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STATE OF WISCONSIN : CIRCUIT COURT : DANE COUNTY

In the Matter of the Rehabilitation of:

SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION	**Case No. 10 CV 1576** **Hon. Richard G. Niess**

UPDATE TO EXPERT REPORT OF DENNIS M. McGETTIGAN REGARDING AMBAC ASSURANCE CORPORATION AND THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORP.

Dated: December 11, 2017.

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UPDATE TO EXPERT REPORT OF DENNIS M. McGETTIGAN REGARDING AMBAC ASSURANCE CORPORATION AND THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORP.

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I. Identity of Expert Witness

I, Dennis M. McGettigan, submit this updated report (the "Updated Report") in the above-captioned matter. I previously filed a report (the "September 22 Report") at the request of the Rehabilitator in respect of this matter, and have determined that subsequent events necessitate an update to the September 22 Report. This update reflects (i) consummation of certain accretive de-risking and value creation transactions and other adjustments to the Projections[1] and (ii) the adverse effects of Hurricane Maria on Puerto Rico.

This Updated Report addresses changes in certain assumptions associated with the durability discussion contained in the September 22 Report. For ease of review, I have retained general structure and exhibit numbers associated with the durability discussion contained in the September 22 Report. Given the updates made to the Projections and subsequent financial market developments, certain data and exhibits contained in other sections of the September 22 Report have also changed, but not in a way that changes my expert opinions or conclusions in the September 22 Report that the Consensual Transaction is fair and equitable and the Company is durable post-exit.[2]

II. Accretive Transactions and Other Updates to the Projections

Since the September 22 Report was filed, the Company has consummated certain de-risking and value-creation transactions. In addition, AAC has revised certain projected expense items, most notably loss allocation expense ("LAE").[3] I have included adjustments related to both of these categories in the Projections found in the Addendum to the Disclosure Statement and employed in this Report.

AAC consummated several de-risking and value-creation transactions in the 77 days between the filing of the September 22 Report and this Updated Report that, in aggregate, involved approximately $400 million in net par outstanding of adversely classified credits. These transactions were accretive relative to the loss expectations contained in the Projections, albeit to varying degrees given the range of assumptions employed across the four Scenarios. Further, these transactions collectively served to reduce insured

[1] The Projections used herein (and incorporated in the Addendum to the Disclosure Statement) have been updated to reflect, among other items, a June 30, 2017 starting point and a March 31, 2018 consummation date for the Consensual Transaction.

[2] I developed the Updated Report with the assistance of colleagues or staff working under my direction. Capitalized terms used but not otherwise herein defined have the meanings ascribed to them in the September 22 Report.

[3] Loss allocation expense, or LAE, refers to expenses incurred by AAC in the course of settling claims, such as attorney fees.

portfolio "tail risk," which is an important consideration in evaluating durability. AAC also benefitted from a mortgage insurance settlement, which allowed for the reimbursement of previously paid RMBS claims.

The Projections do not incorporate de-risking or value creation transactions that are not yet finalized, even though at any given time AAC is evaluating a pipeline of such opportunities. At this time, AAC is exploring de-risking transactions in respect of single risks aggregating more than $2.5 billion in net par outstanding. Over the next four to six months, some of these opportunities will result in transactions; others will not. At the same time, new opportunities will be identified, continuing the de-risking cycle. Based on my experience in this matter, I expect this cycle to represent a significant but unquantifiable source of value for policyholders. Accordingly, additional updates will be provided as warranted.

As noted above, the Projections have been updated to reflect a June 30, 2017 starting point and a March 31, 2018 consummation date for the Consensual Transaction. See an updated form of Exhibit 5 for an illustrative distribution summary assuming a March 31, 2018 consummation date. As part of the ordinary course work of updating the Projections, loss estimates for certain exposures were reviewed and adjusted based upon changes in credit quality and AAC's balance sheet, investment portfolio holdings, and tax position were adjusted to reflect the revised starting point and consummation date.

As one example of the ordinary course adjustments made in this process, through November 30, 2017, AAC has purchased approximately 41% of its aggregate COFINA exposure and 19% of its aggregate PRIFA exposure. See an updated form of Exhibit 13 for a summary of AAC's Puerto Rico exposures that incorporates AAC's ownership positions.

Collectively, the items discussed above generate approximately $152 million (Scenario One) to $244 million (Scenario Four) in benefits, in present value terms using a 5.1% discount rate, relative to the prior iteration of the Projections. Such estimates reflect second-order effects such as increased investment income and changes in tax and/or tolling payments, among other factors.

