Ambac Assurance UK Limited

Annual Report and Financial Statements

for the year ended 31 December 2020

Registered no: 3248674

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Ambac Assurance UK Limited

Directors and advisers

Executive Directors

David Barranco
David Trick
John Tifft (resigned 31 March 2020)
Alan Dee (appointed 31 March 2020)

Non-executive directors

William Fall - Chairman of the Board
Anthony McMahon (resigned 31 March 2020)
Hugh Boyle - Chairman of the Audit and Risk Committee of the Board of Directors
Ben Loomes

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

Ambac Assurance UK Limited

The directors present their strategic report, directors' report and the audited financial statements for the year to 31 December 2020.

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**"). On February 3, 2020, AFG's common stock began trading on the NYSE under the ticker symbol "AMBC." Prior to being listed on the NYSE, it was listed on NASDAQ under the 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 (until December 31, 2020) to do the same through a branch in Milan, Italy, and a number of other EU countries. EU legislation allowed Ambac UK to conduct business in EU states other than the United Kingdom through a "passporting" arrangement, which eliminated the necessity of additional licensing or authorisation in those other EU jurisdictions.

On 31 December 2020 the Company's authorisation to run-off insurance policies in the European Economic Area ("**EEA**") through passporting arrangements ceased. This was a consequence of the end of the transition period ("**Transition Period**") agreed between the UK Government and the EU following the UK's exit from the EU on 31 January 2020 ("**Brexit**"). The Company's outstanding policies in the EEA were either commuted or the benefits of those policies were transferred to UK entities during the year. The Company therefore no longer services any insurance policies in the EEA. The Company maintained a branch in Milan until 18 December 2020 but closed the branch on that date following the transfer of the administration of the last remaining policy in the branch to the UK on 1 December 2020.

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 52 financial guarantee obligations with a gross par outstanding of £8.2 billion as of 31 December 2020 (57 obligations and £8.9 billion gross par outstanding as at 31 December 2019). The portfolio comprises financial guarantees for essential infrastructure, whole business securitisations, utility obligations, and other bond types, primarily in the UK, which were written by the Company prior to December 2007. The portfolio is contractually scheduled to run off through 2047, although certain insured transactions can be prepaid and/or unwound under certain circumstances. 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 insured transactions and also generates fees from processing requests for consents, waivers and amendments to existing transactions.

Parent Undertaking

The Company's parent, AAC, is a financial guarantee insurance firm in run-off. AAC is regulated by the Office of the Commissioner of Insurance for the State of Wisconsin ("**OCI**") who are required to approve certain actions taken by or in respect of AAC. AAC is therefore under enhanced regulatory supervision by its regulator. It remains the view of the directors of the Company that this position will have no material impact on the Company.

Business review

Results and Key performance indicators

Results and Shareholder's Funds

The results for the Company, as set out on page 18, show a profit for the financial year of £25.3 million (2019 profit of £124.3 million). The key drivers of the 2020 result, as compared to the 2019 result, were an increase in premium earned due to the accelerated run off of certain policies during the year offset by lower investment income than in prior years due to the volatile market conditions experienced during the year. In 2019 the profit was driven by a decrease in other technical provisions over the year as a result of the restructuring and commutation in June 2019 of one of the Company's financial guarantee obligations, Ballantyne Re Plc ("**Ballantyne**"). These items are discussed in more detail below.

The Company had a surplus in shareholder's funds of £412.0 million (31 December 2019: surplus of £386.5 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 2020, net premiums earned were £31.9 million (2019: £25.8 million). The year on year increase in premiums earned is primarily due to a greater value of accelerated repayments of financial guarantee obligations in the year which resulted in higher accelerated premium revenues, offset by the normal run-off of the financial guarantees over time.

Premiums earned for the year ended 31 December 2020 are comprised of £23.3 million normal earned premiums and £8.6 million accelerations (2019: £25.2 million normal earned premiums and £0.6 million accelerations).

Claims incurred and changes in other technical provisions

For the year ended 31 December 2020, the Company's claims incurred and other technical provision expense was a charge of £2.6 million (2019: credit of £97.0 million). The charge for other technical provision expense in 2020 arose from loss expenses paid, net of movements in loss expense reserves, in respect of the Company's financial guarantee obligations.

The credit in claims incurred and other technical expense in 2019 was a result of the restructuring and commutation of Ballantyne during the year. This resulted in a decrease in unexpired risk provisions as a result of the release of technical provisions previously held in respect of the expected future claims related to Ballantyne of £181.0 million and net recovery of claims management expenses previously incurred as part of the restructuring of £0.5 million, offset by commutation costs incurred as a consequence of the restructuring of £84.5 million.

Cash, Investments and Investment Income

At 31 December 2020, the carrying value of cash and investments totalled £481.0 million (2019: £470.2 million). The year-on-year increase in cash and investments is primarily due 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.

Investment income for the year ended 31 December 2020 was £6.0 million (2019: £42.8 million). The year on year reduction in investment income is the result of three factors. Firstly, lower income from fixed income securities compared to the prior year where returns were enhanced by the redemption of Ballantyne notes owned by the Company during 2019 as part of the restructuring. Secondly, realised and unrealised losses on assets held at fair value in 2020 due to the impact of COVID-19 on certain asset prices as compared to realised and unrealised profits in the prior year and finally due to foreign exchange losses on foreign currency denominated investments as compared to foreign exchange profits in the prior year.

