OPERATOR
Good morning, and welcome to the Ambac Segregated Account Rehabilitation Plan Exit Update Call. My name is Carol, and I will be your operator for today's call. At this time, all participants are in a listen-only mode.

Later, we will conduct a question-and-answer session.

I will now turn the call over to Lisa Kampf, Managing Director, Head of Investor Relations. Ms. Kampf, you may begin.

Lisa Kampf, Head of Investor Relations
Thank you. Good morning and thank you all for joining today's conference call to discuss the transaction we announced last night.

We'd like to remind you that today's presentation may contain forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance of events. Actual performance and events may differ possibly materially from such forward-looking statements. Factors that could cause this include the factors described in our most recent SEC-filed quarterly or annual reports under Management's Discussion and Analysis of Financial Condition and Results of Operations, and under Risk Factors.

In addition, we note that the completion of the rehabilitation exit plan remains subject to regulatory and court approval, and there can be no assurance that they will be obtained. Ambac is not under any obligation and expressly disclaims any obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

Today's presentation contains non-GAAP financial measures. The reconciliations of such measures to the most comparable GAAP figures are included the presentation that we have posted on our website at ambac.com.

I would now like to turn the call over to Mr. Claude LeBlanc, Ambac's President and CEO.

CLAUDE LEBLANC, Chief Executive Officer

Thank you, Lisa. Good morning, everyone. I'm here today with David Trick, our Chief Financial Officer and Treasurer, and Steve Ksenak, our General Counsel. We are pleased to hold this call to discuss our announcement yesterday that we have successfully reached agreement on a transformational holistic restructuring transaction that, if consummated, will materially improve Ambac's financial condition, create material value for all stakeholders and conclude the rehabilitation of the Ambac's Segregated Account.

This transaction, and the OCI support, represents a significant milestone for Ambac, and if approved by the Rehabilitation Court, will reflect the culmination of months of extensive hard work and determination.

Today, we would like to walk you through the details and key benefits of the transactions and our expectations regarding timing and process for closing. I encourage you to follow along with the investor presentation that can be found in the Investor Relations section of our website, which we will be referring to periodically during the course of the call.

Please note that the purpose of this call is to walk through the restructuring transaction and answer your questions about them. Any questions regarding other initiatives or financial results of the company will be addressed during our second quarter earnings call, which will be held on August 10.

Let me now turn to the presentation. To recap, yesterday, Ambac announced that we had reached definitive agreement on a holistic restructuring transaction. We also announced that the Office of the Commissioner of Insurance for the State of Wisconsin, or the OCI, has expressed support for our transaction and confirmed that it intends to file an amendment to the rehabilitation plan to conclude the rehabilitation of Ambac's Segregated Account as confirmed in its own press release issued yesterday.

The transaction described in the rehabilitation exit support agreement and supported by the OCI is comprised of three main components, which I will describe to you in a minute. When taken together, we believe the transaction will create tremendous value for our shareholders and that it will: one, create significant value and greatly improve the financial condition of AAC; two, improve Ambac's overall operating flexibility; and three, significantly reduce future operating expenses.

The transaction is expected to result in a March 31, 2017 pro forma impact on book value of approximately $8.02 per share and approximately $9.83 per share of adjusted book value. We will review the key benefits and the pro-forma impact of the transaction in more detail a bit later, once we provided you with the overview of the transaction.

The creditors who negotiated the rehabilitation exit support agreement and who fully support the transaction outlined today collectively represent approximately 34% of the beneficial interest in Deferred Amounts or DPOs of the Segregated Account of AAC as of June 30, 2017 and over 50% of the principal and accrued and unpaid interest outstanding on AAC's General Account Surplus Notes as of June 30, 2017, in each case held by third parties.

When combined with Ambac's holdings support for the plan represents over 61% of DPOs and 58% of AAC's General Account Surplus Notes.

I would now like to walk you through the key components of the transaction. As I mentioned earlier, the transaction is comprised of three main components. The first, the rehabilitation plan amendment together with certain exchange offers. Second, the issuance by AAC to a group of fully committed investors of new notes with a principal amount of $240 million that are secured by certain recoveries from RMBS litigations that we refer to as a Tier 2 Note. And third, certain other regulatory capital accretive transactions, which, when all taken together, as of today's date, satisfy the capital requirements of the OCI for the exit from rehabilitation for AAC's Segregated Account.

