

In the Matter of the Rehabilitation of:

Case No. 10-CV-1576

Segregated Account of Ambac Assurance Corporation.

AMICUS CURIAE BRIEF OF THE BANK INSUREDS

Certain holders (the “Bank Insureds”)¹ of financial guaranty insurance policies (the “Policies”) issued by Ambac Assurance Corporation (“AAC”) respectfully submit this amicus curiae brief in opposition to the emergency motions for injunctive and other expedited relief (the “Emergency Motions”) filed by certain holders of residential mortgage-backed securities (the “RMBS Bondholders”) and certain holders of the Las Vegas Monorail Project Revenue Bonds (the “LVM Bondholders”), respectively.

INTRODUCTION

The Policies guarantee payments by Ambac Credit Products, LLC (“ACP”), a wholly-owned subsidiary of AAC, under certain credit default swap agreements between ACP and the Bank Insureds (the “CDS Agreements”). The Bank Insureds have had for some time, and continue to have, the right to assert claims against ACP and AAC that exceed \$12 billion in the aggregate.² The Bank Insureds have agreed to forbear temporarily from terminating the CDS Agreements and asserting claims against AAC to permit time to finalize the proposed settlement that the RMBS Bondholders and LVM Bondholders (collectively, the “Movants”) now

¹ The Bank Insureds consist of the following financial institutions: Banco Bilbao Vizcaya Argentaria, S.A.; Banco Santander, S.A.; Barclays Bank PLC; BNP Paribas; Canadian Imperial Bank of Commerce; Citibank, N.A.; Citigroup Global Markets Limited; Commerzbank AG London Branch; Crédit Agricole Corporate and Investment Bank; Natixis; Natixis Financial Products Inc.; The Royal Bank of Scotland PLC; Société Générale; and UBS AG, London Branch.

² All references herein to the value of aggregate claims include the claims of the Bank Insureds and the claims of other similarly-situated financial institutions. (See Affidavit of Roger A. Peterson (“Peterson Aff.”) ¶¶ 16-24 (filed May 20, 2010).)

challenge. Although the Movants assert that they will suffer irreparable harm if the proposed settlement is consummated, the opposite is true. The proposed settlement is beneficial to all policyholders and, if it is enjoined, the Bank Insureds will be forced to assert their multi-billion dollar claims against the general account of AAC, causing significant collateral damage that will detrimentally affect all policyholders, including the Movants.

The Movants repeatedly cite irrelevant law (or no law at all) and fail to address those portions of Wisconsin insurance law that do not advance their arguments. The *relevant* portions of Wisconsin insurance law³ make clear that the proposed settlement agreement is entirely consistent with the insurance liquidation priority scheme. With respect to the Policies at issue, the Bank Insureds have “insurable interests” and “losses” under Wis. Stat. §§ 631.07(1) and 645.68(3), respectively. The Policies were created, regulated, and treated as insurance policies from the outset, as expressly provided under Wisconsin law and administrative interpretations, and the Movants provide no principled rationale to overcome this well-established fact. Further, the CDS Agreements entered into by ACP and the Policies issued by AAC cannot be collapsed into a single transaction to support the fiction that the Bank Insureds hold some unidentified non-insurance interest. For these reasons, the Emergency Motions should be denied.

BACKGROUND

The Bank Insureds are counterparties to the CDS Agreements with ACP and, separately, beneficiaries of the Policies issued by AAC. Under the CDS Agreements,⁴ ACP agreed to compensate the Bank Insureds for losses resulting from defaults or other credit events related to

³ The Bank Insureds do not concede that Wisconsin law governs the arguments set forth in the Emergency Motions or the CDS Agreements, the Policies, or any related matters. Because the Movants limit their arguments to Wisconsin law, however, the Bank Insureds assume for purposes of this amicus curiae brief only that Wisconsin law applies.

⁴ The terms of the CDS Agreements are contained primarily in the standard International Swaps and Derivatives Association, Inc. Master Agreement (the “ISDA Master Agreement”) and an associated Schedule and Confirmation to the ISDA Master Agreement specific to each CDS Agreement.

the underlying reference obligations. Under the Policies, AAC insured all amounts due to the Bank Insureds from ACP under the CDS Agreements, including any payments due in the event of the termination of any CDS Agreement.⁵ In other words, the Policies guarantee the obligations of ACP for the benefit of the Bank Insureds.

The Bank Insureds can terminate the CDS Agreements upon an event of default. An event of default under many of the CDS Agreements includes, but is not limited to, any situation in which either AAC or ACP becomes insolvent or is unable to pay its debts. Upon the insolvency of either AAC or ACP or any other event of default or termination event under the CDS Agreements, the Bank Insureds are entitled to receive a payment. If the Bank Insureds terminated the CDS Agreements, the aggregate payment due would be approximately \$12.9 billion.⁶

AAC's financial condition deteriorated significantly during 2008 and 2009.⁷ In the fall of 2009, the Bank Insureds began discussions with AAC and ACP regarding a potential commutation of the Policies. Many months of complex and arduous negotiations, which at times included the Wisconsin Office of the Commissioner of Insurance (the "OCI"), resulted in agreement on a non-binding term sheet on March 24, 2010. The term sheet provides that the parties will enter into a settlement agreement (the "Settlement Agreement"), pursuant to which the Policies will be commuted in exchange for \$2.6 billion in cash and \$2 billion in surplus

⁵ Many, if not all, of the Policies expressly provide for such payments.

⁶ As of October 31, 2009. The \$12.9 billion figure is a product of detailed analysis by an independent, highly-qualified appraisal firm. (See Peterson Aff. ¶¶ 19-23.)