Duty to promote the success of the Company

The directors note the requirements under s172 of the Company's Act 2006 that they must act in a way that they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole. In so doing the directors have regard (amongst other matters) to:

a. the likely consequences of any decision in the long term over the remaining life of the run off of policies insured by the Company until 2047,
b. the interests of the Company's employees,
c. the need to foster the Company's business relations with suppliers, policyholders, trustees and regulators,
d. the impact of the Company's operations on the community and the environment,
e. the desirability of the Company maintaining a reputation for high standards of business conduct, and
f. the need to act fairly between members of the Company.

The following summarises how the directors have fulfilled their duties with respect to specific stakeholders:

Shareholders
AAC is the sole shareholder of the Company. Representatives of AAC are also directors of the Company which ensures that the strategies and objectives of the Company are well understood by the shareholder.

Policyholders and Issuers
The Company's senior management and its advisors work closely with the issuers of debt subject to financial guarantees issued by the Company to review their plans and to consider their financial position on a regular basis.

Regulators
The Company's senior management meets regularly with the PRA and is committed to a strong relationship with its regulators.

Employees
The Company's long term success is dependent upon its commitment to its employees and their demonstration of the Company's values. As part of its governance processes the Company conducts regular training for employees on employment law, the regulatory environment, fraud prevention and IT security. The Company also hosts weekly meetings for all staff, which are also attended by non-executive directors on a periodic basis, which enables staff to engage with the Company's senior management on a variety of topics.

Impact of the Company's operations on the community and the environment
Financial guarantee insurance written by the Company covers debt issued by a wide variety of issuers. Many of these issuers bring benefits to communities through infrastructure projects such as the provision of new roads, hospitals, utilities and university buildings. As noted in *Principal risks and uncertainties, Climate Change risk* below, the Company also considers environmental issues in its ongoing surveillance of the performance of individual transactions within its financial guarantee portfolio and investment portfolio and seeks to manage and mitigate these risks where possible.

Suppliers
The Company has developed a vendor management policy which aims to assess the suitability of all suppliers and their ability to meet the standards expected by the Company. Suppliers are assessed under this policy at the point they are initially engaged and on a periodic basis thereafter to ensure that they continue to meet the requirements under the policy.

Going Concern

The Company has Solvency II eligible assets in excess of Minimum Capital Requirements under the Solvency II rules. However, Solvency II eligible assets remain below Solvency Capital Requirements ("**SCR**") and therefore the Company remains in a capital shortfall position. The shortfall has increased over the year due to an increase in regulatory capital requirements for non-life insurers in the credit and surety line of business. The non-compliance with SCR is expected to persist until compliance is restored by the natural run off of the Company's insured portfolio. The Company's regulators are aware of this deficiency, and dialogue between Company management and its regulators remains ongoing with respect to options for addressing the shortcoming, although such options remain few. The Company notes that, as a result of the non-compliance with SCR, 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. Further details of the Company's Solvency II position are set out in its Solvency and Financial Condition Report ("**SFCR**") which is available on AFG's website at www.ambac.com.

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 2020 and 31 December 2019 as follows:

+/-	**Claims Paying Resource Components £'000's**	**At 31/12/2020**	**At 31/12/2019**
(+)	Cash	5,796	5,150
(+)	Investments (at market value)	483,426	469,688
(+)	Minimum Guaranteed Premiums and other minimum contractual premiums	135,690	139,166
(-)	Expected future claims and expenses	(1,931)	(1,524)
(-)	Annual operating expenditure	(5,754)	(6,884)
(+)	Expected Premiums beyond Minimum Guaranteed Premiums	42,417	56,154
(=)	**AUK Net Claims Paying Resources**	**659,644**	**661,750**

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

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

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, in light of the contractual debt service of insured obligations falling due within the coming 12 months and the fact that the majority obligations insured by the Company are of investment grade, the Company regards its exposure to liquidity risk in respect of material claims over the coming 12 months as being 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.

Annually the Company prepares an Own Risk and Solvency Assessment ("**ORSA**"). Within the ORSA, the directors have considered the Company's detailed cash flow projections (not just of claims paying resources), Solvency II capital adequacy position and liquidity position under stressed scenarios, including increased claims payments from currently unimpaired insured transactions, reduced premiums and/or investment income scenarios and other changes to assumptions and estimates. These considerations have included consideration of the impacts which may arise from the ongoing COVID-19 outbreak. Accordingly, taking into account the Company's current position, the impacts on the Company of the COVID-19 outbreak (as set out in more detail below) and the output of the stress scenarios set out in the ORSA, the directors are satisfied that the Company has adequate resources to meet the day-to-day operational needs of the business for at least a year from the date of approval of the financial statements and that the Company's claims paying resources are sufficient to satisfy projected claims as they fall due within this same period. Accordingly, the Company has adopted and continues to consider appropriate the going concern basis in preparing the Annual Report and Financial Statements.

