Ambac Assurance UK Limited

Annual Report and Financial Statements

for the year ended 31 December 2018

Registered no: 3248674

Ambac Assurance UK Limited

Annual Report and Financial Statements for the year ended 31 December 2018

Ambac Assurance UK Limited

Directors and advisers

Executive Directors

David Barranco
John Tifft
David Trick

Non-executive directors

Ken Davies - Chairman of the Audit and Risk Committee of the Board of Directors
Anthony McMahon - Chairman of the Board
William Fall
Hugh Boyle - (appointed 28 November 2018)

Secretary

Miguel Sánchez

Registered Office

2nd Floor,
21 Great Winchester Street
London EC2N 2JA

Registered Auditor

KPMG LLP
15 Canada Square
London E14 5GL

Internal Auditor

BDO LLP
150 Aldersgate Street
London EC1A 4AB

Bankers

Barclays Bank plc
Level 11, 1 Churchill Place
London E14 5HP

Solicitors

Clifford Chance LLP
Ten Upper Bank Street
London E14 5JJ

Ambac Assurance UK Limited

The directors present their strategic report, directors' report and the audited financial statements for the year to 31 December 2018.

Strategic report

Principal activity

Ambac Assurance UK Limited (the "**Company**") is incorporated under the laws of England and Wales and is in the non-life financial guarantee insurance business. The Company is a wholly owned subsidiary of Ambac Assurance Corporation ("**AAC**"), a financial guarantee insurance company domiciled in Wisconsin, United States of America. The ultimate holding company is Ambac Financial Group, Inc., ("**AFG**"). AFG's common stock trades in the U.S. NASDAQ market under ticker symbol AMBC.

The Company is dual regulated and supervised in the United Kingdom by the Prudential Regulation Authority (the "**PRA**") and Financial Conduct Authority. The Company's principal contact is with the PRA. In 2009, the previous regulator, the Financial Services Authority, curtailed the Company's licence to undertake new business, and limited its licence to undertaking only run off related activity. Accordingly, the Company is authorised to run off its financial guarantee insurance portfolio in the United Kingdom, and is authorised to do the same in the European Economic Area ("**EEA**") through "passporting" arrangements in Italy, Spain, Luxembourg, Ireland and France, which eliminates the necessity of additional licensing or authorisation in those other European jurisdictions. The Company maintains a branch in Milan, Italy. As noted on page 6 absent legally binding transitional arrangements, or agreement with relevant regulatory authorities permitting continued orderly run off these passporting arrangements will cease on the date of the United Kingdom's exit from the European Union.

The Company's principal business activity is portfolio risk management of its existing long term book of financial guarantee business. Financial guarantee insurance written by the Company provides an unconditional and irrevocable guarantee that protects the creditor under a debt obligation's scheduled terms. The Company makes payments if the issuer or obligor responsible for making payments fails to do so. In the event the Company does pay any insurance claims, it is generally subrogated to the rights of the claiming policyholders and may be able to claim back from the issuer any payments made under the guarantee through debt restructuring, exercising any security rights or otherwise. The Company is expected to meet potential claims entirely from its own claims paying resources. There is no recourse to or support from other parties, including AAC.

The Company's portfolio comprises 62 financial guarantee obligations with a gross par outstanding of £10.2 billion as of 31 December 2018 (76 obligations and £11.6 billion gross par outstanding as at 31 December 2017). The portfolio comprises financial guarantees for essential infrastructure, whole business securitisations, utility obligations, and other asset classes, principally in Europe, which were written by the Company prior to December 2007. The portfolio is contractually scheduled to run off through 2047, although certain transactions can be prepaid and/or unwound under certain circumstances. With the exception of transactions for which provision has been made in the financial statements, the portfolio continues to perform satisfactorily.

The Company's portfolio of financial guarantee business is monitored by its portfolio risk management team, based in London. Activity in the year has included ongoing monitoring and remediation activity relating to the Company's portfolio. The Company continues to collect instalment premiums from its portfolio of transactions and also generates fees from processing requests for consents, waivers and amendments to existing transactions.

Ambac Assurance UK Limited

Strategic report *–continued*

Parent Undertaking

In March 2010, AAC established a segregated account pursuant to Wisconsin Statute (the "**Segregated Account**") to segregate certain segments of AAC's liabilities. The Office of the Commissioner of Insurance for the State of Wisconsin ("**OCI**") commenced rehabilitation proceedings with respect to the Segregated Account (the "**Segregated Account Rehabilitation Proceedings**") in order to permit the 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. The Segregated Account Rehabilitation Proceedings completed on 12 February 2018 following the successful conclusion of an exchange offer and consent solicitation and satisfaction of other conditions including the discharge of all deferred payment obligations of AAC. Notwithstanding AAC's exit from rehabilitation, AAC remains under enhanced regulatory supervision by its regulator. It remains the view of the directors of the Company that these actions will have no material impact on the Company.

Business review

Results and Key performance indicators

Results and Shareholders' Funds

The results for the Company, as set out on page 15, show a loss for the financial year of £3.6 million (2017 profit of £108.4 million). The key driver of the 2018 result was the significant increase in other technical provisions over the year, offset by the accelerated repayment of certain insured transactions which resulted in increased earned premiums. In 2017 performance was driven by reduction in other technical provisions over the year and the accelerated repayment of certain insured transactions resulting in increased earned premiums. These items are discussed in more detail below.

The Company had a surplus in shareholders' funds of £262.7 million (31 December 2017: surplus of £266.3 million).

Key performance indicators

The Company considers the following to be the key financial performance indicators for measuring the business performance in run-off.

Earned premiums

For the year ended 31 December 2018, net premiums earned were £40.0 million (2017: £44.6 million). The year on year decrease in premiums earned is primarily due to a greater value of accelerated repayment in the prior year which resulted in higher accelerated premium revenues in that year and the normal run-off of the financial guarantees over time.

Premiums earned for the year ended 31 December 2018 are comprised of £28.5 million normal earned premiums and £11.5 million accelerations (2017: £31.0 million normal earned premiums and £13.6 million accelerations).

Claims incurred and changes in other technical provisions

For the year ended 31 December 2018, the Company's claims incurred and other technical provision expense was a charge of £64.3 million (2017: credit of £87.8 million). The charge for other technical provision expense in 2018 arose from the following factors:

- an increase in unexpired risk provisions mainly as a result of :
  - decreases in investment returns (excluding foreign exchange gains/(losses)) which fell to £12.1million during the year (2017:£29.2 million)(see Note 5). This resulted in a fall in the discount rate applied in calculating the present value of claims to 2.46% (2017: 4.42%) leading to an increase of £39.6 million in unexpired risk provisions in the year (see Note 18),

- additional factors in the increase in unexpired risk provisions were,
  - an upward revaluation of unexpired risk provisions denominated in foreign currencies following the decrease in the value of GBP against USD over the year,
  - claims paid of £0.4 million and claims management expenses of £6.3 million during the year, and
  - an increase in unexpired risk reserves due to upward USD LIBOR movements over the year,

- offset by
  - progress in the remediation of policies against which unexpired loss reserves are held over the year, resulting in the expectation of a lower level of future claims in respect of these policies in certain scenarios.

The credit in claims incurred and other technical expense in 2017 arose largely from the decrease in unexpired risk provisions due to a decrease in expected future claims levels, the impact of a higher discount rate used to discount the claims and downward revaluation of unexpired risk provisions denominated in foreign currencies following the increase in the value of GBP against USD and EUR in that year.