The first component of the transaction, the rehabilitation planned amendment and exchanges, includes a discount of 6.5% on the accreted value of DPOs and General Account Surplus Notes outstanding at closing, and will provide to each beneficial holder of DPOs and General Account Surplus Notes including AAC, for every dollar of accreted value of DPOs and surplus notes, an effective consideration package of $0.935 comprising of the following components: 40% in cash, 41% in new secured notes insured by AAC that have a five-year maturity and an interest rate of LIBOR plus 500 basis points with a 1% LIBOR floor effectively secured by the right to receive certain RMBS Litigation recoveries and other assets; and the third component, a 12.5% interest of existing General Account Surplus Notes.

The second component of the transaction is a new money, Tier 2 Note I described earlier, which is fully committed and when issued will provide us with an additional $240 million of regulatory capital. The Tier 2 Note is not guaranteed by AAC, but will be secured by RMBS Litigation recoveries, after reinsurance, in excess of $1.6 billion.

These notes have a legal final maturity date of 2055 and a paid-in-kind coupon of 8.5%. The Tier 2 Notes will be prepaid if the RMBS Litigation proceeds previously mentioned are received and/or when future post closing payments are made on the remaining AAC surplus notes. Lastly, AAC also executed certain other transactions that were accretive to our regulatory capital position.

These initiatives include determination of an interest rate swap at a discount together with the associated retirement of an adversely classified insured transaction.

Next, accumulation over time of approximately 30% and 12% respectively of AAC's insured COFINA and PRIFA bonds and the acquisition of additional RMBS bonds.

Next, the realization of capital gains from the sale of bonds from AAC's investment portfolio, and, finally certain other commutations and other risk remediation activities.

Now I would like to spend a few minutes reviewing the key benefits of the transaction. First, in addition to putting us on a path forward towards the completion of one of our most important priorities, the exit from rehabilitation of AAC's Segregated Account, this transaction will materially increase book and adjusted book values. David will walk us through the pro forma impact of the transaction in more detail in a moment.

Second, another key benefit of the transaction is that at closing all DPOs will be satisfied and discharged and the Segregated Account will be merged back into AAC, and all future claims will once again be paid out at a 100%, a major benefit to all our policyholders.

Third, once the Segregated Account is merged back into AAC, AAC will benefit from reduced oversight and restrictions. Following consummation of the transaction and execution of an amendment and waiver to certain terms of the Bank Settlement Agreement, AAC will also have more streamlined governance structure and have significantly improved its ability to pursue new business opportunities.

Fourth, once the transaction is finalized, we believe that we will realize incremental operating expense savings as a result of improved operating flexibility. Expenses will also decrease directly as a result of reduction in expenses related to the OCI's rehabilitation of the Segregated Account, which amount on average to approximately $6 million a year.

I will now turn the call to David Trick, to review the pro forma impact of the transaction on our pro forma book value and adjusted book value calculations. David?

David Trick, Chief Financial Officer

Thank you, Claude.

As highlighted in our press release, investor deck and as noted earlier by Claude, the transaction will improve March 31, 2017 pro forma Book Value per share by approximately $8.02 and Adjusted Book Value per share by $9.83. The principal drivers behind the impact include the termination of a significant discount of a swap associated with adversely classified credit, the benefit from which amounted to approximately $53 million and $96 million on a pro forma GAAP and non-GAP basis, respectively; the acceleration of income in excess of $90 million associated with investments AAC has made in its own insured RMBS securities; and the capture of discount on the accreted value of DPOs and General Account Surplus Notes.

The discount capture on these obligations is estimated to be approximately $275 million, net of amounts deferred under the applicable accounting rules.

In addition to the impact on book value and adjusted book value, which AAC will recognize through and to the date of closing of the transaction, Ambac will also enjoy the benefit of an overall reduction in liabilities of approximately $2.9 billion on a consolidated basis including the satisfaction of $3.7 billion of DPOs and the reduction of over $700 million of accreted value, $633 million on a carry value, the surplus notes and related accrued interest, partially offset by the issuance of this secured and Tier 2 Notes, deleveraging and to a certain extent simplifying our balance sheet.

