *Share-Based Compensation* (SSAP 104).

(Dollar amounts in thousands, except share and per share data)

In March 2014, Ambac developed a long term incentive compensation plan (the LTIP) as a sub-plan of the 2013 Plan. The LTIP, approved by the Compensation Committee of the Board of Directors of both Ambac and Ambac Assurance, is a significant component of management's compensation program that is intended to strike an appropriate balance between short and long-term incentives aimed at fostering retention and aligning management's interest with those of Ambac's stakeholders. Awards granted under the LTIP are designed to further the financial and operational objectives of both Ambac and Ambac Assurance. The LTIP is intended to be an annual program that allows for both cash and equity performance awards to certain US employees.

Performance awards were granted under the LTIP to certain employees (LTIP Awards). These grants vest in 3 years and are evenly split between performance stock units (PSUs) and cash. Actual awards will be based on performance at both Ambac and Ambac Assurance. Actual awards can payout 0% to 200% of the number of units granted. Ambac performance will be evaluated relative to cumulative earnings before interest, taxes, depreciation and amortization over the vesting period (exclusive of Ambac Assurance and its subsidiaries' earnings), which is intended to reward participants on generating taxable income from new business development. Over the same period, Ambac Assurance performance will be evaluated according to changes in a ratio or value of Ambac Assurance's assets to its insurance and financial obligations, which is intended to reward participants for increases in the relative value of Ambac Assurance. Other than voluntary termination or involuntary termination for cause, and provided that a participant's employment with the Company is not terminated within the first year of the performance period (reduced to six months for the 2016 grant to employees other than executive officers), the performance awards shall partially vest as of the date of such termination in the proportion of the number of calendar days which have lapsed since the start of the performance period and the denominator of which shall be the total number of calendar days of the performance period. Settlements of all performance awards shall be within 60 days after the end of the performance period, including those that had a partial vesting.

In 2016, Restricted Stock Unit (RSU) awards were granted to certain Executive Officers. The awards vest in three equal installments on February 21, 2017, 2018 and 2019 (Time-Based RSUs). The vesting of the Time-Based RSUs are expressly conditioned upon the Executives continued service with Ambac through the applicable vesting date.

In accordance with SSAP 104, share-based payments award programs of the principal stockholder shall be treated as contributed surplus by the principal stockholder. Paid in surplus in the amount of $3,329 and $891 was recognized for the years ended December 31, 2016 and 2015 relating to the expensing of the PSUs and RSUs, net of forfeiture benefits, granted to employees of Ambac Assurance under the LTIP. An additional $1,790 and $891 of compensation expense was recognized related to the cash portion of the LTIP performance awards for the years ended December 31, 2016 and 2015.

A summary of 2016 RSU activity is as follows:

	Shares	Weighted average grant date fair value
Outstanding at beginning of year	—	$ —
Granted	336,232	13.90
Delivered	—	—
Forfeited	(206,972)	13.77
Outstanding at end of year	129,260	$ 14.12

As of December 31, 2016 there was $286 of total unrecognized compensation costs related to unvested RSUs granted. These costs are expected to be recognized over a weighted average period of 2.2 years.

(Dollar amounts in thousands, except share and per share data)

A summary of 2016 PSU activity is as follows:

	Shares [1]	Weighted average grant date fair value
Outstanding at beginning of year	95,545	$ 26.41
Granted	201,480	16.27
Delivered	—	—
Forfeited	(104,952)	17.40
Outstanding at end of year	192,073	$ 20.70

(1) Represents performance share units at 100% of units granted for LTIP Awards.

As of December 31, 2016 there was $2,015 of total unrecognized compensation costs related to PSU portion of unvested performance awards, which are expected to be recognized over a weighted average period of 1.7 years.