Cash and Investments

At 31 December 2018, the carrying value of cash and investments totalled £498.5 million (2017: £459.8 million). The year-on-year increase in cash and investments is due to upward revaluations of the Company's foreign currency investments following the decrease in the value of GBP against USD over the year, the continued receipt of premium income and interest and dividends from the Company's investment portfolio, offset by cash outflows linked to tax payments and other expenses.

Going Concern

The Company has a significant capital shortfall under the Solvency II rules. The Company and its directors continue to take detailed legal, financial and accounting advice since ceasing to write new business, which has informed their view that it remains a going concern. The Company notes that its run-off is subject to PRA supervisory statement SS7/15 "Supervision of firms in difficulty or run-off" and therefore has undertaken, and continues to undertake, close consultation with the PRA with regard to its situation.

The Company continues to be entitled to receive instalment premium income in respect of its guaranteed obligations and is retaining these cash flows for the benefit of its policyholders. These future premium cash flows are supported by contractual make-wholes on certain transactions, which would be payable to the Company in the event that a transaction was prepaid before its scheduled maturity date, thereby ensuring a base-line of premium income. Additionally, the Company invests premium income (as well as investment income and principal receipts), seeking a reasonable return, to further support its guaranteed obligations (however note that projected investment returns are not included in the following claims paying resources calculations).

The Company has net claims paying resources at 31 December 2018 and 31 December 2017 as follows:

+/-	Claims Paying Resource Components £'000's	At 31/12/2018	At 31/12/2017
(+)	Cash	7,928	5,022
(+)	Investments (at market value)	495,872	472,686
(+)	Minimum Guaranteed Premiums and other minimum contractual premiums	153,505	181,702
(-)	Expected future claims and expenses	(170,503)	(160,703)
(-)	Annual operating expenditure	(6,686)	(6,221)
(+)	Expected Premiums beyond Minimum Guaranteed Premiums	58,777	74,063
(=)	AUK Net Claims Paying Resources	538,893	566,549

The calculation of most of these items differs from that for the equivalent items in the accounting balance sheet in the following ways:

<table>
<tr><th>Component</th><th>Balance Sheet</th><th>Claims Paying Resources</th></tr>
<tr><td>Investments</td><td>Fixed income investments are calculated at amortised cost</td><td>Calculated at market value</td></tr>
<tr><td>Expected future claims and expenses</td><td>Discounted at a single rate based on historic investment returns</td><td rowspan="2">Discounted at rates derived from market swap curves</td></tr>
<tr><td>Expected Premiums beyond Minimum Guaranteed Premiums</td><td>Not taken account of</td></tr>
<tr><td>Annual operating expenditure</td><td>Not taken account of</td><td>Deducted at the coming year budgeted level</td></tr>
</table>

The Company's insured obligations are to pay principal and interest when due, and are not generally subject to acceleration (except that the Company may have the right to accelerate insured obligations if they default). Accordingly, the Company's exposure to liquidity risk in respect of material claims in the short term is limited. In addition, in assessing the Company's claims paying resources, the directors have considered the value of its assets compared with the amount of its liabilities, the measure of which, having taken legal and specialist insolvency advice, is assessed on a different basis from the accounting measures set out in the balance sheet.

In making their assessment of the adequacy of the Company's claims paying resources, the directors have considered the Company's detailed cash flow projections (not just of claims paying resources) under stressed scenarios, including increased claims payments, reduced premiums and/or investment income scenarios and other changes to assumptions and estimates. These considerations have included consideration of the impact of the possible exit of the UK from the EU without arrangements for the ongoing orderly run-off of insurance contracts entered into prior to the exit date. The directors are satisfied that the Company has adequate resources to meet the day-to-day operational needs of the business for the foreseeable future and that the Company's claims paying resources are sufficient to satisfy projected claims as they fall due.

Principal risks and uncertainties

The key risks and uncertainties to which the Company is exposed are:

Insurance risk

The Company is exposed to insurance risk on its portfolio of financial guarantee business, which is the risk that losses within the portfolio might exceed those identified by management. The Company undertakes ongoing surveillance of the performance of individual transactions within its portfolio, and of the portfolio as a whole, including stress testing and downside scenario modelling.

Estimates of any future claim payments and recoveries under subrogation rights in respect of these financial guarantees are made to establish unexpired loss provisions (see Note 18). Given the duration of the period until repayment of obligations guaranteed by the Company, actual claims costs could differ from these estimates and as such there is an element of uncertainty in these estimates. Management considers a range of possible outcomes (including stress scenarios) in order to determine the most appropriate basis for unexpired loss provisions.

Credit risk

The Company has credit risk on issuers of assets in its investment portfolio. This is mitigated by the Company's investment policy, which provides for ongoing monitoring of the credit rating of the issuers of those securities. The Company has appointed an investment advisor to assist it in the management of its investment portfolio.

Market risk

Market risk is the risk that the performance of the Company's investment portfolio declines as a result of adverse movements in market prices of assets in which the Company is invested. Market price movements may be impacted by interest rates, credit spreads, foreign exchange rates or equity and property markets. Additionally, the Company has exposure to interest and foreign exchange rate movements in respect of the insured portfolio, particularly those transactions that have unexpired risk provisions. The Company continually reviews its investment policy in consultation with its investment advisor to ensure that the duration, yield, investment return and currency of its investment portfolio remain appropriate in light of its potential future liabilities.

Liquidity risk

Liquidity risk is the risk that the Company has insufficient liquid assets to meet claims as they fall due. The Company's insured obligations generally require the payment of principal and interest by the Company when due, and are not generally subject to acceleration (except that the Company may have the right to accelerate insured obligations if the insured obligation defaults). Further, the transactions within the Company's financial guarantee portfolio include transaction-level mitigants such as cash reserves and other credit enhancements which enable the Company to manage liquidity within each individual transaction that it has guaranteed. In addition, claims may arise if issuers face difficulties in refinancing maturing debt obligations.

The Company mitigates liquidity risk by investing the majority of its investment portfolio in liquid securities and by holding cash and money market liquidity funds sufficient to meet any known liabilities falling due in the coming three months. There are however, some investments in its portfolio which are subject to certain limitations on the ability of the Company to liquidate or redeem these investments.

Ambac Assurance UK Limited

Strategic report *–continued*

Operational risk

The Company monitors the operational risks in relation to its policies, premium billing and collection processes, cash and investments, claims processes and other operational processes through a Risk Management Governance Framework. A member of the senior management team is the Head of the Risk Management function and reports on the effectiveness of the controls over operational risks on a quarterly basis to the Audit and Risk Committee. The Company outsources certain operational functions to AAC and to third party service providers under services agreements. The effectiveness of these outsourcing arrangements is reviewed at least annually by a member of the management team and the Board is updated on a quarterly basis as to the continuing suitability of the various outsource providers to carry out the functions required of them.

As a small business with only 11 employees as at 31 December 2018 the Company recognises that staff retention is a key business risk and has accordingly established a long term incentive plan which addresses the risk of employees leaving the Company. The Company maintains a business continuity plan which users test annually. The Company continues to monitor its operating requirements and risk management structure to ensure that they continue to meet its requirements.

Brexit

In March 2017 the UK government gave the European Union ("**EU**") formal notification of its intention to leave the EU ("**Brexit**") with the expectation of formal withdrawal two years later on 29 March 2019. In November 2018 the UK Government and EU agreed upon the terms of a legal binding treaty ("**Withdrawal Agreement**") setting out the terms of a transition period to apply to the UK until 31 December 2020. The effect of the withdrawal agreement, if ratified, will be to retain the rights and obligations between the UK and the EU within this transition period.