Whilst the directors have focused their going concern assessment on a period of one year from the date of approval of the financial statements, the Company's insured obligations run off until 2047. There is inherent subjectivity in the process for determining the cost of future claims from insured obligations over such a long period. Consequently, in light of these time frames and uncertainties, the adoption of a going concern basis in preparing the financial statements is not a guarantee that the Company will continue in operation or continue to be able to meet all claims as they fall due over the entire remaining duration of the run-off.

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 insured 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 risk 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. Uncertainties include the impact of future economic shocks and idiosyncratic events which may impact the future performance of the insured portfolio. Such economic shocks could, for example, include recessions or other events resulting from the impact of COVID-19. Management considers a range of possible outcomes (including stress scenarios) in order to determine the most appropriate basis for unexpired risk 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 and ensures that counterparty exposure is well diversified. 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 insured 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 insured 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.

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.

Both the Company and AAC actively seek to mitigate cyber risk across the organization. Specific measures include a cybersecurity training program, active monitoring to ensure the integrity and security of IT systems and data and regular internal cyber risk assessments and vulnerability scans. The Company maintains a business continuity plan which users test annually and has largely been operating remotely from the office since mid-March 2020 as a consequence of the COVID-19 outbreak.

As a small business with only 10 employees as at 31 December 2020 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 continues to monitor its operating requirements and risk management structure to ensure that they continue to meet its requirements.

Climate Change risk

The Company monitors its exposure to climate change risk both within its portfolio of financial guarantee business and within its investment portfolio. The Company's portfolio of financial guarantee business is in run-off with the last policy expiring in 2047. The Company therefore considers long term climate change impacts as part of this monitoring process.

Brexit

As noted in *Principal activity* on page 2 the Company's outstanding policies in the EEA were either commuted or the benefits of those policies were transferred to UK entities during the year. Whilst no legal or operational difficulties are envisaged in continuing to service those policies transferred, there can be no guarantee that the wider impacts of Brexit upon the UK economy will not affect the Company in the future.

COVID-19

In response to the COVID-19 outbreak globally during the first quarter of 2020 the Company undertook detailed analysis of the potential impacts upon its insured obligations, balance sheet asset valuations and general financial stability. The Company and its parent, AAC, adopted wide-ranging operational changes to protect staff well being and implemented their respective Business Continuity plans including remote working in advance of any formal government guidance and restrictions. To date no significant issues have been experienced in the Company's ability to operate as a result of these measures which remain in place.

With regard to the insured portfolio, whilst there are some credits where the economic environment created by COVID-19 has given rise to elevated credit concerns (primarily those transactions where the revenue of the issuer is demand dependent or where the issuer is already below investment grade), no COVID-19 related claims were received during the year. Additionally, the UK Government has introduced a number of measures to mitigate the economic impacts of the virus including rebating employers up to 80% of staff salaries (up to a £2,500 per month per employee cap), tax deferrals, reductions in VAT, business loan schemes and property tax relief. The mitigating measures noted continue into 2021. The underlying strong liquidity of those issuers, the support that impacted issuers have received from the UK Government and additional financing raised by issuers (through the Coronavirus Business Interruption Loan Scheme, or other measures) means the directors do not believe that any specific unexpired risk provisions linked to COVID-19 are required at this time.

The Company and its advisors continue to work closely with impacted issuers to review their plans and liquidity facilities in light of these events.

The downturn in global markets during 2020 from COVID-19 concerns temporarily impacted the market value of the Company's investment portfolio; however these market moves largely reversed over the remainder of the year and overall the investment portfolio generated positive returns for the year.

Taking into account the Company's current position, the output of stress scenarios and additional analysis performed, the current COVID-19 situation does not change the directors' view that these financial statements should be prepared on the Going Concern basis, as set out above and in Note 1, *Basis of Preparation*.

At this time, there are significant uncertainties surrounding the ultimate scope of damage resulting from this pandemic. Actual losses from the economic consequences of COVID-19, in terms of both future claims related to the Company's insured portfolio and to the Company's future results of operations and financial condition, may vary materially from management's current expectations due to several factors, including the inherent uncertainties in making judgements in this area and the evolving nature of this pandemic.

By order of the Board

M Sánchez
Secretary
Registered no: 3248674
Date: 25 March 2021

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 18.

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.

Auditor

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

BDO LLP continued as outsourced Internal Auditor 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 auditor is 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 auditor is 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

Date: 25 March 2021

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 2020 which comprise the profit and loss account, 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 2020 and of its profit 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 first appointed as auditor by the directors for the period ended 31 December 1997. The period of total uninterrupted engagement is for the 24 financial periods ended 31 December 2020. 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: 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
Unexpired Risk Provision ***(included within Other Technical Provisions)*** (£1.9 million, 2019: £1.5 million) Refer to page 24 (accounting policies), page 36 (financial disclosures).	**Subjective valuation** The provision for losses in relation to the financial guarantee obligations is 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 which could involve subjective assumptions about the future performance of the credits and, where a risk of expected loss is established, to develop cash flow models which incorporate scenarios to estimate the loss. The COVID-19 pandemic and related government-imposed lockdowns have increased the risk of defaults and consequently the judgement with respect to the valuation of the unexpired risk provision, especially in relation to credits exposed to demand based sectors such as hospitality	**Our procedures included:** ***Control design and operation:*** Tested the design, implementation and operating effectiveness of the key controls over the credit monitoring process and completeness of the credits on the adversely classified credits list. ***Independent re-performance:*** Used our own internal specialist to perform a credit review on a sample of credits, including credits most exposed to demand based sectors impacted by COVID-19, to assess the appropriateness of the Directors' conclusions with respect to risk grading. ***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 (2019 result: acceptable).