(11) Guarantees in Force

The gross par amount of bonds guaranteed, for non-affiliates, was $74,420,000 and $102,709,000 at December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, the guarantee portfolio, net of reinsurance, was diversified by type of insured bond as shown in the following table:

	Net par amount outstanding	
(Dollars in millions)	2016	2015
Public finance:		
Lease and tax-backed revenue	$ 15,688	$ 22,060
General obligation	9,867	15,946
Utility revenue	4,298	8,218
Housing revenue	6,508	6,810
Transportation revenue	3,860	5,589
Higher education	2,339	3,439
Health care revenue	1,484	2,234
Other	1,018	1,140
Total public finance	45,062	65,436
Structured finance:		
Mortgage-backed and home equity	9,383	11,387
Investor-owned utilities	3,833	4,921
Student loan	1,388	2,323
Asset-backed	565	1,140
CDOs	132	306
Other	750	837
Total structured finance	16,051	20,914
International finance:		
Investor-owned and public utilities	1,613	1,843
Transportation revenue [(1)]	1,153	1,512
Asset-backed	501	876
Sovereign/sub-sovereign [(1)]	650	786
CDOs	185	190
Other	128	154
Total international finance	4,230	5,361
Total net par outstanding	$ 65,343	$ 91,711

(1) Included are Ambac Assurance second to pay guarantees on certain policies where Ambac UK is the primary guarantor of $1,078 and $1,259 as of December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015, the international guaranteed portfolio is shown in the following table by location of risk:

	Net par amount outstanding	
(Dollars in millions)	**2016**	**2015**
Australia	$ 1,393	$ 1,851
United Kingdom	1,183	1,462
Internationally diversified	648	974
Austria	317	336
New Zealand	270	265
France	255	254
Other international	164	219
Total international finance	$ 4,230	$ 5,361

Internationally diversified obligations represent pools of geographically diversified exposures which may include significant components of domestic exposure.

Gross financial guarantees in force (principal and interest) were $117,891,000 and $164,804,000 at December 31, 2016 and 2015, respectively. Net financial guarantees in force (after giving effect to reinsurance) were $106,388,000 and $146,872,000 as of December 31, 2016 and 2015, respectively.

In the United States, California, New York and New Jersey were the states with the highest aggregate net par amounts in force, accounting for 21.9%, 8.3%, and 5.7%, respectively, of the total net par at December 31, 2016. No other state accounted for more than five percent. The highest single insured risk represented 2.5% of aggregate net par amount guaranteed.

(12) Fair Values of Financial Instruments

The fair values of the Company's financial assets have been classified, for disclosure purposes, based on a hierarchy defined by the Statement of Statutory Accounting Principles No. 100 *Fair Value Measurements* (SSAP 100). SSAP 100 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 market assumptions. In accordance with SSAP 100, the fair value hierarchy prioritizes model inputs into three broad levels as follows:

- Level 1 – Quoted prices for identical instruments in active markets. Assets classified as Level 1 include U.S. treasury securities, variable rate demand obligations, money market funds and mutual 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 classified as Level 2 generally include fixed income securities representing municipal, asset-backed and corporate obligations.
- 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 typically include certain fixed income securities for which quoted prices are not available, transactions with the Segregated Account, and fair value of financial guarantees. Valuation models require significant Company based assumptions.

When available, the Company generally uses quoted market prices to determine fair value, and classifies such items within Level 1. Because many fixed income securities do not trade on a daily basis, pricing sources apply available information through processes such as matrix pricing to calculate fair value. In those cases the items are classified within Level 2. If quoted market prices are not available or cannot be reasonably corroborated, fair value is based upon models that use, where possible, current market-based or independently sourced market parameters. 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.

(Dollar amounts in thousands, except share and per share data)

The determination of fair value for financial instruments categorized in Level 2 or 3 involves significant 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 prices for securities. As a result of these factors, the actual trade value of a financial instrument in the market may be significantly different from its reported fair value.

The carrying amount and estimated fair value of these financial instruments are presented below:

			Fair value measurements categorized as		
	Carrying amount	Estimated fair value	Level 1	Level 2	Level 3
December 31, 2016:					
Financial assets:					
Bonds	$ 4,694,129	$ 4,815,156	$ 72,226	$ 4,066,662	$ 676,268
Short-term investments	306,180	306,143	260,384	45,759	—
Cash and cash equivalents	41,771	41,771	15,375	26,396	—
Receivable for securities	1,176	1,176	1,176	—	—
Other unaffiliated invested assets	136,774	135,952	51,158	80,728	4,066
Liabilities allocated to Segregated Account	4,568,933	6,319,694	—	—	6,319,694
Financial liabilities:					
Borrowed money and interest thereon	$ 103,308	$ 103,308	$ —	$ 103,308	$ —
Liabilities assumed from Segregated Account	4,981,931	6,818,120	—	—	6,818,120
Liability for net financial guarantees written	3,345,026	5,751,818	—	—	5,751,818
December 31, 2015:					
Financial assets:					
Bonds	$ 4,362,180	$ 4,494,112	$ 71,949	$ 3,823,729	$ 598,434
Short-term investments	133,023	133,023	105,632	27,391	—
Cash and cash equivalents	5,836	5,836	5,836	—	—
Receivable for securities	43,881	43,881	43,881	—	—
Other unaffiliated invested assets	7,420	6,338	—	1,210	5,128
Liabilities allocated to Segregated Account	4,615,637	7,185,717	—	—	7,185,717
Financial liabilities:					
Borrowed money and interest thereon	$ 132,837	$ 132,837	$ —	$ 132,837	$ —
Liabilities assumed from Segregated Account	5,031,961	7,661,616	—	—	7,661,616
Liability for net financial guarantees written	2,908,247	5,424,749	—	—	5,424,749