In addition to the foregoing adjustments, I have also incorporated updated LAE and operating expense data in the Projections. The primary purpose of LAE in this matter is to fund efforts to mitigate policy losses and maximize RMBS Litigation proceeds. The Projections contemplate such increased spending in respect of these initiatives despite assuming relatively adverse outcomes – further underscoring the conservative nature of the Projections. The net cost of these adjustments, in present value terms using a 5.1% discount rate, ranges from $115 million (Scenario One) to $134 million (Scenario Four).

Such estimates reflect second-order effects such as reduced investment income and changes in tax and/or tolling payments, among other factors.

III. Updates Related to Puerto Rico

In the September 22 Report, I made the following statement:

> The loss projections contemplated herein, including those for Puerto Rico, incorporate allowances for unknown catastrophic developments, such as hurricanes. Although limited visibility exists with respect to the ultimate economic effects of Hurricane Maria on Puerto Rico and AAC's Puerto Rico exposures, at this time I do not believe that any changes, if necessary, to the Puerto Rico loss estimates used herein resulting from Hurricane Maria would materially change my conclusions.

As a result of my continuing review and analysis of the Puerto Rico situation, I have updated my Puerto Rico loss estimates to reflect the aftermath of Hurricane Maria. Accordingly, I have made the following adjustments to my Puerto Rico loss estimates and related assumptions:

- Increased the term of the debt service moratorium contemplated in the Projections; and
- Increased the loss given default assumptions associated with AAC's various Puerto Rico exposures in both our base and stress case scenarios.

In updating my loss estimates for Puerto Rico, I have reviewed (i) developments in the Title III proceedings, (ii) market prices for various insured and uninsured Puerto Rico debt obligations, (iii) materials prepared by the Commonwealth, other parties in interest, and third parties, and (iv) publicly-available information regarding settlement offers between various creditor groups. I also performed on-island due diligence during the week of November 13, meeting with present and former government officials, the chairman of the oversight board (the "Oversight Board") established by the PROMESA legislation, professionals working on behalf of the Oversight Board, the Commissioner and Deputy Commissioner of Insurance for the Commonwealth of Puerto Rico, and prominent members of the Puerto Rico business community. In addition, I have engaged in discussions with professionals involved in various aspects of the Puerto Rico restructuring, including people involved in certain ongoing mediation and litigation matters. These activities have informed the updated Puerto Rico loss estimates employed in the Projections.

I believe it is instructive to compare my updated Puerto Rico loss estimates to certain benchmarks in order to provide some context for our assumptions. On a present value basis (as of June 30, 2017 and using a 5.1% discount rate), my revised Puerto Rico loss projections contemplate that AAC's Puerto Rico losses will account for approximately 63% to 66% of AAC's prospective losses. Given the March 31, 2018 consummation date for the Consensual Transaction, nominal policy claims related to AAC's Puerto Rico exposures represent between 57% (stress) and 63% (base) of all post-Transaction claim payments through the end of 2023, when I assume the debt service moratorium will end.

Further, the updated Puerto Rico loss estimates reflect a weighted-average loss given default on AAC's Puerto Rico exposures of 60% or more, depending upon the Scenario. Such loss given default expectations are more severe, in percentage terms, than those of many policies currently allocated to the Segregated Account. Further, the weighted-average loss given default on AAC's Puerto Rico exposures exceeds the comparable loss given default metric for the $16.5 billion of ABS CDO exposure commuted in the Bank Settlement Agreement approved by the Court in 2010.

Both our base and stress case loss projections, when applied to the debt issued by Puerto Rico entities covered under the fiscal plan dated March 13, 2017 (the "Fiscal Plan") developed by the Commonwealth of Puerto Rico and certified by the Oversight Board, contemplate that the debt issued by these Puerto Rico obligors will generate the largest creditor losses ever experienced in the United States municipal finance market – representing a multiple of the $7 billion of creditor losses experienced in the Detroit restructuring.[4]

I am comfortable that the Puerto Rico loss estimates incorporated in the Projections appropriately reflect the risks associated with this situation to the extent practical. Given the Projections reflect Puerto Rico related risks, I am also comfortable in reaffirming my expert opinion to a reasonable degree of certainty in my field of expertise that AAC is durable such that it can be expected to pay all claims presented on a going forward basis, in full.

IV. Ability of Post-Rehabilitation Ambac to Pay Policy Claims

A. Overview

[4] Other Puerto Rico issuers not covered under the Fiscal Plan may also generate substantial creditor losses. For example, PREPA, the Puerto Rico Electricity utility, is subject to a different fiscal plan than the Fiscal Plan identified above. Therefore, any creditor losses attributable to debt issued by PREPA (to which AAC has no exposure) is not included in this comparison of prospective Puerto Rico creditor losses to those experienced in the Detroit bankruptcy.