	The risk	Our response
Going concern Refer to pages 4 to 8 (strategic report), pages 21 to 22 (financial disclosures)	**Unprecedented levels of uncertainty** 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 risks most likely to adversely affect the Company's available financial resources over this period are considered to be: the financial and operational resilience of the business and its ability to continue to operate through a period of significant disruption brought on by COVID-19 pandemic; larger than expected losses over the financial guarantee obligations; and defaults on credits especially exposed to demand based sectors such as hospitality impacted by COVID-19, thus increasing the existing Solvency Capital Requirement ("SCR") deficit, as noted on pages 21 and 22 and leading to regulatory intervention. There are also less predictable but realistic second order impacts such as a broader economic downturn caused by COVID-19, which could result in a longer period of, and more pronounced reduction in, available financial resources. 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:** We considered the directors' assessment of the risks to the Company's operational resilience, financial investments, financial guarantee exposures and solvency position compared with our own understanding of these risks and knowledge of the business. We considered whether these risks could plausibly affect the liquidity in the going concern period by assessing the directors' sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of severe, but plausible, adverse effects that could arise from these risks individually and collectively. We considered and challenged the directors' assessment of financial guarantee obligations, specifically exposures in those sectors considered to be in demand based sectors most exposed to COVID-19. Additionally, we evaluated the governance and oversight process applied to the directors' going concern assessment. ***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 in its Own Risk and Solvency Assessment ("ORSA") taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively by considering the directors' stress testing of critical factors such as a reduction in premium income and/or higher than expected losses on the insured portfolio. We evaluated the degree to which reasonably foreseeable downside scenarios that would impact the Company's business as a result of COVID-19 would be covered by the stresses and reverse stress tests that the directors had used within the ORSA. ***Assessment of Directors' plans:*** We assessed the plans and progress to ensure the continued operation of the business in the face of the disruption caused by COVID-19. ***Key dependency assessment:*** We performed inquiries with the directors, considered correspondence with the regulator and held our annual meeting with the regulator to assess the implications of the directors' assessment on the current capital shortfall and the likelihood of regulatory intervention.

The risk	Our response
Going concern (continued)	*Assessing transparency*: We assessed the appropriateness of the matters covered in the going concern disclosure with management's assessment of the risks and uncertainties of the Company's ability to pay its liabilities as they fall due within the going concern period. **Our results** We found the going concern disclosures and basis of preparation without any material uncertainty to be acceptable (2019: 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 £3.1 million (2019: £3.2 million), determined with reference to a benchmark of total assets of which it represents 0.5% (2019: 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.

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole.

Performance materiality was set at 75% (2019: 75%) of materiality for the financial statements as a whole, which equates to £2.3 million (2019: £2.4 million). We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit and risk committee any corrected or uncorrected identified misstatements exceeding £0.15 million (2019: £0.16 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

4. 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 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").

An explanation of how we evaluated management's assessment of going concern is set out in the related key audit matter in section 2 of this report.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate; and
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for the going concern period.

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 above conclusions are not a guarantee that the Company will continue in operation.

5. Fraud and breaches of laws and regulations – ability to detect

Identifying and responding to risks of material misstatement due to fraud

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included:

- Enquiring of directors, the audit and risk committee and inspection of policy documentation as to the Company's high-level policies and procedures to prevent and detect fraud and the Company's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud.
- Reading Board and audit and risk committee minutes.
- Considering remuneration incentive schemes and performance targets for management.
- Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, we perform procedures to address the risk of management override of controls, in particular the risk that management may be in a position to make inappropriate accounting entries. On this audit we do not believe there is a fraud risk related to revenue recognition because the Company has relatively simple revenue streams and the opportunities for manipulating revenue are limited given the Company is in runoff and has not written any new financial guarantee contracts for a number of years.

We did not identify any additional fraud risks.

We performed procedures including identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those related to cash that were posted to seldom used accounts.

Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations

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, through discussion with the directors and other management (as required by auditing standards), 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.

As the Company is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

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 license to operate. Recognising the financial and regulated nature of the Company's activities, we identified regulatory capital, liquidity and certain aspects of company legislation 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. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach. Through these procedures we confirmed continuing non-compliance with the regulatory capital requirement and considered the effect of this as part of our procedures on the going concern basis of preparation of the financial statements. The identified actual non-compliance was significant to our audit and resulted in our response being identified as a key audit matter in section 2 above. 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.

Context of the ability of the audit to detect fraud or breaches of law or regulation

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 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 fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6. We have nothing to report on the strategic report and the directors' 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.

7. 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, 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.

8. Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on page 10, 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 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 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.