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Bonds, loan-backed securities, investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account (collectively bonds) and Other Unaffiliated Invested Assets

The estimated fair values represent fair values as determined by using independent market sources, when available, and appropriate valuation methodologies when market quotes are not available. The estimated fair values are based primarily on market prices received from dealer quotes or alternative pricing sources with reasonable levels of price transparency. Such quotes generally consider a variety of factors, including recent trades of the same and similar securities. For those bonds where quotes were not available or cannot be reasonably corroborated, fair values are based on internal valuation models, which require significant management judgment to interpret market data and estimate fair values. Accordingly, the estimates presented are not necessarily indicative of the amount Ambac Assurance could realize in the market.

Short-Term Investments and Cash and Cash Equivalents

The fair values of short-term investments are determined by using independent market sources. The fair value of cash and cash equivalents are determined by using independent market sources, when available, or its bank balance.

Receivable for Securities

The fair value of receivable for securities approximates carrying value before any non-admitted asset adjustment.

Liabilities Allocated to the Segregated Account

The fair value estimate represents a net asset to the Company and is the sum of the present values of expected losses (excluding the effect of reinsurance or subrogation recoveries which are not allocated to the Segregated Account) of allocated policies for both defaulted and policies expected to default in the future, claims presented and not yet paid as a result of the Segregated Account Rehabilitation Proceedings and accrued and unpaid interest on Deferred Amounts. The Company and the Segregated Account are a single corporate entity and the estimated fair value below does not include a credit valuation adjustment for the creditworthiness of the Segregated Account.

Key variables are par amounts outstanding, expected term, discount rate and expected net loss and loss expense payments. The risk free rate was utilized to calculate present values, and net par outstanding is monitored by Ambac Assurance's Portfolio Risk Management Group. The fair value estimate considers an estimated profit margin on net cash flows. This profit margin represents what another financial guarantee insurer would require to assume the liabilities allocated. Given the unique nature of financial guarantees and current state of the industry, there is a lack of observable market information to make this estimate. The profit margin was developed based on discussions with the third-party institutions with valuation expertise, discussions with industry participants and yields on Ambac Assurance surplus notes.

This methodology is based on management's expectations of how a market participant would estimate net cash flows. We are aware of a number of factors that may cause such fair or exit value to differ, perhaps materially. For example, (i) since no financial guarantor with Ambac Assurance's credit quality is writing or otherwise obtaining new financial guarantee business (e.g. reinsurance or novation of policies from other insurers) we do not have access to observable pricing data points; and (ii) certain segments of Ambac Assurance's financial guarantees have been allocated to the Segregated Account and timing of the payments of such liabilities are at the sole discretion of the Rehabilitator.

Liabilities Assumed from the Segregated Account

The fair value estimate represents a net liability to the Company. It is the remainder of the estimated fair value of liabilities allocated to the Segregated Account less the sum of the estimated fair value of the Segregated Account's net financial assets. Net financial assets include cash, receivables and other invested assets, investment income due and accrued, partially offset by Ambac Assurance's obligation to support payments under surplus and junior surplus notes issued by the Segregated Account, as discussed below.

Under the terms of the Reinsurance Agreement, Ambac Assurance assumes all claims and other liabilities in excess of liquid assets of the Segregated Account, subject to the Minimum Surplus Amount at Ambac Assurance. Since the surplus of Ambac Assurance is contingent on the activities of Ambac Assurance and its insured book of financial guarantees, there is no guarantee that such surplus will exceed the Minimum Surplus Amount for the life of the Segregated Account and accordingly the value of such reinsurance could be reduced. The Company considers Ambac Assurance and the Segregated Account to be a single corporate entity. As such, the estimated fair value of the liabilities assumed from the Segregated Account to Ambac Assurance does not include a credit valuation adjustment for Ambac Assurance's creditworthiness. Accordingly, the Segregated Account surplus notes, including junior surplus notes, are reflected at the sum of principal and interest at the statement date.