In March 2019 the UK government and EU agreed to amend the date of the UK's exit from the EU from 29 March 2019 to 22 May 2019 if the withdrawal agreement is ratified by 29 March 2019 or, if there is no such ratification by this date, to 12 April 2019 (with the relevant date being defined as "**Exit Day**").

The withdrawal agreement remains subject to ratification by the UK Parliament, EU Council and EU Parliament. If the withdrawal agreement is not ratified and no transitional arrangement is put into place, Brexit may mean that the activities in the EEA of UK passporting insurers may become unlawful after Exit Day. They may lose their legal authorisation to serve clients who benefit from policies issued by a UK incorporated insurer under freedom of services and freedom of establishment passporting rights (and thereby maybe unable to legally collect premiums or pay claims). Additionally, if they have branches in EEA Member States they may be legally obliged to close them down and no longer be legally represented in those jurisdictions.

On 19 February 2019, the European Insurance and Occupational Pensions Authority ("**EIOPA**") made a series of recommendations to EU insurance regulators in light of Brexit. These recommendations include the recommendation that regulatory authorities apply legal frameworks that facilitate the orderly run off (without time limit) of insurance policies issued in EEA member states by UK insurers prior to Exit Day that terminate after this date. The recommendations will require to be incorporated into EEA member states legal and regulatory frameworks in an appropriate manner to bring them into effect. The Company is in discussion with the PRA and other relevant regulatory authorities to enable the continued orderly run off of its policies issued in the EEA under passporting rights in line with this recommendation.

As at 31 December 2018 the Company's insured portfolio included 6 financial guarantee obligations with a gross par outstanding of £1.9 billion issued under EU passporting rules. Debtors arising out of direct insurance operations from policyholders and Other Technical Provisions include premiums receivable and unexpired risk provisions (net of subrogation receivable) of £20.8 million and £182.6 million respectively in relation to these policies. As noted, absent legally binding transitional arrangements, or agreement with relevant regulatory authorities permitting the continued orderly run off of these policies, the Company may be unable to collect these premium debtors or pay the claims to which these premiums receivable and unexpired risk provisions relate after Exit Day.

By order of the Board

M Sánchez
Secretary
Registered no: 3248674

Ambac Assurance UK Limited

Directors' report

Results and dividends

The results for the year are set out in the profit and loss account on page 15.

The directors do not recommend the payment of a dividend. For the avoidance of doubt, any dividend recommended by the directors would require the non-objection of the PRA prior to payment.

Financial Risk Management Objectives and Policies

An overview of the Company's financial risk management objectives and policies is set out within the Principal risks and uncertainties section of the Strategic Report.

Future Developments

It is the intention of the directors to continue the run off of the financial guarantee insurance portfolio as set out in the Strategic Report.

Directors and directors' interests

The directors who held office during the year are shown on page 1.

Auditors

The Company has, by elective resolution, dispensed with the need to appoint the registered auditor annually and therefore KPMG LLP continue to hold office.

Moore Stephens LLP (now merged with BDO LLP and renamed BDO LLP) continued as outsourced Internal Auditors of the Company throughout the year.

Statement as to disclosure of information to auditors

Each person who is a director at the date of approval of this report confirms that: i) so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and ii) each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Statement of directors' responsibilities in respect of the Strategic Report and the Directors' Report and the financial statements

The directors are responsible for preparing the Strategic Report and Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including FRS 102, which is the Financial Reporting Standard applicable in the UK and Republic of Ireland.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless unless they intend to liquidate the Company or to cease operations, or have no alternative but to do so. As explained in note 1, the financial statements are prepared on a going concern basis.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

By order of the Board

M Sánchez
Secretary
Registered no: 3248674

Ambac Assurance UK Limited

Independent Auditor's Report to the Members of Ambac Assurance UK Limited

1. Our opinion is unmodified

We have audited the financial statements of Ambac Assurance UK Limited ("the Company") for the year ended 31 December 2018 which comprise the profit and loss account, the statement of comprehensive income, statement of changes in equity, balance sheet, and the related notes, including the accounting policies in note 2.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 31 December 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Audit and Risk Committee.

We were appointed as auditor by the directors for the period ended 31 December 1997. The period of total uninterrupted engagement is for the 22 financial periods ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

	The risk	Our response
The Impact of uncertainties due to the UK exiting the European Union ("Brexit") on our audit Refer to page 6 (strategic report), page 19 (financial disclosures)	**Unprecedented levels of uncertainty** All audits assess and challenge the reasonableness of estimates, in particular as described in the unexpired risk provision below and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements (as described below). Both of these depend on assessments of the future economic environment and the company's future prospects and performance. Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. **Our procedures included:** ***Our Brexit knowledge:*** We considered the directors' assessment of Brexit-related sources of risk for the company's business and financial resources compared with our own understanding of the risks. ***Sensitivity analysis:*** When assessing the appropriateness of the going concern basis of preparation of the financial statements, the unexpired risk provision and other areas that depend on forecasts, we compared the directors' analysis to our assessment of the range of reasonably possible scenarios resulting from Brexit uncertainty. ***Assessing transparency:*** As well as assessing individual disclosures as part of our procedures on the unexpired risk provision and the going concern basis of preparation of financial statements we considered all of the Brexit related disclosures together, including those in the strategic report, comparing the overall picture against our understanding of the risks. **Our results** As reported under the unexpired risk provision and the going concern basis of preparation, we found the resulting estimates and related disclosures associated with the unexpired risk provision and disclosures in relation to going concern to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Independent Auditor's Report to the Members of Ambac Assurance UK Limited

	The risk	Our response
Going concern basis of preparation Refer to pages 4 and 5 (strategic report), page 18 (financial disclosures)	**Disclosure quality** The financial statements explain how the Board has formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Company. That judgement is based on an evaluation of the inherent risks to the Company's business model, and how those risks might affect the Company's financial resources or ability to continue operations over a period of at least a year from the date of approval of the financial statements. The risk most likely to adversely affect the Company's ability to continue as a going concern is a deterioration in the Company's regulatory capital shortfall caused by larger than expected losses in relation to financial guarantee obligations, leading to potential Regulatory intervention. There are also less predictable but realistic second order impacts, such as the impact of Brexit and the ability of the Company to collect the premiums receivable of £20.8m and service potential claims related to the 6 financial guarantee obligations issued under EU passporting rules. The risk for our audit was whether or not those risks were such that they amounted to a material uncertainty that may have cast significant doubt about the ability to continue as a going concern. Had they been such, then that fact would have been required to have been disclosed.	**Our procedures included:** ***Historical comparison:*** We assessed the directors' track record of forecasts vs actual cash flows achieved in the year. ***Sensitivity analysis:*** With the assistance of our actuarial specialists we considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively by challenging the directors' stress testing, of the identified critical factors such as reduction in premium income and higher than expected losses on the insured portfolio. ***Key dependency assessment:*** We performed inquiries with the directors, inspected regulatory correspondence and held discussions with the regulator to assess the implications of the capital shortfall and current business activity and its impact on our opinion. ***Assessing transparency***: Assessing the completeness and accuracy of the matters covered in the going concern disclosure with our understanding of the overall business risks and the Company's environment. **Our results** We found the going concern disclosures and basis of preparation without any material uncertainty to be acceptable.