9. 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: 25 March 2021

Ambac Assurance UK Limited

Profit and Loss Account

For the year ended 31 December 2020

Technical account - general business

	Notes	2020 £'000	2019 £'000
Earned premiums			
Gross premiums written	*3*	**22,942**	11,073
Change in the gross provision for unearned premiums	*18*	**8,920**	14,677
Earned premiums		**31,862**	25,750
Other technical income		**1,012**	1,025
Claims incurred and changes in other technical provisions	*18*		
Claims paid, net of subrogation received		—	(84,472)
Claims management expenses		**(2,176)**	496
Change in other technical provisions		**(380)**	180,984
Claims (incurred)/benefit and other technical provisions		**(2,556)**	97,008
Operating expenses	*4*	**(5,487)**	(12,260)
Balance on the general business technical account		**24,831**	111,523

Non - technical account - general business

	Notes	2020 £'000	2019 £'000
Balance on the general business technical account		**24,831**	111,523
Investment income	*5*	**6,038**	42,792
Investment expenses and charges	*6*	**(561)**	(732)
Other income		**528**	591
Interest expense	*20*	**(729)**	(379)
Profit on ordinary activities before tax	*7*	**30,107**	153,795
Tax charge on result on ordinary activities	*10*	**(4,827)**	(29,452)
Profit on ordinary activities after tax		**25,280**	124,343
Profit for the financial year		**25,280**	124,343

All amounts are derived from continuing operations

Ambac Assurance UK Limited

Statement of Comprehensive Income

For the year ended 31 December 2020

	2020	2019
	£'000	£'000
Profit for the financial year	**25,280**	124,343
Currency translation differences on the branch net of related tax	**130**	(507)
Total comprehensive income for the year	**25,410**	123,836

Statement of Changes in Equity

For the year ended 31 December 2020

	Called Up Share Capital £'000	Profit and Loss Account £'000	Capital Reserve £'000	Total £'000
Balance at 1 January 2020	**36,000**	**346,198**	**4,345**	**386,543**
Profit for the financial year	—	25,280	—	25,280
Currency translation differences on the branch net of tax	—	130	—	130
Balance at 31 December 2020	**36,000**	**371,608**	**4,345**	**411,953**

	Called Up Share Capital £'000	Profit and Loss Account £'000	Capital Reserve £'000	Total £'000
Balance at 1 January 2019	**36,000**	**222,362**	**4,345**	**262,707**
Profit for the financial year	—	124,343	—	124,343
Currency translation differences on the branch net of tax	—	(507)	—	(507)
Balance at 31 December 2019	**36,000**	**346,198**	**4,345**	**386,543**

Ambac Assurance UK Limited

Balance sheet

at 31 December 2020

	Notes	2020 £'000	2019 £'000
Assets			
Investments			
Other financial investments	*11*	**475,226**	465,031
Debtors			
Debtors arising out of direct insurance operations from policyholders	*12*	**135,690**	139,166
Other debtors	*13*	**4,217**	2,062
Deferred taxes	*10*	**568**	546
Other assets			
Tangible assets	*14*	**18**	52
Cash and cash equivalents		**5,796**	5,150
Prepayments and accrued income			
Deferred acquisition costs	*15*	**2,262**	2,527
Total assets		**623,777**	614,534
Liabilities			
Capital and reserves			
Called up share capital	*17*	**36,000**	36,000
Capital Reserve		**4,345**	4,345
Profit and Loss account		**371,608**	346,198
Shareholder's funds – equity interests		**411,953**	386,543
Technical Provisions			
Provision for unearned premium	*18*	**181,808**	190,719
Other Technical Provisions	*18*	**1,931**	1,524
Creditors			
Other creditors including current taxation and social security	*16*	**11,623**	18,452
Deferred taxes	*10*	**—**	867
Accruals and deferred income	*19*	**6,518**	6,870
Interest bearing loans and borrowings	*20*	**9,944**	9,559
Total liabilities		**623,777**	614,534

The financial statements were approved and authorised for issue by the board of directors on 25 March 2021 and were signed on its behalf by:

Alan Dee - *Chief Executive Officer*
Registered no: 3248674

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. 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 Solvency II eligible assets in excess of Minimum Capital Requirements under the Solvency II rules. However, Solvency II eligible assets remain below SCR and therefore the Company remains in a capital shortfall position. The shortfall has increased over the year due to an increase in regulatory capital requirements for non-life insurers in the credit and surety line of business. The non-compliance with SCR is expected to persist until compliance is restored by the natural run off of the Company's insured portfolio. The Company's regulators are aware of this deficiency, and dialogue between Company management and its regulators remains ongoing with respect to options for addressing the shortcoming, although such options remain few. The Company notes that, as a result of the non-compliance with SCR, 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. 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 insured 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, in light of the contractual debt service of insured obligations falling due within the coming 12 months and the fact that the majority obligations insured by the Company are of investment grade, 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.

Annually the Company prepares an ORSA. Within the ORSA, the directors have considered the Company's detailed cash flow projections (not just of claims paying resources), Solvency II capital adequacy position and liquidity position under stressed scenarios, including increased claims payments from currently unimpaired insured transactions, reduced premiums and/or investment income scenarios and other changes to assumptions and estimates. These considerations have included consideration of the impacts which may arise from the ongoing COVID-19 outbreak. Accordingly, taking into account the Company's current position and the output of the stress scenarios set out in the ORSA, the directors are satisfied that the Company has adequate resources to meet the day-to-day operational needs of the business for at least a year from the date of approval of the financial statements and that the Company's claims paying resources are sufficient to satisfy projected claims as they fall due within this same period. Accordingly, the Company has adopted and continues to consider appropriate the going concern basis in preparing the Annual Report and Financial Statements.