Borrowed Money and Interest Thereon

The fair value estimates of borrowed money and interest thereon are valued using market prices received from dealer quotes.

Liability for Net Financial Guarantees Written

Fair value of net financial guarantees written represents our estimate of the cost to Ambac Assurance to completely transfer its insurance obligation to another financial guarantor under current market conditions. This amount should be the same amount that another financial guarantor hypothetically charge in the market place to provide the same protection as of the balance sheet date. This fair value estimate of financial guarantees is disclosed on a net basis, and includes direct and assumed insurance policies, which represents a net liability to the Company, net of ceded reinsurance contracts, which represents a net asset to the Company. The fair value estimate of financial guarantees is computed by utilizing cash flows calculated at the policy level. Projected future net cash flows for each policy included: (i) installment premium receipts, (ii) estimated gross claim payments for both defaulted and policies expected to default in the future, (iii) estimated subrogation receipts for both defaulted and policies expected to default in the future and (iv) unpaid claims on claims presented and not yet paid for policies allocated to the Segregated Account, including Deferred Amounts and interest thereon. The timing of future claim payments on policies allocated to the Segregated Account are at the sole discretion of the Rehabilitator. For ceded reinsurance contracts, projected future net cash flows for each policy included: (i) installment ceded premium payments, (ii) ceding commission receipts, (iii) ceded claim receipts, and (iv) ceded subrogation payments. For each individual policy or reinsurance contract (assumed and ceded), the respective undiscounted cash flow components are aggregated to determine if we are in a net asset or net liability position. For each individual policy or reinsurance contract in a net liability position, we estimate the fair value using LIBOR and subsequently apply a profit margin as discussed above in Liabilities Allocated to the Segregated Account. 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.

(Dollar amounts in thousands, except share and per share data)

Similar to liabilities allocated to the Segregated Account as discussed above, this methodology is based on management's expectations of how a market participant would estimate net cash flows. Pursuant to paragraph 14 of SSAP 100, a credit valuation adjustment for the Company's creditworthiness has not been incorporated in our current fair value estimate.

Assets and Liabilities Measured at Fair Value

The following table sets forth Ambac Assurance's financial assets and liabilities that were measured and reported at fair value in the statement of financial position after initial recognition as of December 31, 2016 and 2015 by level within the fair value hierarchy. These assets are bonds that have a NAIC designation of 3 or higher and their fair value is lower than amortized cost. The NAIC designation for loan backed securities considers the two step process and these securities are determined based on the first step.

	Level 1	Level 2	Level 3	Total
2016:				
Financial assets:				
Bonds:				
Issuer obligations	$ —	$ 31,677	$ —	$ 31,677
Commercial mortgage-backed securities	—	—	65,990	65,990
Total financial assets measured at fair value	$ —	$ 31,677	$ 65,990	$ 97,667
Financial liabilities:				
Total financial liabilities measured at fair value	$ —	$ —	$ —	$ —
2015:				
Financial assets:				
Bonds:				
Issuer obligations	$ —	$ 1,042	$ —	$ 1,042
Commercial mortgage-backed securities	—	70,707	—	70,707
Other loan-backed and structured securities	—	—	174,518	174,518
Total financial assets measured at fair value	$ —	$ 71,749	$ 174,518	$ 246,267
Financial liabilities:				
Total financial liabilities measured at fair value	$ —	$ —	$ —	$ —

There were no transfers in or out of Level 1 and 2 in 2016 or 2015.