	The risk	Our response
Unexpired Risk Provision (£182.6 million, 2017: £125.0m) Refer to page 20 (accounting policies), pages 32 to 33 (financial disclosures).	**Subjective valuation:** The provision for losses in relation to the financial guarantee obligations continues to be a significant audit risk due to the magnitude of the potential losses which could arise over the remaining period during which the Company will earn premium income. This risk is the largest and most judgemental on the Company's balance sheet. Valuation of these liabilities is highly judgemental because it requires the Company to consider the credit quality of underlying contracts and, where a risk of expected loss is established, to develop cash flow models which incorporate scenarios to estimate the loss. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of unexpired risk provision has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount.	**Our procedures included:** ***Control design and operation:*** Updating and documenting our understanding of the processes and controls in the valuation process. Testing the design, implementation and operating effectiveness of the key controls over the governance processes in place for the models, the forums where key judgements are considered, completeness and accuracy of the data used in the models and the appropriateness of the output from the models. ***Methodology implementation:*** Using our own internal specialist to assess the appropriateness of the model used for the unexpired risk provision calculation to establish whether it operates appropriately. ***Test of detail:*** Agreeing key data inputs in the calculation to third party source documentation. Evaluating the appropriateness and adequacy of the provision by inspecting latest surveillance reports and challenging assumptions where relevant. Assessing the appropriateness of the discount rate used through re-performing the calculation and evaluating the appropriateness of the accounting policy associated with the discount rate. ***Assessing transparency:*** Assessing the appropriateness of the accounting policy and the disclosures in the financial statements around the uncertainty inherent within the unexpired risk provision. **Our results** We found the Company's assessment of the valuation of unexpired risk provision to be acceptable (2017 result: acceptable).

3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £3.3m (2017: £3.3m), determined with reference to a benchmark of total assets, of which it represents 0.5% (2017: 0.5%). We consider total assets to be the most appropriate benchmark as it provides a more stable measure year on year than profit before tax.

We agreed to report to the audit and risk committee any corrected or uncorrected identified misstatements exceeding £0.16m (2017: £0.16m), in addition to other identified misstatements that warranted reporting on qualitative grounds. Our audit of the Company was undertaken to the materiality level specified above and was all performed at the Company's head office in London and the parent company office in New York.

4. We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and as such they have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

We identified going concern as a key audit matter (see section 2 of this report). Based on the work described in our response to that key audit matter, we are required to report to you if:

- we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements.

We have nothing to report in these respects.

5. We have nothing to report on the strategic report and the director's report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 8, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud, other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditors responsibilities.

Irregularities - ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors and other management (as required by auditing standards), and from inspection of the Company's regulatory and legal correspondence and discussed with the directors and other management the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Company's licence to operate. Recognising the financial and regulated nature of the company's activities, we identified regulatory capital and liquidity as the areas most likely to have such an effect. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Through these procedures we confirmed continuing non-compliance with the regulatory capital requirement and considered the effect as part of our procedures on the related financial statement items. Further detail in respect of non-compliance with the regulatory capital requirement is set out in our assessment of risks of material misstatement arising from the use of the going concern basis of preparation in section 2 of this report.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Karen Orr (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London E14 5GL

Date: 28 March 2019

Ambac Assurance UK Limited
Profit and Loss Account
For the year ended 31 December 2018

Technical account - general business

	Notes	2018 £'000	2017 £'000
Earned premiums			
Gross premiums written	*3*	**15,844**	20,160
Change in the gross provision for unearned premiums	*18*	**24,151**	24,458
Earned premiums		**39,995**	44,618
Other technical income		**1,064**	1,129
Claims incurred and changes in other technical provisions	*18*		
Claims paid, net of subrogation received		**(401)**	(538)
Claims management expenses		**(6,318)**	(17,303)
Change in other technical provisions		**(57,576)**	105,658
Claims (incurred)/benefit and other technical provisions		**(64,295)**	87,817
Operating expenses	*4*	**(8,267)**	(9,191)
Balance on the general business technical account		**(31,503)**	124,373

Non - technical account - general business

	Notes	2018 £'000	2017 £'000
Balance on the general business technical account		**(31,503)**	124,373
Investment income	*5*	**26,771**	10,306
Investment expenses and charges	*6*	**(748)**	(758)
Other income		**30**	54
(Loss) / profit on ordinary activities before tax	*7*	**(5,450)**	133,975
Tax credit/(charge) on result on ordinary activities	*10*	**1,953**	(25,545)
(Loss) / profit on ordinary activities after tax		**(3,497)**	108,430
(Loss) / profit for the financial year		**(3,497)**	108,430

All amounts are derived from continuing operations

Ambac Assurance UK Limited
Statement of Comprehensive Income
For the year ended 31 December 2018

	2018	2017
	£'000	£'000
(Loss) / profit for the financial year	**(3,497)**	108,430
Currency translation differences on the branch net of related tax	**(81)**	(42)
Total comprehensive income for the year	**(3,578)**	108,388

Statement of Changes in Equity
For the year ended 31 December 2018

	Called Up Share Capital £'000	Profit and Loss Account £'000	Capital Reserve £'000	Total £'000
Balance at 1 January 2018	**36,000**	**225,940**	**4,345**	**266,285**
Loss for the financial year	—	(3,497)	—	(3,497)
Currency translation differences on the branch net of tax	—	(81)	—	(81)
Balance at 31 December 2018	**36,000**	**222,362**	**4,345**	**262,707**
Balance at 1 January 2017	**36,000**	**117,552**	**4,345**	**157,897**
Profit for the financial year	—	108,430	—	108,430
Currency translation differences on the branch net of tax	—	(42)	—	(42)
Balance at 31 December 2017	**36,000**	**225,940**	**4,345**	**266,285**

Ambac Assurance UK Limited
Balance sheet
at 31 December 2018

	Notes	**2018**	2017
		£'000	£'000
Assets			
Investments			
Other financial investments	*11*	**490,558**	454,762
Debtors			
Debtors arising out of direct insurance operations from policyholders	*12*	**153,505**	181,702
Other debtors	*13*	**12,077**	6,808
Deferred taxes	*10*	**805**	563
Other assets			
Tangible assets	*14*	**56**	89
Cash and cash equivalents		**7,928**	5,022
Prepayments and accrued income			
Deferred acquisition costs	*15*	**2,837**	3,254
Total assets		**667,766**	652,200
Liabilities			
Capital and reserves			
Called up share capital	*17*	**36,000**	36,000
Capital Reserve		**4,345**	4,345
Profit and Loss account		**222,362**	225,940
Shareholder's funds – equity interests		**262,707**	266,285
Technical Provisions			
Provision for unearned premium	*18*	**205,399**	229,541
Other Technical Provisions	*18*	**184,252**	127,730
Creditors			
Other creditors including current taxation and social security	*16*	**7,679**	19,802
Deferred taxes	*10*	**507**	1,268
Accruals and deferred income	*19*	**7,222**	7,574
Total liabilities		**667,766**	652,200

The financial statements were approved and authorised for issue by the board of directors on 28 March 2019 and were signed on its behalf by:

John Tifft - *Chief Executive Officer*
Registered no: 3248674

Ambac Assurance UK Limited
Notes to the financial statements
for the year ended 31 December 2018

1 Basis of preparation

The financial statements have been prepared under the provisions of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance companies.

Ambac Assurance UK Limited is a limited liability company incorporated under the laws of England and Wales. The Registered Office is 2nd Floor, 21 Great Winchester Street, London, EC2N 2JA. These financial statements have been prepared in accordance with Financial Reporting Standard 102, which is the Financial Reporting Standard applicable in the UK and Republic of Ireland ("FRS 102").

The presentation currency of these financial statements is sterling. All amounts in the financial statements have been rounded to the nearest £1,000, except where otherwise required. The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules. The following accounting policies have been applied consistently in dealing with items which are considered material to the financial statements.