My updated analysis confirms that the Consensual Transaction still provides for a durable exit. In a durable exit, AAC is able to pay all prospective policy claims in full and in cash under all four Scenarios, while also maintaining a sufficient buffer, or margin of safety, so that AAC will be able to maintain payment in full even if adverse developments occur over the course of the Projection Period.

My opinions regarding AAC's durability under the Consensual Transaction reflect my informed judgment given the facts and circumstances as they exist on the date hereof, and do not guarantee that further regulatory actions will not be necessary in the future in the event of unforeseen catastrophic loss and/or litigation developments over the course of the next 37 years. Further, retaining the Status Quo structure may not eliminate the need for further regulatory action either in the event of such unforeseen catastrophic loss and/or litigation developments over the course of the next 37 years.[5]

B. Margin of Safety Metric

To measure the margin of safety, I have employed a minimum net economic surplus construct, defined as the present value of all claims-paying resources, minus the present value of all policy, operating expense and tax/tolling payments, measured on a rolling present value basis using the prescribed statutory discount rate of 5.1%. While this rate does not reflect an appropriate market discount rate for use in evaluating AAC financial obligations, I believe that it is a reasonable estimate for AAC's long-term reinvestment rate and therefore appropriate for this purpose.

The margin of safety components listed above are derived from the Rehabilitator's Financial Projections, which employ the loss, RMBS Litigation, AUK residual value, and other assumptions summarized in the Addendum to the Disclosure Statement. Taken as a whole, the assumptions employed in the Projections are materially more conservative than those of AAC in its reserving and other calculations. In fact, I estimate that my scenarios are, in present value terms, at least $1.2 billion (Scenario One) to $1.5 billion (Scenario Four) more conservative than the assumptions underlying AAC's second quarter GAAP financial statements.[6] The more conservative assumptions embodied in the Projections are informed by (i) my experience with AAC's business, insured portfolio, and loss mitigation capabilities, and (ii) my independent review of certain credits and sectors of AAC's insured portfolio, among many other factors.

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[5] Further, my opinion assumes that the Plan will be consummated in accordance with the terms and conditions set forth in that document (including section 6.13).

[6] I estimate that my scenarios are at least $1.4 billion (Scenario One) to $1.7 billion (Scenario Four) more conservative than the assumptions underlying AAC's second quarter statutory financial statements

The margin of safety calculation does not contemplate any interest or principal payments on the GA Surplus Notes that remain outstanding after the Effective Date under the Consensual Transaction other than the initial interest payment contemplated by the Consensual Transaction. All future payments in respect of these instruments require OCI approval – and such approval or disapproval will be determined based upon the facts and circumstances at the time of the request. I do not believe that OCI will allow payments to be made on the GA Surplus Notes that remain outstanding under the Consensual Transaction if such payment would endanger AAC's ability to pay prospective policy claims in full – and the Projections reflect that expectation.

C. Managing Uncertainty

AAC's financial condition remains subject to many uncertainties that cannot be definitively incorporated in any projection model. For example, as noted in the June 2017 Report and the September 22 Report, further adverse credit developments could occur with respect to (i) Puerto Rico, (ii) other public finance exposures, (iii) the military housing and equipment-leasing sectors, as well as other segments of AAC's insured book. In addition, losses associated with the Segregated Account's remaining student loan and RMBS exposures are correlated with interest rates, meaning that losses may ultimately exceed my estimates in the event of a prolonged upward shift in the term structure of interest rates. Accordingly, actual losses attributable to General Account and/or Segregated Account policies may exceed the base case and stress case loss estimates employed in the Projections, perhaps materially. However, I believe these uncertainties have been taken into account to the extent possible through (i) the margin of safety, and (ii) the inherent conservatism of the Projections as a whole, as well as certain considerations discussed below.

The Projections reflect a relevant range of potential outcomes at a given point in time; in contrast, businesses operate in a dynamic environment that cannot be precisely replicated in any projection model. For example, the Projections do not reflect the many tools at AAC's disposal that can be used to mitigate or eliminate potential policy claims, such as the control rights incorporated in AAC's insurance policies.

Further, the Projections do not fully reflect the interplay between certain value drivers. For example, a sustained increase in interest rates may lead to higher losses in respect of certain structured finance obligations, but should also allow for higher portfolio returns and gains on interest rate swap positions. AAC can also match its assets to its liabilities with respect to troubled (or potentially troublesome) credits through advantageous purchases, as it has done in respect of certain Puerto Rico, student loan, and military housing exposures.