(Dollar amounts in thousands, except share and per share data)

The following table set forth Ambac Assurance's financial assets and liabilities that were carried at fair value in Level 3 of the fair value hierarchy as of December 31, 2016 and 2015:

	Balance at January 1, 2016	Transfers into Level 3[(a)]	Transfers out of Level 3	Total gains and (losses) included in Net Income	Total gains and (losses) included in Surplus	Purchases	Issuances	Sales	Settlements	Balance at December 31, 2016
Assets:										
Commercial and mortgage-backed securities	$ —	$ 70,707	$ —	$ 1,931	$ (4,900)	$ —	$ —	$ —	$ (1,748)	$ 65,990
Loan-backed and structured securities	174,518	—	(174,803)	—	285	—	—	—	—	$ —
Total assets	$ 174,518	$ 70,707	$ (174,803)	$ 1,931	$ (4,615)	$ —	$ —	$ —	$ (1,748)	$ 65,990
Liabilities:										
	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Total liabilities	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —

	Balance January 1, 2015	Transfers into Level 3[(b)]	Transfers out of Level 3	Total gains and (losses) included in Net Income	Total gains and (losses) included in Surplus	Purchases	Issuances	Sales	Settlements	Balance December 31, 2015
Assets:										
Loan-backed and structured securities	—	173,912	—	891	(285)	—	—	—	—	174,518
Total assets	$ —	$ 173,912	$ —	$ 891	$ (285)	$ —	$ —	$ —	$ —	$ 174,518
Liabilities:										
	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Total liabilities	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —

(a) Transfers into Level 3 represent bonds having an NAIC designation of 3 or higher and the fair value is lower than the amortized cost at December 31, 2016. Prior to 2016, these Level 3 securities were priced by broker and were considered a Level 2 security.

(b) Transfers into Level 3 represent bonds having an NAIC designation of 3 or higher and the fair value is lower than the amortized cost at December 31, 2015. Previously these Level 3 securities had fair value greater than amortized cost.

All Level 1, 2, and 3 transfers are recognized at the beginning of each quarterly accounting period.

The fair values of fixed income securities held by Ambac Assurance that are carried at fair value and classified as Level 2 are based primarily on market prices received from alternative pricing sources with reasonable levels of price transparency or from brokers. Such quotes generally consider a variety of factors, including recent trades of the same and similar securities. These quotes represent the only input to the reported fair value of Level 2 fixed income securities.

(Dollar amounts in thousands, except share and per share data)

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

Commercial and mortgage-backed securities: These securities classified as Level 3 at December 31, 2016 are a subordinate tranche of a military housing bond resecuritization. The fair value of such securities 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 December 31, 2016, include the following weighted averages:

December 31, 2016:	
a. Coupon rate:	5.93%
b. Maturity:	17.74 years
c. Yield:	13.5%

Other loan-backed and structured securities: These securities classified as Level 3 at December 31, 2015 are obligations of a U.S. commercial asset-backed securitization transaction and are guaranteed by Ambac Assurance. The fair value of such securities was calculated as the sum of the present value of expected future cash flows from the underlying assets plus the present value of the related Ambac financial guarantee cash flows. The discount rates applied to cash flows from the underlying assets were based on interest rates for similar obligations. The fair value of financial guarantee cash flows include internal estimates of future loss payments by Ambac discounted at a rate that incorporates Ambac's own credit risk. Significant inputs for the valuation at December 31, 2015, include the following weighted averages:

December 31, 2015:	
a. Coupon rate:	5.88%
b. Maturity:	21.81 years
c. Yield:	9.14%

(13) Debt

At December 31, 2016, Ambac Assurance has the following outstanding surplus notes classified as debt:

Date issued	Interest rate	Par value (face amount of the note)	Carrying value of note	Principal and/ or interest paid current year	Total ever-to-date principal and/or interest paid	Unapproved principal and/ or interest on outstanding notes	Date of maturity
June 7, 2010	5.1%	$ 874,749	$ 874,749	$ —	$ 388,135	$ 304,213	June 7, 2020

The principal amount of the surplus notes is scheduled to be paid on June 7, 2020. All payments of principal and interest on the Ambac Assurance surplus notes are subject to the prior approval of the OCI. If the OCI does not approve the payment of interest on the Ambac Assurance surplus notes, such interest will accrue and compound annually until paid. The Ambac Assurance surplus notes were issued pursuant to the Fiscal Agency Agreement entered into on June 7, 2010 with The Bank of New York Mellon, as fiscal agent.

Surplus note interest payments require the approval of the OCI. Annually from 2011 through 2016, OCI issued its disapproval of the requests of Ambac Assurance to pay interest on outstanding surplus notes issued by Ambac Assurance on the annual scheduled interest payment date of June 7th or the next business day. Total unapproved interest for surplus notes that remain outstanding at December 31, 2016, at the scheduled interest payment date of June 7, 2016, is $304,213.