Taking into account the Company's current position, the output of stress scenarios and additional analysis performed, the current COVID-19 situation does not change the directors' view that these financial statements should be prepared on the Going Concern basis, as explained in more detail in the Strategic Report.

At this time, there are significant uncertainties surrounding the ultimate scope of damage resulting from this pandemic. Actual losses from the economic consequences of COVID-19, in terms of both future claims related to the Company's insured portfolio and to the Company's future results of operations and financial condition, may vary materially from management's current expectations due to several factors, including the inherent uncertainties in making judgements in this area and the evolving nature of this pandemic.

Whilst the directors have focused their going concern assessment on a period of one year from the date of approval of the financial statements, the Company's insured obligations run off until 2047. There is inherent subjectivity in the process for determining the cost of future claims from insured obligations over such a long period. Consequently, in light of these time frames and uncertainties, the adoption of a going concern basis in preparing the financial statements is not a guarantee that the Company will continue in operation or continue to be able to meet all claims as they fall due over the entire remaining duration of the run-off.

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 have had a significant effect on amounts recognised in the financial statements:

- Other technical provisions are based upon judgements by management supported by the Portfolio Risk Management group ("PRM") which performs active surveillance of the insured portfolio. From period to period PRM tracks credit migration of insured obligations and updates internal credit classifications and ratings for each transaction. Other technical provisions are established when management has observed credit deterioration, for example when the underlying credit is considered adversely classified, and when in the judgement of management a monetary default in the timely payment of debt service is likely to occur. The criteria for an exposure to be assigned an adversely classified credit rating includes the deterioration of an issuer's financial condition and creditworthiness, underperformance of the underlying collateral, poor performance by the servicer of the underlying collateral and other adverse economic events or trends. Key judgements made by PRM include the risk of default, the severity of loss upon default, management's ability to execute policy commutations and/or restructurings, and estimated remediation recoveries. The timing and amount of claim payments and claim management expenses may differ from such judgements. This is described further in '*Claims and Unexpired risk provisions*' below.

Basis of accounting for underwriting activities

All business is accounted for on an annual basis.

2 Accounting policies - continued

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.

Pension costs, termination benefits 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.

Severance costs and other termination benefits are recognised and charged to the profit and loss account immediately once a commitment is identified.

The Company operates long term incentive plans ("**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 profit and loss account 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.

2 Accounting policies - continued

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 for an amount exceeding the value of unearned premium reserve for a policy. An unexpired risk provision is established in an amount that is sufficient to cover the present value of the excess of anticipated debt service payments compared to unearned premium reserve 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 under subrogation rights.

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.

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.

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.

2 Accounting policies - continued

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 investment income.

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.

Interest-bearing borrowings classified as basic financial instruments

Interest-bearing borrowings are recognised initially at the present value of future payments discounted at a market rate of interest. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using effective interest method.

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 were 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.

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

	2020 £'000	2019 £'000
Change in deferred acquisition costs	**265**	310
Administrative expenses	**5,222**	11,950
Operating expenses	**5,487**	12,260

5 Investment income - non-technical account

	2020 £'000	2019 £'000
Investment income including interest receivable	**6,272**	26,027
Net realised gains on fixed income securities	**6,463**	1,196
Impairment losses	**(340)**	(23)
Total investment income on financial assets measured at amortised cost	**12,395**	27,200
Net realised and unrealised (losses)/gains on assets held at fair value	**(1,471)**	11,816
Net foreign exchange (losses)/gains	**(4,886)**	3,776
Investment income	**6,038**	42,792

Investment income includes £6,272,000 (2019: £26,027,000) of income from listed investments.

6 Investment expenses

	2020 £'000	2019 £'000
Investment management expenses	**561**	732

7 Profit on ordinary activities before tax

	2020 £'000	2019 £'000
Profit 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	**155**	121
Depreciation	**34**	37
Hire of office equipment - Operating leases	**3**	3
Hire of land and buildings - Operating leases	**197**	188

8 Remuneration of directors

	2020 £'000	2019 £'000
Directors' emoluments	**3,565**	1,189

The emoluments of the highest paid director were £2,189,000 in 2020 (2019: £978,000). No Company pension contributions were made to any money purchase scheme on his behalf (2019: £Nil).

The aggregate compensation expensed by the Company in respect of loss of office by directors in 2020 was £53,000 (2019: £363,000). The aggregate amount of money paid to or receivable by directors under the LTIP scheme in 2020 was £2,738,000 (2019: £Nil).

As of 31 December 2020, the Company did not have any advances outstanding or amounts guaranteed on behalf of any of the directors (2019: £Nil).

There are no retirement benefits accruing to the directors of the Company (31 December 2019: £Nil).

9 Staff numbers and costs

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

	Number of Employees 2020	2019
Insured portfolio management	**5**	7
Finance and investments management	**3**	3
Administration	**2**	2
	10	12

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

	2020 £'000	2019 £'000
Wages and salaries	**2,541**	4,126
Social security costs	**307**	556
Other pension costs	**71**	93
	2,919	4,775

Included within wages and salaries is £88,000 (2019: £853,000) in respect of employee severance costs incurred during the year. All amounts accrued are payable within one year.