As permitted under FRS102, the Company has not prepared a cashflow statement nor disclosed transactions with related group undertakings, as it is a wholly owned subsidiary of AFG. The Company's cashflow is included within AFG's financial statements, which include a consolidated cashflow statement.

Going concern

The financial statements are prepared on a going concern basis for the following reasons.

The Company has a significant capital shortfall under the Solvency II rules. The Company and its directors have taken detailed legal, financial and accounting advice as necessary since ceasing to write new business which has informed their view that it remains a going concern. The Company notes that its run-off is subject to PRA supervisory statement SS7/15 "Supervision of firms in difficulty or run-off" and therefore has undertaken and continues to undertake, close consultation with the PRA with regard to this situation.

The Company continues to be entitled to receive instalment premium income in respect of its guaranteed obligations. Accordingly, it is retaining these cash flows for the benefit of its policyholders. These future premium cash flows are supported by contractual make-wholes on certain transactions, which would be payable to the Company in the event that a transaction was prepaid before its scheduled maturity date, thereby ensuring a base-line of premium income. Additionally, the Company invests premium income (as well as investment income and principal receipts), seeking a reasonable return to further support its guaranteed obligations.

The Company's insured obligations are to pay principal and interest when due, and are not generally subject to acceleration (except that the Company may have the right to accelerate insured obligations if they default). Accordingly, the Company's exposure to liquidity risk in respect of material claims in the short term is limited. In addition, in assessing the Company's claims paying resources, the directors have considered the value of its assets compared with the amount of its liabilities, the measure of which, having taken legal and specialist insolvency advice, is assessed on a different basis from the accounting measures set out in the balance sheet.

In making their assessment of the adequacy of the Company's claims paying resources, the directors have considered stressed scenarios, including increased claims payments, reduced premium and/or investment income scenarios and other changes to assumptions and estimates. These considerations have included consideration of the impact of the possible exit of the UK from the EU without arrangements for the ongoing orderly run-off of insurance contracts entered into prior to the exit date.

The directors are satisfied that the Company has adequate resources to meet the day-to-day operational needs of the business for the foreseeable future and that the Company's claims paying resources are sufficient to satisfy currently expected claims as they fall due. The Board considers that the Company remains a going concern.

The financial statements do not include any adjustments that would result if the Company were unable to continue as a going concern.

2 Accounting policies

Judgements and key sources of estimation uncertainty

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year. However the nature of estimation means that actual outcomes could differ from these estimates.

The following judgements (apart from those involving estimates) have had a significant effect on amounts recognised in the financial statements:

- Other technical provisions are based upon judgements by management. The timing and amount of claim payments and claim management expenses may differ from such judgements.
- As at 31 December 2018 the Company's insured portfolio included financial guarantee obligations issued under EU passporting rules. The financial statements have been prepared on the basis that transitional arrangements or new agreements are put into place between the UK and EU by Exit Day which will enable the Company to continue to service these financial guarantee obligations. The financial statements do not include any adjustments that would result if the Company were unable to continue to service these policies. Debtors arising out of direct insurance operations from policyholders and other technical provisions include amounts due from financial guarantee obligations issued under EU Passporting rules as set out in Notes 12 and 18 respectively.

Basis of accounting for underwriting activities

All business is accounted for on an annual basis.

Premium income and unearned premiums

The policy for premium recognition is dependent upon whether a premium is received by instalment or up-front. Where the premium on a policy is received up front, the premium is recognised as written at the date of inception, and earned in the technical account on a basis proportionate to the remaining scheduled periodic maturity of principal and payment of interest to the original total principal and interest insured. Unearned premiums for premiums received upfront represent the portion of premiums written that relate to unexpired terms of policies in force at the balance sheet date.

When the premium on a policy is received in instalments, the premium recognition is dependent on whether the Company is contractually entitled to future premiums. For those contracts with guaranteed premium amounts, the contractually entitled amount was recognised as written at the inception of the policy. Changes to such contractually entitled amounts, including negotiated settlements, are recognised as written at the time of such change. For those contracts where there is no contractual entitlement to future premiums, future instalment premiums are considered sufficiently uncertain such that recognition of future premiums as written at inception is not considered appropriate. For these contracts, instalment premiums are generally recognised as written when received. Instalment premiums are earned in the technical account over each instalment period. Unearned premiums for instalment premiums represent the portion of premiums written that relate to a future period.

When an obligation insured by the Company has been refunded or called, the remaining unrecognised premium is recognised at that time. Differences between settlement proceeds on refunded or called issues and unrecognised premium are taken to profit and loss.

Other technical income

Other technical income comprises fees earned in connection with the Company's portfolio of insured transactions. Structuring fees represent consideration received from clients in return for the Company's involvement in structuring or restructuring certain insured transactions. These non-refundable fees are collected at the time of structuring and are earned over the remaining estimated life of the insured transaction.

The Company also receives certain fees from clients in respect of consents, waivers, amendments and surveillance relating to certain insured transactions. Amendment, waiver and consent fees are earned in the period in which they are received and surveillance fees are earned in the period to which they relate. Where fees are received in relation to an amendment to a policy and where that amendment has an impact on the risk profile of the policy then the fee is earned over the remaining estimated life of the insured transaction.

2 Accounting policies - continued

Pension costs and long term incentive plans

Pension contributions are charged to the profit and loss account and represent the contributions payable to a money purchase pension scheme in respect of the financial year for UK employees.

The Company operates a long term incentive plan ("**LTIP**") and recognises a liability for the present value of expected future obligations accrued at the balance sheet date discounted at the LTIP Plan rate. The expense is charged to the statement of income on the movement in this obligation in each year.

Acquisition costs

Certain costs incurred in prior years that related to the production of new business were deferred in those respective years. These costs generally included compensation costs, premium taxes and certain other costs. These deferred acquisition costs are charged to the accounting periods in which the related premiums are earned. Deferred acquisition costs on the balance sheet represent the proportion of acquisition costs that corresponds to the proportion of premiums written which are unearned at the balance sheet date. Given that no new business was underwritten during the current or prior year, the Company has not deferred further acquisition costs during these periods.

Claims and Unexpired risk provisions

An unexpired risk provision is established for insured obligations when, in the judgement of management, a monetary default in the timely payment of debt service is likely to occur, which would result in the Company incurring a loss. An unexpired risk provision is established in an amount that is sufficient to cover the present value of the anticipated debt service payments over the expected period of default and estimated expenses associated with settling the claim less estimated recoveries under salvage and subrogation rights. Provisions for insured obligations denominated in foreign currencies are converted to sterling at the prevailing spot rate as of the balance sheet date, with foreign currency movements included as a component of the provision for claims.

The unexpired risk provision is based upon estimates and judgements by management, including consideration as to whether any events arising between the reporting date and the date of signing of the financial statements require amendments of those estimates. As such, there can be no assurance that the actual losses in the Company's financial guarantee insurance portfolio will not exceed its unexpired risk reserves.

The company owns fixed income securities which benefit from guarantee policies issued by the Company (**"Own Wrapped Debt"**) against those guarantees. Therefore, a proportion of any guarantee amounts payable by the Company will be repaid to the Company in its capacity as an investor where a technical provision exists. Unexpired risk provisions related to policies where the Company owns a proportion of the fixed income securities which benefit from a guarantee policy are therefore reduced by the fraction of the outstanding exposure owned by the Company.

Where the Company purchases Own Wrapped Debt for which an unexpired risk provision is in place, the purchase price paid is split into two elements. The first element is the **"Intrinsic Price"** of the debt. This is the value of the Own Wrapped Debt excluding the market's assessment of the value of the guarantee that the Company provides. The second element is the excess of the price paid over this Intrinsic Price and represents the value of the Company's guarantee. The Intrinsic Price paid is recognised as the cost of the fixed income security purchased. The price paid in excess of the Intrinsic Price is recorded as a claims management expense.