On April 25, 2017, OCI issued its disapproval of the request of the Company to pay interest on outstanding surplus notes on the annual scheduled payment date of June 7, 2017. As a result of this disapproval, the total unapproved interest for surplus notes outstanding at April 25, 2017 will be $364,340, of which $328,290 relates to surplus notes held by third parties and $36,050 relates to surplus notes held by Ambac at the scheduled payment date of June 7, 2017. If OCI approves interest payments on surplus notes in the future, Ambac Assurance will also be required to pay interest accrued on certain repurchased surplus notes through their call option exercise dates.

In June 2012, Ambac Assurance repurchased surplus notes pursuant to call option agreements entered into respect to the Ambac Assurance Surplus Notes. The acquisition of these surplus notes pursuant to such call option agreements had been approved by OCI and by the Rehabilitator, whose approval was conditioned upon the approval of such transactions by the Rehabilitation Court, which was granted on June 4, 2012. In connection with certain call option agreements, Ambac Assurance was obligated to pay accrued and unpaid interest through the call option date in the event that OCI approves interest payments on the remaining surplus notes. The Company settled a portion of the accrued interest on certain repurchased surplus notes during the year ended December 31, 2015. The Company repurchased $18,551 par value of the surplus notes and settled a portion of the accrued interest on certain repurchased surplus notes during the year ended December 31, 2016, resulting in a reduction of $7,499 in the Company's capital and surplus and included within other loss on the Company's Statutory Statements of Operation. On April 6, 2017, OCI approved a payment of $2,940 for the remaining unpaid interest on certain repurchased surplus notes.

On July 24, 2015, the Company borrowed $146,000 with a stated maturity date in July 2047 through a secured borrowing transaction (the Secured Borrowing) in which certain RMBS securities guaranteed by Ambac Assurance (the Underlying Securities) were deposited into a third party trust to collateralize and fund repayment of the debt. The financial guarantee insurance policies on the Underlying Securities were allocated to the Segregated Account. The Underlying Securities are reported as investments of Ambac Assurance and have an admitted carrying value of $370,661 at December 31, 2016. Interest on the Secured Borrowing is payable monthly at an annual rate of one month LIBOR + 2.80%. The par amount of the Secured Borrowing reported under Borrowed Money and Interest Thereon is $102,986 at December 31, 2016. Repayments under the Secured Borrowing will be from cash flows received from the Underlying Securities. Only non-insurance proceeds from the Underlying Securities are used to pay interest and principal on the Secured Borrowing.

(14) Subsequent Events

Pursuant to Statement of Statutory Accounting Principles No. 9, *Subsequent Events* (SSAP 9), the date through which subsequent events have been evaluated was May 30, 2017 for the year year ended December 31, 2016, the same date on which Ambac Assurance's financial statements are issued.

1. There are no quota share reinsurance contracts containing provisions for limiting the reinsurer's losses below the stated quota share percentage.
2. The Company has not reinsured risks with another entity and agreed to release that entity from liability, in whole or in part, from any loss that may occur on the risk, or portion thereof.
3. The Company has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statutory financial statements: (i) the Company recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders, or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) the Company accounted for the contract as reinsurance and not as a deposit; and (iii) the contract contained one or more of the following features or other features that would have similar results:
   a) A contract term longer than two years and the contract is noncancelable by the reporting entity during the contract term;
   b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or affiliate of the reinsurer;
   c) Aggregate stop loss reinsurance coverage;
   d) An unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
   e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
   f) Payment schedule, accumulating retention from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.
4. The Company has not, during the period covered by the statutory financial statements, ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), where the Company recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:
   a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statements; or
   b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity of the affiliates.
5. Except for the transactions meeting the requirements of the paragraph 31 of SSAP No. 62R, Property and Casualty Reinsurance, the Company has not ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the statutory financial statements, and either:
   a) Accounted for that contact as reinsurance (either prospective or retroactive) under NAIC SAP and as a deposit under U.S. GAAP; or
   b) Accounted for that contract as reinsurance under U.S. GAAP and as a deposit under NAIC SAP.

See accompanying independent auditors' report.

AMBAC ASSURANCE CORPORATION
(A Wholly Owned Subsidiary of Ambac Financial Group, Inc.)
Supplemental Schedule of Investment Risk Interrogatories

December 31, 2016
(Dollar amounts in thousands)

The Company's total admitted assets, excluding assets from the Segregated Account, as reported in the Statement of Admitted Assets, Liabilities and Surplus were $5,442,446 at December 31, 2016.