In connection with this deleveraging, you will note in the March 31, 2017, summary pro forma financials provided on page 8 of the investor presentation, Ambac's assets are also reduced by nearly $2.5 billion. The principal drivers to the reduction in assets is the payment of approximately $1.3 billion of cash, net of receipts by AAC to fund the cash component of the transaction and the satisfaction of $1.3 billion in fair value of DPOs owned by AAC. These amounts are then partially offset by cash received from the Tier 2 Note issuance.

The transaction will also have the benefit in improving statutory surplus by over $450 million, including the impact of reallocating remaining surplus notes $357 million on a stat-basis from a liability to statutory surplus.

I will now turn the call back to Claude to review the timeline and next steps. Claude?

Claude LeBlanc, Chief Executive Officer

Thank you, David. Finalization of the transaction includes many steps that must be completed and require certain approvals and consents that are not within our control, including the approval of the Rehabilitation Court.

In addition, as a condition to the transaction a one-time current interest payment or approximately $12.5 million on the remaining surplus notes is required to be approved by the OCI.

We've summarized our estimated timeline for the conclusion of the transaction and the core process and ultimate closing of the transaction on slide 11 of the investor presentation.

Our expectation is that the OCI will file its motion with the Rehabilitation Court seeking the amendment – to the amended rehabilitation plan within the next 75 days. Once the OCI has filed its proposed amendment, the Rehabilitation Court will schedule a hearing on such amendment at which time we would anticipate launching the exchange offers with consummation subject to Rehabilitation Court approval of the amendment and the satisfaction of certain other conditions precedent.

Assuming that the Rehabilitation Court approves the amendment and all of the conditions precedent to the amendment and the exchange offers are satisfied, the transaction will be consummated.
We and the OCI are targeting a transaction closing and conclusion of the rehabilitation of the

Segregated Account during the fourth quarter of 2017 or early 2018. However at this time, we can provide no assurance or guarantee as to whether and when the requisite conditions will be satisfied or if or when the closing will occur.

In conclusion, the culmination of the transactions I have just described will represent a significant accomplishment for all stakeholders of Ambac and a major milestone towards Ambac's commitment to seek to execute on transactions that will deliver value to our stakeholders. We are grateful for the support and patience from our investors throughout this process. We look forward to concluding the Segregated Account's rehabilitation process and we'll continue to focus on long-term outlooks and success for the company.

As I emphasized in our last earnings call, the board, executive management and all the employees at Ambac remain committed to and are working diligently towards generating long-term value for our shareholders. In order to do so, we are focused on executing on our strategic objectives and we view today's announcement as a substantial milestone in furtherance of these objectives. We look forward to updating you on the progress of our other initiatives during our second quarter earnings call.

I would like to thank the entire management team and staff, our Board of Directors, our advisors, the SDC, the OCI and all our supporting creditors for their hard work and commitment over the last few months in bringing forward this transformational transaction to this stage.

David, Steve, and I, will now take your questions.

Operator
And as a reminder, in order to ask a question, please press * followed by the number 1 on your telephone keypad. And our first question today comes from Andrew Gadlin from Odeon Capital Group. Please go ahead.

Andrew Gadlin, Odeon Capital Group
Thank you very much for taking my question, and congratulations on completing the deal. I wanted to know if you could help me understand a little bit of the movement within the surplus notes at the holding company level, and what's happening there?

Claude LeBlanc, Chief Executive Officer
Thanks, Andrew. Yeah.

David Trick, Chief Financial Officer
Sure, Andrew. The holding company has what is equivalent to about a $170 million of principal interest accrued of General Account Surplus Notes. It also owns approximately $55 million of all the surplus notes that are issued by the Segregated Account. Those notes are currently held by AFG, they will be, except for these Segregated Account notes, be part of the transaction, and AFG will be using and facilitating the transaction in part by using those surplus notes as part of the – in part of the exchange to facilitate the distribution of surplus notes that will make up the 12.5% of the transaction that is accounted for, for surplus notes. But to be clear, those surplus notes are not being contributed to the transaction by AFG. So we are not making a capital contribution to AAC. AFG ultimately, through the mechanics of the transaction, will be participating in the same way as everyone else in the transaction, except for the fact that they will not be receiving cash and will be receiving only secured notes as part of the exchange process.