D. Detail Regarding Loss Estimates Incorporated in the Projections

The Projections contemplate aggregate nominal post-exit policy claims through 2054, net of reinsurance and waterfall recoveries, ranging from $6.4 billion (base case) to $7.3 billion (stress case).[7] The comparable numbers from the September 22 Report, adjusted for the revised Effective Date and an arithmetical correction[8] that served to overstate post-exit nominal losses, are $5.4 billion (base case) and $7.0 billion (stress case). As stated in the June 2017 Report and the September 22 Report, I believe that the risk and potential losses associated with the General Account insured portfolio is greater than that of the Segregated Account insured portfolio at this point in time, and this perspective has been reflected in the loss estimates incorporated in the Projections. Projected policy claims associated with policies currently in the General Account represent approximately 73% of all projected nominal policy claims in the base case and 74% of all projected nominal policy claims in the stress case.

The timing and quantum of projected policy claims contemplated in the Projections are not uniform. For example, there are notable spikes in projected policy claims in 2037 and 2038, and again from 2047 through 2054. See the updated form of Exhibit 14.

E. Results of the Analysis

The updated form of Exhibit 15 sets forth the projected margin of safety in present value terms for each of the four Scenarios on an annual basis until the end of the Projection Period. The minimum margin of safety, in present value terms, ranges from $476 million, in Scenario Four, to $864 billion, in Scenario One, with a four Scenario average margin of safety of $671 million.

Set forth below is a bridge from the minimum margin of safety (calculated in present value terms) incorporated in the September 22 Report to this Report. This bridge is constructed in three modular steps. First, I incorporated all adjustments related to accretive transactions and other adjustments other than increased (i) LAE and operating expenses and (ii) Puerto Rico losses. I next incorporated the increased LAE and operating expenses. In the third and final step I incorporated the increased Puerto Rico losses.

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[7] These totals reflect projected nominal claims after the assumed Effective Date of March 31, 2018, and thus do not include any of the distributions contemplated by the Consensual Transaction.

[8] This comparison of post-exit policy claims, when calculated for the September 22 Report, inadvertently included pre-exit claims running through the Projections

Dollars in Millions	Scenario One	Two	Three	Four	Mean
Margin of Safety (MOS) from Septermber 22 Report	$1,254	$1,180	$715	$637	$946
Changes due to Accretive Transactions and Other Updates	152	202	210	244	203
Revised MOS before (i) LAE and OPEX and (ii) Puerto Rico	$1,406	$1,382	$925	$881	$1,149
Changes due to Increased LAE & OPEX	(115)	(133)	(130)	(134)	(128)
Revised MOS before Puerto Rico Losses	$1,292	$1,249	$795	$747	$1,021
Changes due to Increased Puerto Rico Losses	(427)	(433)	(268)	(271)	(350)
Margin of Safety (MOS)	$864	$816	$527	$476	$671
Difference in:					
Dollar	($390)	($364)	($188)	($161)	($275)
Percentage	-31%	-31%	-26%	-25%	-29%

It is important to note that any change to the Projections results in changes in investment income and tax and/or tolling payments, among other factors. Therefore, the "Changes due to Accretive Transactions and Other Updates," "Changes due to Increased LAE and OPEX," and "Changes due to Increased Puerto Rico Losses" line items incorporate the positive or negative ripple effects resulting from such changes. For example, the line item that displays the adverse effect of increased loss allocation and operating expense incorporates changes in projected tax and/or tolling payments resulting from this changed assumption. Similarly, the line item that displays the adverse effect of increased Puerto Rico losses incorporates the negative effect upon investment income resulting from greater policy claims.

As policy claims are paid in nominal dollars, I have set forth the nominal margin of safety for each of the four Scenarios on an annual basis through the end of the Projection Period. See the updated form of Exhibit 16. I have also set forth the projected margin of safety, in present value and nominal terms, in 2054 by Scenario, along with a four Scenario average in the chart below:

Projected Margin of Safety as of Year-End 2054
Dollars in Millions

	Scenario One	Two	Three	Four	Scenario Average
Present Value @ 5.1%	$864	$816	$527	$476	$671
Nominal Value	$5,378	$5,079	$3,280	$2,961	$4,174

The foregoing analyses indicate that even in the most conservative Scenario employed herein, the nominal buffer available to address (i) greater-than-expected losses from non-performing credits, (ii) losses from currently performing credits, and (iii) other adverse developments is projected to reach $3.0 billion by 2054. Across the four Scenarios, this buffer is expected to average $4.2 billion by the end of 2054. I believe this buffer, whether stated in nominal or present value terms, demonstrates that AAC has ample financial wherewithal to pay policy claims in the ordinary course even in the event of adverse developments.