1. The 10 largest exposures to a single issuer/borrower/investment at December 31, 2016 are as follows:

Issuer	Description of Exposure	Amount	Percentage of total admitted assets
Impac Secured Assets Corp. Series 2006-3	Bond	$ 116,878	2.148%
Lehman XS Trust Series 2007-6	Bond	110,549	2.031
Countrywide Asset-Backed Certificates Series 2006-S6	Bond	79,203	1.455
Countrywide Home Equity Loan Trust Series 2005-F	Bond	78,722	1.447
National Collegiate Student Loan Trust 2007-4	Bond	77,309	1.421
Impac Secured Assets Corp. Series 2007-2	Bond	76,457	1.405
Nomura Asset Acceptance Corp Alternative Loan Trust Series 2007-3	Bond	73,360	1.348
Countrywide Home Equity Loan Trust Series 2006-C	Bond	69,907	1.285
National Collegiate Student Loan Trust 2007-3	Bond	67,875	1.247
Lehman XS Trust Series 2007-14H	Bond	67,153	1.234

2. The amounts and percentages of the Company's total admitted assets held in bonds, excluding investments in Ambac-insured bonds with policies allocated to the Segregated Account, and preferred stocks by NAIC rating are as follows:

Bonds			Preferred Stock		
NAIC-1	$ 1,784,177	32.783%	P/RP-1	$ —	—%
NAIC-2	761,073	13.984	P/RP-2	—	—
NAIC-3	65,990	1.213	P/RP-3	—	—
NAIC-4	771	0.014	P/RP-4	—	—
NAIC-5	—	—	P/RP-5	—	—
NAIC-6	95,778	1.760	P/RP-6	—	—

3. The amount of the Company's total admitted assets held in foreign investments are greater than 2.5% of total admitted assets, including (i) total admitted assets held in foreign investments of $333,676, (ii) foreign-currency-denominated investments of $4,888, and (iii) insurance liabilities denominated in that same foreign currency of $12,301 at December 31, 2016. The amounts below are the aggregate foreign investment exposure categorized by the NAIC sovereign rating:

(Dollar amounts in thousands)

	Amount	Percentage of total admitted assets
Countries rated NAIC-1	$ 322,126	5.919%
Countries rated NAIC-2	11,550	0.212
Countries rated NAIC-3 or below	—	—
The largest foreign investment exposures by country, categorized by the country's NAIC sovereign rating are detailed below:		
Countries rated NAIC-1:		
Cayman Islands	97,087	1.784%
Netherlands	60,453	1.111
Countries rated NAIC-2:		
Italy	7,136	0.131%
Spain	2,520	0.046
Countries rated NAIC-3:	—	—%

The ten largest non-sovereign (i.e. non-governmental) foreign issues are below:

Issuer	NAIC Rating	Amount	Percentage of total admitted assets
Sumitomo Mitsui Banking Corporation	1	$ 17,287	0.318%
LCM Ltd Partnership Series 2015-19A	1	15,799	0.290
BP Capital Markets PLC	1	14,378	0.264
Lloyds Banking Group PLC	1	13,465	0.247
BNP Paribas SA	1	12,848	0.236
ALM Loan Funding Series 2013-10A	1	12,498	0.230
Shell International Finance BV	1	12,190	0.224
Madison Park Funding Ltd Series 2014-12A	1	10,020	0.184
Venture CDO Ltd Series 2014-16A	1	9,915	0.182
Air Liquide Finance	1	9,874	0.181

4. The Company's total admitted assets held in Canadian investments and unhedged Canadian currency exposure is less than 2.5% of the Company's total admitted assets at December 31, 2016.

5. The aggregate amount of the reporting entity's total admitted assets held in investments with contractual sales restrictions (defined as investments having restrictions that prevent investments from being sold within 90 days) at December 31, 2016 is $0.

6. The Company's total assets held in equity interests of $359,581 is greater than 2.5% of the Company's total admitted assets at December 31, 2016. The Company has equity interests in the following:

Issuer	Amount	Percentage of total admitted assets
Connie Lee Holdings, Inc	$ 227,695	4.184%
Western Asset Open End Fund	80,728	1.483
Blackrock FDS II Fltg Rate Income Port Instl SH	51,158	0.940

(Dollar amounts in thousands)

7. The amount of admitted assets held in non-affiliated privately placed equities at December 31, 2016 is $0.

8. The amount of the reporting entity's total admitted assets held in general partnership interests at December 31, 2016 is $0.