Andrew Gadlin, Odeon Capital Group
Got it. So, roughly the same 93.5% recovery?

David Trick, Chief Financial Officer
Correct.

Andrew Gadlin, Odeon Capital Group
Got it. That's it from me. Thank you.

Claude LeBlanc, Chief Executive Officer
Thanks, Andrew.

Operator
And again that's *1 in order to ask a question. Now our next question comes from David Williams from CQS. Please go ahead.

David Williams, CQS
Good morning. I'm a little curious about I see there is a vote for the surplus notes to approve the plan. Do DPO holders get a vote in this as well?

Claude LeBlanc, Chief Executive Officer
Hi. Good morning. So the DPO holders, there will be a plan filed as we mentioned by the rehabilitator in Wisconsin Rehabilitation Court. That court proceeding will provide the OCI's recommendation vis-à-vis the treatment of the DPOs and really the court proceeding and the OCI's recommendation will determine the outcome for the DPOs.

David Williams, CQS
With all due respect, that's a dodge, the answer is, no. You're saying, no, the DPO holders don't get to vote. Correct?

Claude LeBlanc, Chief Executive Officer
That is correct. We believe that this is attractive transaction for the DPOs.

David Williams, CQS
Again, with all due respect, I can decide what's good for me. And when the OCI said, they were going to protect shareholders, excuse me, policyholders, I guess that was not entirely true, was it? I mean, I had – it's not lost on me that the people that went behind the curtain are also the largest equity holders and are getting $240 million sweetener. And so I'm kind of curious as to why you think this is a good deal for me as a DPO holder?

Claude LeBlanc, Chief Executive Officer
We think it is a very attractive deal for DPO holders and surplus note holders and the group of creditors that we negotiated with was a group of creditors that was interested, primarily creditors, I would say.

Your comments about equity holders, I'm not sure I understand, maybe some had equity, I believe most did not have any equity.

David Williams, CQS
Go on Bloomberg to AMBC and look at HDS, it's not that complicated.

Claude LeBlanc, Chief Executive Officer
Okay. Well, I'll leave that up to you.

But in terms of the negotiations, there were very robust negotiations when coming up with a package that we thought would be very equitable for the policyholders, create meaningful value through the acceleration and creation of liquidity for DPO holders, and also result in an acceleration of value for the DPO holders. So it was a very robust process, this group of creditors actually grew materially over time as well. So we started with a group that had been interested for some time and was expanded over time. We worked very closely and carefully with the regulator as well in order to meet their requirements all the way through the process, and this was the ultimate agreement we're able to reach with again this very significant group of DPO holders and surplus note holders.

David Williams, CQS
So, if it's so wonderful for DPO holders and you're so proud of it, why not let it stand the true test and put it to a vote for the DPO holders. What are you afraid of?

Steve Ksenak, General Counsel
Well, that's really up to the rehabilitator and the way they run the process with the Rehabilitation Court.

David Williams, CQS
Well, you're giving the surplus note holders to vote, why not DPO holders?

Steve Ksenak, General Counsel
The consideration, you know, gets delivered to the DPO holders via a court process, because these are Segregated Account obligations. The general account is obligor on the surplus notes, so that can't be done through an in-court process.

Operator
Your next question comes from Glenn Tongue from T2. Please go ahead.

Glenn Tongue, T2
Good morning, and congratulations and thanks for your hard work here. Can you make any comment on the ratings agency implications?

Claude LeBlanc, Chief Executive Officer
Good morning, thanks, for your call. Right now, we don't have any feedback from the rating agencies. We're not currently rated obviously, but we believe that this has a material positive impact on the overall financial condition of AAC and from a – from a risk-adjusted perspective, a material improvement

on its risk-adjusted profile. So while we are not seeking a rating, we don't have any feedback from the rating agencies. It is something that we could consider at some point in the future.

Glenn Tongue, T2
Yeah, obviously it's materially positive. And I guess the implications are, your ability to buying your RMBS in the market is – at a discount is going to be reduced, yet the RMBSs that you wrap – that you hold, will go up – ought to go up pretty materially in value, is that embedded in your book value estimate?

David Trick, Chief Financial Officer
Any mark-to-market on that portfolio that we owned is not, or potential mark -to-market upside, is not embedded. What is embedded is the expectation in how we built the pro forma. Effective March 31 is when the transaction happens, so as a result of that, what is embedded in the pro forma is about $90 million of accelerated income which represents basically the difference between where we carry the bonds and future income will be accelerated because of the restructuring.