In addition to the above payroll costs the Company charged £194,000 (2019: £4,004,000) in respect of LTIP costs including associated payroll taxes to the profit and loss account. Benefits will be paid out between 2021 and 2023 under the LTIP.

10 Taxation

	2020 £'000	2019 £'000
Analysis of charge in year:		
Current tax:		
UK corporation tax at 19%	5,645	28,810
UK Tax adjustment in respect of prior periods	10	—
Total UK tax expense	5,655	28,810
Foreign tax expense at 30.82% (prior period 30.82%)	90	—
Foreign Tax adjustment in respect of prior periods	32	(17)
FX on foreign tax provisions	—	2
Total foreign tax expense	122	(15)
Total current tax	5,777	28,795
Deferred tax:		
UK Tax losses utilised	—	215
UK Tax timing differences	46	397
Foreign tax origination of timing differences	(928)	45
Tax adjustment in respect of prior periods	(68)	—
Total deferred tax (credit) / expense	(950)	657
Tax expense on Profit on ordinary activities	4,827	29,452

Factors affecting tax charge for period:

The tax assessed for the years ended 31 December 2020 and 2019 differ from the standard rates of corporation tax in the UK of 19%. The differences are explained below:

	2020 £'000	2019 £'000
Profit on ordinary activities before tax	30,107	153,795
Tax charge at 19%	5,720	29,221
Non-taxable income	(41)	(163)
Differences in effective tax rates on overseas earnings	11	(35)
Difference in overseas taxation basis	(849)	397
Adjustment in respect of prior periods	(26)	28
Other	12	4
Tax (credit) / expense	4,827	29,452

10 Taxation - continued

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 19% (2019: 17%)
- 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 2019	519	27	546
Movements in the year	16	6	22
At 31 December 2020	**535**	**33**	**568**

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

	Other Provisions	Total
	£'000	£'000
At 31 December 2019	867	867
Movements in the year	(867)	(867)
At 31 December 2020	—	—

Deferred tax assets of £225,000 (2019: £196,000) are expected to be recovered and Deferred tax liabilities of £Nil (2019: £867,000) 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	
	2020	2019	**2020**	2019	**2020**	2019
	£'000	£'000	**£'000**	£'000	**£'000**	£'000
Financial assets measured at fair value through the Profit and Loss account						
Units in money market liquidity funds	**79,073**	107,284	**78,665**	106,822	**78,705**	106,824
Other pooled funds at current value	**201,761**	175,668	**218,062**	208,746	**218,062**	208,746
Financial assets measured at amortised cost						
Listed fixed income securities	**185,919**	153,463	**186,699**	154,120	**178,459**	149,461
	466,753	436,415	**483,426**	469,688	**475,226**	465,031

The fixed income securities are carried at amortised cost, net of foreign currency translation gains or losses. At 31 December 2020, the amount receivable upon maturity of listed fixed income securities is £5,121,000 lower than the amortised cost (2019: exceeded amortised cost by £2,046,000).

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 by the Company 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 2020 and at 31 December 2019.

	At 31 December 2020		At 31 December 2019	
	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	**(30,036)**	**228,455**	(20,696)	230,810
200 basis point rise	**(21,098)**	**237,393**	(14,814)	236,692
100 basis point rise	**(11,150)**	**247,341**	(7,916)	243,590
Base scenario	**—**	**258,491**	-	251,506
100 basis point decline	**7,255**	**265,746**	8,933	260,439
200 basis point decline	**10,603**	**269,094**	18,857	270,363
300 basis point decline	**10,677**	**269,168**	29,709	281,215

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 £169,953,000 (2019: £215,762,000). 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 2020

	20% Decrease	**10% Decrease**	**10% Increase**	**20% Increase**
	£'000	**£'000**	**£'000**	**£'000**
Estimated change in fair value	**(33,991)**	**(16,995)**	**16,995**	**33,991**

Change in Foreign Exchange rates against sterling 31 December 2019

	20% Decrease	10% Decrease	10% Increase	20% Increase
	£'000	£'000	£'000	£'000
Estimated change in fair value	(43,152)	(21,576)	21,576	43,152

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:

	2020	2019
	£'000	£'000
AAA	**79**	90
AA	**90,440**	78,888
A	**17,088**	13,824
BBB	**58,474**	41,553
Below investment grade	**13,642**	10,205
Not rated	**6,976**	9,560
	186,699	154,120

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. Own Wrapped Debt, which is not rated, represents £6,874,000 (2019: £9,436,000) of not rated fixed income portfolio.

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 2020			
	Level 1 £'000	**Level 2 £'000**	**Level 3 £'000**	**Total £'000**
Financial assets measured at amortised cost	**88,822**	**91,003**	**6,874**	**186,699**
Financial assets measured at fair value	**141,467**	**155,260**	**—**	**296,727**
Total Financial assets	**230,289**	**246,263**	**6,874**	**483,426**

	At 31st December 2019			
	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets measured at amortised cost	76,892	67,793	9,436	154,121
Financial assets measured at fair value	148,227	167,340	—	315,567
Total Financial assets	225,119	235,133	9,436	469,688

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.

As at 31 December 2020 unexpired risk provisions within technical provisions relate to loss adjusting expenses which are expected to be incurred within one year. This was also the case as at 31 December 2019.