9. The amount of the reporting entity's total admitted assets held in mortgage loans at December 31, 2016 is $0.

10. The amount of the reporting entity's total admitted assets held in each of the five largest investments of real estate at December 31, 2016 is $0.

11. The amount of the reporting entity's total admitted assets held in mezzanine real estate loans at December 31, 2016 is $0.

12. The amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements are as follows:

	At year end		At end of each quarter		
	Amount	**Percentage of total admitted assets**	**First quarter amount**	**Second quarter amount**	**Third quarter amount**
Securities lending (do not include assets held as collateral for such transactions)	$ —	—%	$ —	$ —	$ —
Repurchase agreements	—	—	—	—	—
Reverse repurchase agreements	—	—	—	—	—
Dollar repurchase agreements	—	—	—	—	—
Dollar reverse repurchase agreements	—	—	—	—	—

13. The amounts and percentages of warrants not attached to other financial instruments, options, caps, and floors at December 31, 2016 are as follows:

	Owned		Written	
	Amount	**Percentage of total admitted assets**	**Amount**	**Percentage of total admitted assets**
Hedging	$ —	—%	$ —	—%
Income generation	—	—	—	—
Other	—	—	—	—

14. The amounts and percentages of potential exposure for collars, swaps, and forwards at December 31, 2016 are as follows:

	At year end		At end of each quarter		
	Amount	**Percentage of total admitted assets**	**First quarter amount**	**Second quarter amount**	**Third quarter amount**
Hedging	$ —	—%	$ —	$ —	$ —
Income generation	—	—	—	—	—
Replications	—	—	—	—	—
Other	—	—	—	—	—

December 31, 2016
(Dollar amounts in thousands)

15. The amounts and percentages of potential exposure for futures contracts at December 31, 2016 are as follows:

	At year end		At end of each quarter		
	Amount	**Percentage of total admitted assets**	**First quarter amount**	**Second quarter amount**	**Third quarter amount**
Hedging	$ —	—%	$ —	$ —	$ —
Income generation	—	—	—	—	—
Replications	—	—	—	—	—
Other	—	—	—	—	—

See accompanying independent auditors' report.

AMBAC ASSURANCE CORPORATION
(A Wholly Owned Subsidiary of Ambac Financial Group, Inc.)
Summary of Investments Schedule

December 31, 2016
(Dollar amounts in thousands)

Investment categories	Gross investment holdings	Percentage	Admitted assets as reported in the annual statement	Percentage
Bonds:				
U.S. Treasury securities	$ 72,108	1.3%	$ 72,108	1.3%
U.S. government agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government sponsored agencies	4,025	0.1	4,025	0.1
Non-U.S. government (including Canada, excluding mortgage-backed securities)	4,004	0.1	4,004	0.1
Securities issued by states, territories and possessions and and political subdivisions in the U.S.:				
States, territories and possessions general obligations	22,151	0.4	22,151	0.4
Political subdivisions of states, territories and possessions and political subdivisions general obligations	49,346	0.9	49,346	0.9
Revenue and assessment obligations	185,235	3.3	185,235	3.4
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	—	—	—	—
Issued or guaranteed by FNMA and FHLMC	—	—	—	—
CMOs and REMICs:				
All other	224,406	4.0	224,406	4.2
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	1,473,870	26.1	1,473,870	27.2
Unaffiliated non-U.S. securities (including Canada)	341,562	6.0	341,562	6.3
Equity interests:				
Other equity securities:				
Affiliated	450,229	8.0	227,695	4.2
Receivables for securities	1,257	—	1,176	—
Cash, cash equivalents and short-term investments	347,951	6.1	347,951	6.4
Other invested assets [(1)]	2,467,238	43.7	2,461,071	45.5
Total invested assets	$ 5,643,382	100.0%	$ 5,414,600	100.0%

* Gross Investment Holdings are valued in compliance with NAIC Accounting Practices and Procedures Manual.
(1) Includes investments in Ambac Assurance-insured bonds with policies allocated to the Segregated Account.

See accompanying independent auditors' report.