Glenn Tongue, T2
Right, right. You said that, I understand that, but the potential markup is further upside?

David Trick, Chief Financial Officer
Correct, but that is not embedded in the pro forma.

Glenn Tongue, T2
Terrific. Thanks so much.

Claude LeBlanc, Chief Executive Officer
Thank you.

Operator
And once again that's *1 in order to ask a question. And our next question comes from Michael Cohen from Opportunistic Research. Please go ahead.

Michael Cohen, Opportunistic Research
Hi guys. Thanks for taking my question. Just relatively quick question, and I know you had flagged it within the first quarter earnings release about incremental cost associated with Segregated Account rehabilitation. But perhaps maybe you could frame at a higher level, how you see your ongoing expense run rates now that sort of this fairly large legal negotiation is behind you?

Claude LeBlanc, Chief Executive Officer
As I mentioned earlier, obviously we do have direct OCI cost that relate to the ongoing operations of the rehabilitation and we would see those recurring costs being eliminated or materially reduced and they are currently running at around $6 million. We do have other incremental costs with advisors, systems and redundancies that we will be doing a review of that we do believe should result in some additional

incremental cost savings. We've not completed that analysis, but we'll be looking forward to providing additional guidance in the near future. I think, that's something that we'll be looking at, once we exit rehabilitation, but again, there should be some additional material savings from that.

David Trick, Chief Financial Officer
And just to add on that, we did include in the pro forma about $35 million of expenses related to the transaction, which are expenses that we will be incurring – did incur in the first quarter, but going forward we'll be incurring through the remainder of the year, including the second quarter, as we look to bring the transaction and deal through close.

Michael Cowen, Opportunistic Research
Great. And then, how should one think about it in the context as well, about the litigation expense, related to the remaining rep and warranty cases. Is that fully in the operating expense or some of that reflected in the LAE, on an ongoing basis?

David Trick, Chief Financial Officer
Sure. That expense is embedded in LAE and is not impacted by anything related to this transaction.

Michael Cowen, Opportunistic Research
No, no, of course. I'm just suggesting, at what point do you expect litigation expenses related to rep and warranty to ramp down as some of these cases wind to their conclusion?

David Trick, Chief Financial Officer
I think, what we said publicly with regards to our largest case or cases, is that we anticipate those cases going to trial sometime in next year. And so you would see ultimately a ramp down of those expenses mid next year presumably.

Michael Cowen, Opportunistic Research
Great. Thanks, David. Congratulations.

David Trick, Chief Financial Officer
Thank you.

Claude LeBlanc, Chief Executive Officer
Thank you.

Operator
Our next question comes from Mark Palmer from BTIG. Please go ahead.

Mark Palmer, BTIG
Yes. Thank you. Thanks for taking my call and congratulations on the transaction. My question is that, page 7 on the slide deck, particularly with regard to your accumulation of approximately 30% of AAC

insured COFINA bonds. Wanted to see if you could tell us what the current net insured exposure to COFINA is net of that transaction?

David Trick, Chief Financial Officer
Mark, so if you look at the ultimate debt service on COFINA, we're talking about, I think it's net debt services about $7.5 billion lifetime, because those are zero coupon bonds that mature starting in 2047. We own approximately 30% in terms of current par that translates to about $2.5 billion of the current par on those bonds, so that's our position on Puerto Rican CABS.

Claude LeBlanc, Chief Executive Officer
And these are obviously zeros, so the current accreted phase is around $1.3 billion, again as David mentioned we own 30% of those currently.

Mark Palmer, BTIG
And what was the timeframe over which that accumulation occurred? In other words, how much of that was recent?

Claude LeBlanc, Chief Executive Officer
A portion of it happened in the first quarter and about two-thirds of it happened during the second quarter, which we mentioned in our prepared remarks in our second quarter earnings call.

Mark Palmer, BTIG
Okay. Very good. Thank you.

David Trick, Chief Financial Officer
Sure.

Claude LeBlanc, Chief Executive Officer
Thanks, Mark.

Operator
And there are no further questions in queue at this time. Thank you very much for participating in today's conference, and you may now disconnect.