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

	2020	2019
	£'000	£'000
Due within one year	**11,644**	8,299
Due after one year	**124,046**	130,867
	135,690	139,166

13 Other Debtors

	2020	2019
	£'000	£'000
Accrued interest on financial investments	**1,396**	1,473
Receivable for Securities	**2,778**	284
Other assets	**43**	122
Corporation tax receivable	—	183
	4,217	2,062

14 Tangible assets

	Leasehold Improvements £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost:			
At beginning of year	225	587	812
Additions	—	—	—
Disposals	—	(43)	(43)
31 December 2020	225	544	769
Depreciation:			
At beginning of year	201	559	760
Charge for the year	24	10	34
Disposals	—	(43)	(43)
31 December 2020	225	526	751
Net book value:			
At beginning of year	24	28	52
31 December 2020	0	18	18

	Leasehold Improvements £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost:			
At 31 December 2018	225	554	779
Additions	—	33	33
Disposals	—	—	—
31 December 2019	225	587	812
Depreciation:			
At 31 December 2018	177	546	723
Charge for the year	24	13	37
Disposals	—	—	—
31 December 2019	201	559	760
Net book value:			
31 December 2018	48	8	56
31 December 2019	24	28	52

15 Deferred Acquisition Costs

	2020	2019
	£'000	£'000
Deferred acquisition costs		
At beginning of year	**2,527**	2,837
Movement in provision in year	**(265)**	(310)
At end of year	**2,262**	2,527

16 Other creditors

	2020	2019
	£'000	£'000
Accrued LTIP costs	**2,524**	7,296.
Other accrued expenditure	**2,490**	3,651
Payable for securities	**2,219**	—
Corporation Tax payable	**4,165**	7,223
Amounts owed to parent company	**225**	282
	11,623	18,452

17 Called up share capital

	2020	2019
	£'000	£'000
Ordinary shares of £1 each		
Allotted and called up and fully paid : 36,000,000 shares (2019 : 36,000,0000)	**36,000**	36,000

18 Technical provisions

	2020 Unearned Premium £'000	2020 Other Technical Provisions £'000	2020 Total £'000	2019 Unearned Premium £'000	2019 Other Technical Provisions £'000	2019 Total £'000
At beginning of year	**190,719**	**1,524**	**192,243**	205,399	182,593	387,992
Movement in the provision	**(8,920)**	—	**(8,920)**	(14,677)	—	(14,677)
Claim paid net of subrogation received	—	—	—	—	(84,472)	(84,472)
Claims management and loss expenses paid	—	**(2,176)**	**(2,176)**	—	496	496
Movement in unexpired risk provision in respect of prior accident years	—	**2,556**	**2,556**	—	(95,349)	(95,349)
Movement in the estimated recoveries under subrogation	—	—	—	—	(1,659)	(1,659)
Exchange rate movements	**9**	**27**	**36**	(3)	(85)	(88)
At end of the period	**181,808**	**1,931**	**183,739**	190,719	1,524	192,243

Other technical provisions includes the unexpired risk provision linked to loss adjusting expenses and a deduction for estimated recoveries under subrogation rights. As at 31 December 2020 and 31 December 2019 the unexpired risk provision related only to loss adjusting expenses which are not discounted.

	2020 £'000	2019 £'000
Other technical provisions		
Unexpired risk provision	**1,931**	1,524
Estimated recoveries under subrogation rights	—	—
	1,931	1,524

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 and believe that at 31 December 2020 an unexpired risk provision (net of estimated recoveries under subrogation rights) of £1,931,000 (2019: £1,524,000) is most appropriate.

The unexpired risk provision is predominately 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 2020

	20% Decrease £'000	**10% Decrease £'000**	**10% Increase £'000**	**20% Increase £'000**
Undiscounted unexpired risk provision	**(330)**	**(165)**	**165**	**330**
Discounted unexpired risk provision	**(330)**	**(165)**	**165**	**330**

Change in Foreign Exchange rates against sterling 31 December 2019

	20% Decrease £'000	10% Decrease £'000	10% Increase £'000	20% Increase £'000
Undiscounted unexpired risk provision	(305)	(152)	152	305
Discounted unexpired risk provision	(305)	(152)	152	305

19 Accruals and deferred income

	2020	2019
	£'000	£'000
Deferred restructuring and consent fees	6,518	6,870

20 Interest-bearing loans and borrowings

The Company issued a US Dollar zero coupon note on 18th June 2019 and recorded this as long term debt at an initial valuation of $12,180,000. The par value of the note is $40,600,000 and the initial valuation reflects the management's assessment of the market rate of interest relevant to the note of 7.4%. The zero coupon note is repayable on 2nd May 2036.

	2020	2019
	£'000	£'000
Due after more than one year	9,944	9,559

The interest charge to the profit and loss account for the period in respect of this note was £729,000 (2019: £379,000).

21 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 £71,000 (2019: £93,000).

22 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	
	2020	2019	2020	2019
	£'000	£'000	£'000	£'000
Operating leases that expire:				
Within one year	—	—	—	—
Between two through five years	197	188	8	7
In more than five years	—	—	—	—

23 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 World Trade Center, 41st Floor, New York, NY 10007, USA or via AFG's website: www.ambac.com.