The rate utilised to discount provisions and estimated recoveries under subrogation rights is equal to the lower of the rate of return on invested assets for either: i) the current year or ii) the average of the period covering the current year plus the four previous years.

Claims paid comprise claims and related expenses paid in the year, less amounts recovered from subrogation received.

Cash and cash equivalents

Cash and cash equivalents comprise cash deposits and financial investments that are within three months of maturity at the date of acquisition. These assets are highly liquid, convertible into known amounts of cash and have insignificant risk of change in fair market value.

2 Accounting policies - continued

Provisions

Provisions are recognised where there is a present obligation (legal or constructive) as a result of a past event that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle that obligation.

Financial Assets and Liabilities

When a financial asset or liability is first recognised it is measured at fair value (which is the transaction price (including transaction costs)). The Company has adopted sections 11 and 12 of FRS 102 for presentation and measurement of these assets and liabilities. The Company treats all investments as financial assets and any other assets as non-financial assets. No liabilities are treated as financial liabilities.

Investments

Investments which are financial assets are measured in accordance with Section 11 and 12 of FRS 102.

Fixed income securities are shown at amortised cost. The difference between the purchase price of such securities and the amount repayable at maturity is charged or credited to the profit and loss account over the period to maturity using the effective interest method. As noted under Claims and Unexpired risk provisions above, the purchase price of Own Wrapped Debt fixed income securities, for which an unexpired risk provision is in place, is the Intrinsic Price at the date of purchase.

Investments in securities other than fixed income securities are included in the balance sheet at fair value. Fair value is determined using the closing bid price of the securities on the balance sheet date. The difference between the purchase price and current value is charged or credited to the non-technical profit and loss account as unrealised gains and losses.

Investment income

Investment income is accounted for on an accrual basis. Interest is accrued up to the balance sheet date. All investment income, including realised and unrealised gains and losses on investments, is reported in the non-technical account.

Realised gains or losses represent, for investments included in the balance sheet at amortised cost, the difference between net sales proceeds and amortised cost, and for investments included in the balance sheet at current value, the difference between net sale proceeds and purchase price.

An impairment loss is recognised where a fixed income security valued at amortised cost has suffered an other-than-temporary diminution in value. The loss recognised is for the amount by which the carrying value exceeds its recoverable amount.

Foreign currencies

Transactions in foreign currencies are translated to sterling at the rate ruling at the date the transaction is made. Monetary assets and liabilities expressed in foreign currencies, other than those within the Italian branch, are translated to the Company's functional currency (sterling) at rates of exchange ruling at the end of the financial year. Differences arising on exchange, not related to claims outstanding, are reflected in the non-technical account.

The profit and loss accounts of the Italian branch are translated to sterling using average rates of exchange. Assets and liabilities of the branch are translated to sterling at year-end rates of exchange. The impact of these foreign currency translations are recognised in comprehensive income.

Taxation

Provision is made for all taxation expected to be payable on taxable profits of the year and adjustments to tax payable in respect of prior years. Taxation includes current taxation plus deferred taxation. Where taxation is recognised in income, comprehensive income or Equity, the tax rates used are those enacted at the balance sheet date.

Deferred tax is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date.

Deferred tax assets are only established as far as it is considered that there is a reasonable expectation that the tax will be recoverable.

2 Accounting policies - continued

Tangible assets

Tangible fixed assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives. The estimated useful lives are as follows:

Leasehold improvements	- Remaining life of the lease
Fixtures, fittings and office equipment	- 5 years
Computer equipment	- 3 years

3 Segmental information

The Company only wrote one class of business, that being non-life financial loss insurance, therefore the directors regard any segmental analysis as inappropriate at the present time.

4 Operating expenses

	2018	2017
	£'000	£'000
Change in deferred acquisition costs	**417**	333
Administrative expenses	**7,850**	8,858
Operating expenses	**8,267**	9,191

5 Investment income - non-technical account

	2018	2017
	£'000	£'000
Investment income including interest receivable	**16,915**	18,254
Net realised gains on fixed income securities	**1,789**	2,562
Impairment losses	**(478)**	(58)
Total investment income on financial assets measured at amortised cost	**18,226**	20,758
Net realised and unrealised (losses) / gains on assets held at fair value	**(6,106)**	8,477
Net foreign exchange gains / (losses)	**14,651**	(18,929)
Investment income	**26,771**	10,306

Investment income includes £16,915,000 (2017: £18,254,000) of income from listed investments.

6 Investment expenses

	2018 £'000	2017 £'000
Investment management expenses	**748**	758

7 Loss on ordinary activities before tax

	2018 £'000	2017 £'000
Loss on ordinary activities before tax is stated after charging:		
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**112**	97
Fees payable to the Company's auditor and its Associates for other services		
Audit related assurance services	**—**	44
Depreciation	**39**	67
Hire of office equipment - Operating leases	**7**	8
Hire of land and buildings - Operating leases	**188**	188

8 Remuneration of directors

	2018 £'000	2017 £'000
Directors' emoluments	**813**	783

The emoluments of the highest paid director were £609,800 in 2018 (2017: £580,000). No Company pension contributions were made to any money purchase scheme on his behalf (2017: £Nil).

As of 31 December 2018, the Company did not have any advances outstanding or amounts guaranteed on behalf of any of the directors.

There are no retirement benefits accruing to the directors of the Company (31 December 2017: none).

Ambac Assurance UK Limited
Notes to the financial statements - *continued*
for the year ended 31 December 2018

9 Staff numbers and costs

The average number of persons employed by the Company during the year was as follows:

	Number of Employees	
	2018	2017
Insured portfolio management	**7**	7
Finance and investments management	**3**	3
Administration	**1**	2
	11	12

The aggregate payroll costs in respect of these persons were as follows:

	2018	2017
	£'000	£'000
Wages and salaries	**3,066**	3,066
Social security costs	**428**	422
Other pension costs	**90**	104
	3,584	3,592

In addition to the above payroll costs the Company made an accrual of £976,000 (2017: £2,438,000) in respect of LTIP costs including associated payroll tax accruals. Benefits will be paid out beginning in 2020 under the LTIP should AUK be successful in delivering on a number of goals assessed both annually and as at 31 December 2019.

10 Taxation

	2018	2017
	£'000	£'000
Analysis of charge in year:		
Current tax:		
UK corporation tax at 19% (prior period 19.25%)	**(1,053)**	25,859
UK Tax adjustment in respect of prior periods	**99**	(83)
Total UK tax expense	**(954)**	25,776
Foreign tax expense at 30.82% (prior period 30.82%)	**15**	376
Foreign tax adjustment in respect of prior periods	—	2
Foreign exchange on foreign tax provisions	—	(52)
Total foreign tax expense	**15**	326
Total current tax (credit)/expense	**(939)**	26,102
Deferred tax:		
UK Tax timing differences	**(171)**	(377)
Foreign tax origination of timing differences	**(771)**	(35)
Tax adjustment in respect of prior periods	**(72)**	(145)
Total deferred tax (credit)/expenses	**(1,014)**	(557)
Tax (credit)/charge on result on ordinary activities	**(1,953)**	25,545

Ambac Assurance UK Limited

Notes to the financial statements - *continued*

for the year ended 31 December 2018

10 Taxation - continued

Factors affecting tax charge for period:

The tax assessed for the years ended 31 December 2018 and 2017 differ from the standard rates of corporation tax in the UK of 19% and 19.25% respectively. The differences are explained below:

	2018	2017
	£'000	£'000
(Loss)/Profit on ordinary activities before tax	(5,450)	133,975
Tax charge at 19% (prior period 19.25%)	(1,036)	25,790
Non-taxable income	(171)	(126)
Differences in effective tax rates on overseas earnings	(281)	122
Difference in overseas taxation basis	(509)	—
Adjustment in respect of prior periods	28	(228)
Other	16	(13)
Tax (Credit)/Expense	(1,953)	25,545

Deferred tax has been provided at the local rate in force when temporary timing differences are expected to reverse. The tax rates used are:

- UK 18%
- Italy 30.82%

The deferred tax asset is attributable to temporary differences arising on the following;

	Other Provisions	Other Timing Differences	Total
	£'000	£'000	£'000
At 31 December 2017	526	37	563
Movements in the year	248	(6)	242
At 31 December 2018	774	31	805

The deferred tax liability is attributable to temporary timing differences arising from the following;

	Other Provisions	Total
	£'000	£'000
At 31 December 2017	1,268	1,268
Movements in the year	(761)	(761)
At 31 December 2018	507	507

Deferred tax assets of £310,000 (2017 £556,000) are expected to be recovered and Deferred tax liabilities of £507,000 (2017 £1,268,000) are expected to be settled after more than 12 months from the balance sheet date.

11 Other financial investments

	Original Cost		Market Value		Carrying value	
	2018	2017	**2018**	2017	**2018**	2017
	£'000	£'000	**£'000**	£'000	**£'000**	£'000
Financial assets measured at fair value through the Profit and Loss account						
Units in money market liquidity funds	**42,986**	27,800	**43,029**	28,263	**43,029**	28,263
Other pooled funds at current value	**231,014**	235,099	**253,996**	267,843	**253,996**	267,843
Financial assets measured at amortised cost						
Listed fixed income securities	**162,779**	146,630	**198,847**	176,580	**193,533**	158,656
	436,779	409,529	**495,872**	472,686	**490,558**	454,762

The fixed income securities are carried at amortised cost, net of foreign currency translation gains or losses. At 31 December 2018, the amount receivable upon maturity of listed fixed income securities exceeds the amortised cost by £7,101,000 (2017: the amount receivable upon maturity of listed fixed income securities exceeded the amortised cost by £18,384,000).

11 a) Interest Rate Risk

Financial instruments for which fair value may be affected by changes in interest rates consist of fixed income securities and money market liquidity funds. Own Wrapped Debt purchased as part of the Company's loss remediation strategy neutralises interest rate risk associated with future financial guarantee claim payments. Accordingly, such securities are excluded from the Company's interest rate sensitivity measures. The following table summarises the estimated change in fair value on financial instruments, assuming immediate changes in interest rates at specified levels at 31 December 2018 and at 31 December 2017.

	At 31 December 2018		At 31 December 2017	
	Estimated Change in Net Fair Value £'000	**Estimated Net Fair Value £'000**	Estimated Change in Net Fair Value £'000	Estimated Net Fair Value £'000
300 basis point rise	**(15,115)**	**138,221**	(13,756)	108,484
200 basis point rise	**(10,566)**	**142,770**	(9,640)	112,600
100 basis point rise	**(5,556)**	**147,780**	(5,079)	117,161
Base scenario	**-**	**153,336**	—	122,240
100 basis point decline	**6,122**	**159,458**	5,533	127,773
200 basis point decline	**12,077**	**165,413**	11,143	133,383
300 basis point decline	**17,179**	**170,515**	14,421	136,661

11 b) Currency risk

The Company holds cash and cash equivalents and has invested in financial instruments denominated in currencies other than sterling amounting to £296,252,000 (2017 £264,428,000). The table below summarises the estimated net change in fair value of these instruments assuming immediate shifts in foreign exchange rates.

Change in Foreign Exchange rates against sterling 31 December 2018

	20% Decrease	**10% Decrease**	**10% Increase**	**20% Increase**
	£'000	**£'000**	**£'000**	**£'000**
Estimated change in fair value	**(59,250)**	**(29,625)**	**29,625**	**59,250**

Change in Foreign Exchange rates against sterling 31 December 2017

	20% Decrease	10% Decrease	10% Increase	20% Increase
	£'000	£'000	£'000	£'000
Estimated change in fair value	(52,886)	(26,443)	26,443	52,886

11 c) Credit Risk

The assets bearing credit risk are summarised below by credit rating in the table below. The fair value of fixed income securities by rating is summarised as follows:

	2018	2017
	£'000	£'000
AAA	**435**	449
AA	**56,939**	43,525
A	**11,174**	8,649
BBB	**32,546**	32,758
Below investment grade	**21,326**	7,163
Not rated	**76,427**	84,036
	198,847	176,580

Ratings are based on the lower of Moody's or S&P ratings. If guaranteed, the rating represents the higher of the underlying or guarantor's financial strength rating. Not rated Own Wrapped Debt purchased as part of the loss remediation strategy represent £76,427,000 (2017 £82,603,000) of not rated and £12,113,000 (2017 £nil) of below investment grade fixed income portfolios respectively.

11 d) Fair value estimation

The table below analyses financial instruments by valuation method. The different levels have been defined as follows:

- Level 1 Quoted prices for government bonds and UCIT funds in active markets.
- Level 2 Quoted prices for other bonds in active markets and other funds
- Level 3 Model derived valuations for Own Wrapped Debt, where the fair value is determined by reference to the market value of the security excluding the market's assessment of the value of the guarantee which the Company provides.

	At 31 December 2018			
	Level 1 £'000	**Level 2 £'000**	**Level 3 £'000**	**Total £'000**
Financial assets measured at amortised cost	**55,420**	**54,887**	**88,540**	**198,847**
Financial assets measured at fair value	**77,497**	**219,528**	**—**	**297,025**
Total Financial assets	**132,917**	**274,415**	**88,540**	**495,872**
	At 31st December 2017			
	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets measured at amortised cost	42,610	51,367	82,603	176,580
Financial assets measured at fair value	104,859	191,247	—	296,106
Total Financial assets	147,469	242,614	82,603	472,686

11 e) Liquidity risk

The estimation of the timing of payment of claims liabilities is uncertain and incorporates a significant amount of judgement. The Company will make a claim payment only if the issuer or obligor responsible for making principal or interest payments fails to do so. The Company's obligation in relation to the timing of payments is to pay scheduled interest and principal. For those transactions for which the Company has established an unexpired risk provision, the debt service dates at which any payment of principal would become due, were the issuers of those transactions to default, are predominately more than five years from the balance sheet date. Prior to those dates the Company would only have an obligation to pay scheduled interest. With respect to the claims which may arise from contractual debt service cashflows from policies for which unexpired risk provisions are in place, the Company estimates that more than 99.5% of its undiscounted unexpired risk provision will become due after more than 5 years. The Company has the option to accelerate insured obligations should the issuer of the debt default and therefore the actual timing of payment of claims may differ from these estimates.

As noted in the Strategic Report the Company invests the majority of its investment portfolio in liquid securities and holds cash and money market funds sufficient to meet any known liabilities falling due in the coming three months. Longer dated liabilities will be met from the Company's holdings of fixed income securities and pooled funds.

12 Debtors arising out of direct insurance operations from policyholders

	2018	2017
	£'000	£'000
Due within one year	8,990	24,639
Due after one year	144,515	157,063
	153,505	181,702

Debtors arising out of direct insurance operations from policyholders includes premium receivable of £20,823,000 (2017 £22,328,000) due in respect of financial guarantee obligations issued under EU passporting rules.