I have also reviewed AAC's prospective liquidity under the Projections, and determined that AAC will have ample liquidity to pay projected claims after giving effect to the Consensual Transaction. The updated form of Exhibit 17 sets forth the aggregate projected level of highly and medium liquid assets on an annual basis for each of the four Scenarios employed herein.

I have found that, with few exceptions, the nature of AAC's insured portfolio tends to provide for significant lead time identifying potential loss policies.[9] Further, administrative constraints and OCI's post-transaction review of AAC's investment portfolio guidelines is expected to ensure that AAC maintains adequate liquidity to pay policy claims. The updated form of Exhibit 18 assesses AAC's liquidity by devising a ratio of (i) the sum of projected highly and medium liquid assets to (ii) projected claim payments for the next five years in present value terms, calculated on a rolling basis. I consider this to be a very conservative metric given the five-year period employed in the denominator. Summary metrics for this ratio by Scenario are set forth below:

	Maximum	**Minimum**	**Mean**	**Median**
Scenario One	18.0x	1.3x	3.9x	2.5x
Scenario Two	17.4x	1.2x	3.7x	2.5x
Scenario Three	8.4x	0.8x	2.3x	1.8x
Scenario Four	7.9x	0.8x	2.2x	1.7x

The substantial variance in this metric is a function of the spikes in policy claims contemplated in the Projections. Given the debt service schedules associated with the policies that generate these claim spikes, if my loss estimates prove to be accurate AAC would have ample time to adjust the liquidity profile of its investment portfolio – a step I

[9] For example, Detroit and Puerto Rico exhibited signs of financial distress years before their initial payment defaults.

have not taken in this analysis – if necessary to ensure that it has sufficient resources to meet prospective claims.

The nature of claim development, the safeguards in place, and the foregoing analyses indicate that AAC should retain sufficient liquidity to meet prospective policy claims over the course of the Projection Period.

F. Market Information

Financial markets provide some confirmation of my conclusion regarding durability. I periodically track the prices of certain General Account AAC-insured bonds and, in some cases, comparable uninsured bonds issued by the same entity. Review of price changes for these instruments in the time period following the announcement of the Consensual Transaction did not suggest materially reduced investor confidence in AAC's ability to pay policy claims in full.

Consider the case of certain senior COFINA bonds insured by AAC. COFINA bonds are the subject of an ongoing dispute being adjudicated in the Puerto Rico Title III proceedings. An adverse ruling could result in substantial policy claims (although I note that the Projections do in fact contemplate significant policy payments in respect of AAC's COFINA exposures).

I tracked price and yield data for CUSIP 74529JAP0, a capital appreciation bond issued by COFINA and insured by AAC with debt service payable from 2048 through 2054, from the beginning of June through the date hereof. If investors believed that the Consensual Transaction would materially impair AAC's ability to make claim payments on this instrument, I would have expected to see yields increase materially after the Consensual Transaction was announced– which did not occur. However, I note that yields have increased following the aftermath of Hurricane Maria – although not to the extent observed in other instruments. See the updated form of Exhibit 19.

V. The Consideration Distributed under the Consensual Transaction to Non-Affiliate Third Parties is Fair and Equitable

In Section VII of the September 22 Report, I set forth arguments supporting my opinion that the consideration distributed to non-affiliate third party beneficiaries of Deferred Amounts and holders of GA Surplus Notes under the proposed Consensual Transaction is fair and equitable to such beneficiaries and holders. The updated Projections described above results and subsequent financial market developments in modest numerical changes to certain other analyses and exhibits unrelated to durability contained in the September 22 Report. However, such changes do not affect my conclusion that the Consensual Transaction is fair and equitable to non-affiliate third party Deferred Amount beneficiaries and GA Surplus Note holders. As this conclusion has not been challenged, I have not included the updated analyses in this submission.

VI. Conclusion

Based on the foregoing, I continue to find, and continue to recommend to the Rehabilitator, that the Consensual Transaction is (i) fair and equitable to non-affiliate third party Deferred Amount beneficiaries and GA Surplus Note holders and (ii) durable.

All of these findings are contingent on the information available to me at this time. As new information becomes available, I may amend or update my findings.

Sincerely,

Dennis M. McGettigan