13 Other Debtors

	2018	2017
	£'000	£'000
Accrued interest on financial investments	1,689	2,517
Estimated recoveries under subrogation rights	1,659	2,730
Receivable for Securities	2,478	1,436
Other miscellaneous assets	150	125
Corporation tax receivable	6,101	—
	12,077	6,808

Ambac Assurance UK Limited
Notes to the financial statements - *continued*
for the year ended 31 December 2018

14 Tangible assets

	Leasehold Improvements £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost:			
At beginning of year	225	548	773
Additions	—	6	6
Disposals	—	—	—
At 31 December 2018	225	554	779
Depreciation:			
At beginning of year	153	531	684
Charge for the year	24	15	39
Disposals	—	—	—
At 31 December 2018	177	546	723
Net book value:			
At beginning of year	72	17	89
At 31 December 2018	48	8	56

	Leasehold Improvements £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost:			
At 31 December 2016	220	521	741
Additions	5	27	32
Disposals	—	—	—
At 31 December 2017	225	548	773
Depreciation:			
At 31 December 2016	130	487	617
Charge for the year	23	44	67
Disposals	—	—	—
At 31 December 2017	153	531	684
Net book value:			
At 31 December 2016	90	34	124
At 31 December 2017	72	17	89

15 Deferred Acquisition Costs

	2018	2017
	£'000	£'000
Deferred acquisition costs		
At beginning of year	**3,254**	3,587
Movement in provision in year	**(417)**	(333)
At end of year	**2,837**	3,254

16 Other creditors

	2018	2017
	£'000	£'000
Accrued LTIP costs	**3,778**	2,920
Other accrued expenditure	**2,235**	2,062
Payable for securities	**1,339**	1,411
Corporation Tax payable	—	13,130
Inter-company balance	**327**	279
	7,679	19,802

17 Called up share capital

	2018	2017
	£'000	£'000
Ordinary shares of £1 each		
Allotted and called up and fully paid : 36,000,000 shares (2017 : 36,000,000)	**36,000**	36,000

18 Technical provisions

	2018			2017		
	Unearned Premium	**Unexpired Risk Provision**	**Total**	Unearned Premium	Unexpired Risk Provision	Total
	£'000	**£'000**	**£'000**	£'000	£'000	£'000
At beginning of year	**229,541**	**125,000**	**354,541**	253,967	230,663	484,630
Movement in the provision						
Premiums written in year	**(4,940)**	**—**	**(4,940)**	(2,995)	—	(2,995)
Premiums earned	**(19,211)**	**—**	**(19,211)**	(21,463)	—	(21,463)
Claim paid net of subrogation received	**—**	**(401)**	**(401)**	—	(538)	(538)
Claims management and loss expenses paid	**—**	**(6,318)**	**(6,318)**	—	(17,303)	(17,303)
Movement in unexpired risk provision in respect of prior accident years	**—**	**63,224**	**63,224**	—	(90,336)	(90,336)
Movement in the estimated recoveries under subrogation	**—**	**1,071**	**1,071**	—	2,518	2,518
Exchange rate movements	**9**	**17**	**26**	32	(4)	28
At end of the period	**205,399**	**182,593**	**387,992**	229,541	125,000	354,541

The unexpired risk provision includes other technical provisions and a deduction for estimated recoveries under subrogation rights.

All unexpired risk provisions arise in respect of financial guarantee obligations issued under EU passporting rules.

	2018	2017
	£'000	£'000
Unexpired risk provision		
Other technical provisions	**184,252**	127,730
Estimated recoveries under subrogation rights	**(1,659)**	(2,730)
	182,593	125,000

The undiscounted other technical provisions and estimated recoveries under subrogation rights are £257,953,000 and £1,697,000 respectively (2017: £246,256,000 and £2,969,000).

Estimates of future claim payments and recoveries under subrogation rights are based upon complex models that contain a number of long-term financial assumptions. Key assumptions are made in relation to such things as:

- Operating performance and cash flows of the insured risks
- Foreign exchange rates
- Interest rates
- Movements in values of assets securing the insured risks

18 Technical provisions - continued

Given the duration of the period until repayment of the obligations guaranteed by the Company, actual claims costs could differ from these estimates. Management has therefore considered a range of possible outcomes (including stress scenarios in relation to the above) and believe that at 31 December 2018 an unexpired risk provision (net of estimated recoveries under subrogation rights) of £182,593,000 (2017: £125,000,000) is most appropriate on a discounted basis.

The Company discounts estimated future claims and recoveries under subrogation rights at a rate of 2.46% (2017: 4.42%). Due to the long term nature of the claims payment schedule, future investment returns on the assets maintained to cover the provisions for claims may not reflect the historical returns used to discount the provision. The following table summarises the estimated change in the unexpired risk provision assuming an immediate shift in the Company's discount rate only at specified levels.

	2018		2017	
	Unexpired risk provision (net of recoveries and subrogation)	**Impact of changes in provision**	Unexpired risk provision (net of recoveries and subrogation)	Impact of changes in provision
	£'000	**£'000**	£'000	£'000
200 basis point rise	**142,362**	**(40,231)**	95,228	(29,772)
100 basis point rise	**160,726**	**(21,867)**	108,774	(16,226)
50 basis point rise	**171,179**	**(11,414)**	116,519	(8,481)
Base case	**182,593**	**—**	125,000	—
50 basis point decline	**195,060**	**12,467**	134,293	9,293
100 basis point decline	**208,687**	**26,094**	144,480	19,480
200 basis point decline	**239,895**	**57,302**	167,922	42,922

The unexpired risk provision is entirely denominated in currencies other than sterling. The table below summarises the estimated change in value assuming immediate shifts in foreign exchange rates.

Change in Foreign Exchange rates against sterling 31 December 2018

	20% Decrease	**10% Decrease**	**10% Increase**	**20% Increase**
	£'000	**£'000**	**£'000**	**£'000**
Undiscounted unexpired risk provision	**(51,591)**	**(25,795)**	**25,795**	**51,591**
Discounted unexpired risk provision	**(36,519)**	**(18,259)**	**18,259**	**36,519**

Change in Foreign Exchange rates against sterling 31 December 2017

	20% Decrease	10% Decrease	10% Increase	20% Increase
	£'000	£'000	£'000	£'000
Undiscounted unexpired risk provision	(48,657)	(24,329)	24,329	48,657
Discounted unexpired risk provision	(25,000)	(12,500)	12,500	25,000

19 Accruals and deferred income

	2018	2017
	£'000	£'000
Deferred restructuring and consent fees	7,222	7,574
	7,222	7,574

20 Pension scheme

The Company operates a defined contribution pension scheme in respect of its full time employees and directors. The charge to the profit and loss account for the period for pensions was £90,000 (2017: £ 104,000).

21 Commitments

There are no commitments in respect of contracts for capital expenditure not provided for.
Annual commitments for the next financial year under non-cancellable operating leases are as follows:

	Land and Buildings		Office Equipment	
	2018	2017	**2018**	2017
	£'000	£'000	**£'000**	£'000
Operating leases that expire:				
Within one year	—	—	—	4
Between two through five years	**188**	188	7	7
In more than five years	—	—	—	—

22 Ultimate parent company

The Company is a wholly owned subsidiary of AAC. The ultimate holding company is AFG, a company incorporated under the laws of the State of Delaware, United States of America.

The largest and smallest groups in which the results of the Company are consolidated are AFG and AAC, respectively. The consolidated financial statements of AFG are available to the public and may be obtained either from One State Street Plaza, New York, NY 10004, USA or via AFG's website: www.ambac.com.