⁷ Rating agencies repeatedly downgraded AAC's financial strength during this period. More recently, AAC's parent company, Ambac Financial Group, Inc. ("AFGI"), which primarily depends upon AAC for liquidity, announced that (1) it has a negative equity position of over \$1.6 billion; (2) "its liquidity may run out prior to the second quarter of 2011"; (3) it is considering a "negotiated restructuring of its outstanding debt through a prepackaged bankruptcy proceeding"; and (4) it "will be unable to pay dividends in 2010 absent special approval from the [OCI]." (See AFGI Form 10-K for 2009, at 3, 91, 117, 130 (Apr. 9, 2010) (attached as Ex. A).)

notes⁸ issued to the Bank Insureds, and the referenced CDS Agreements will be terminated (the “Proposed Settlement”).⁹ To permit time to finalize the Settlement Agreement, the Bank Insureds entered into an agreement (the “Forbearance Agreement”) to forbear temporarily from terminating the CDS Agreements and asserting any claims against AAC based on the creation of a segregated account of AAC (the “Segregated Account”) or the commencement of rehabilitation proceedings related to the Segregated Account (the “Rehabilitation”). The Forbearance Agreement will expire imminently.

On March 24, 2010, AAC’s Board of Directors voted to establish the Segregated Account and directed that any policies not transferred to the Segregated Account at that time (with limited exceptions) would remain in AAC’s general account (the “General Account”). The OCI commenced the Rehabilitation the same day to facilitate an orderly run-off and/or settlement of liabilities in the Segregated Account. The Policies remain in AAC’s General Account pursuant to the Forbearance Agreement and the Proposed Settlement and, therefore, are not subject to the Rehabilitation.

ARGUMENT

The Bank Insureds limit their amicus brief to two issues raised by the Emergency Motions: (1) whether the Proposed Settlement of the Bank Insureds’ multi-billion dollar claims benefits the Bank Insureds to the detriment of other policyholders; and (2) whether the Proposed Settlement is consistent with the Bank Insureds’ priority status under Wisconsin law.¹⁰ As set

⁸ The surplus notes are scheduled to mature on the tenth anniversary of the closing date of the Settlement Agreement and bear interest at a rate of 5.1% per annum.

⁹ The Proposed Settlement involves the Bank Insureds and other similarly-situated financial institutions. (*See* Peterson Aff. ¶¶ 16-24.)

¹⁰ The Bank Insureds reserve their rights to address any other issues raised by the Emergency Motions.

forth below, the Proposed Settlement is beneficial to *all* policyholders and consistent with the Bank Insureds' status as policyholders.

I. THE PROPOSED SETTLEMENT IS BENEFICIAL TO ALL POLICYHOLDERS.

The Proposed Settlement is a carefully constructed compromise based upon months of complex negotiations among the Bank Insureds, AAC, ACP and the OCI. Those negotiations were further complicated because the financial institutions that constitute the Bank Insureds have divergent interests vis-à-vis AAC and ACP. The parties' interest in continuing negotiations despite these obstacles was influenced by the significant collateral damage that would result from the failure to reach a resolution. If AAC is enjoined from commuting the Policies and the Bank Insureds assert aggregate claims worth approximately \$12.9 billion, all policyholders, including the Movants, will suffer as a result.¹¹ Indeed, the OCI's approval of the Proposed Settlement reflects its conclusion that, in light of that collateral damage, the Proposed Settlement benefits not just the Bank Insureds, but *all* policyholders.¹²

II. THE PROPOSED SETTLEMENT IS CONSISTENT WITH THE BANK INSUREDS' STATUS AS POLICYHOLDERS.

Even though the Policies are not in the Segregated Account that is the exclusive subject of the Rehabilitation, the LVM Bondholders challenge the Proposed Settlement on the ground that it is inconsistent with the priority scheme established for the order of distribution in a liquidation under Wis. Stat. § 645.68. In the LVM Bondholders' view, the Bank Insureds are not entitled to policyholder priority but rather general creditor priority and, therefore, the Bank Insureds should receive nothing if AAC has insufficient assets to pay its policyholders in full.

¹¹ The OCI estimates that the collateral damage to AAC as a result of the Proposed Settlement being enjoined would exceed \$9.3 billion. (See Peterson Aff. ¶¶ 9(a), 35.) In contrast, consummating the Proposed Settlement would "immediately create substantial additional statutory surplus, which will help better support the Segregated Account . . ." (*Id.* ¶ 43.)

¹² (See Peterson Aff. ¶ 29.)

That conclusion is premised on the LVM Bondholders' assertion that the Policies do not constitute "insurance" under Wisconsin law. Such an assertion is unsupported by the facts and is untenable as a matter of law.

A. The CDS Agreements And The Policies Cannot Be Collapsed To Support The Fiction That AAC Issued The CDS Agreements Directly.

Without citing any factual or legal support, the LVM Bondholders contend that the transactions culminating in the CDS Agreements and the Policies "were nothing more than disguised [credit default swaps] with [AAC]." (LVM Bondholders' Emergency Mot. 15.) The LVM Bondholders further contend that "[s]uch transactions are not 'insurance'"¹³ and, therefore, the Bank Insureds are not entitled to policyholder priority under Wisconsin law. *Id.* These contentions ignore both the form and the substance of the CDS Agreements and the Policies, and are contrary to Wisconsin law.

To be clear, the Bank Insureds entered into the CDS Agreements with ACP, a non-insurer affiliate of AAC, in order to mitigate credit risk related to the obligations underlying the CDS Agreements. Additionally, the Bank Insureds obtained the Policies from AAC to insure against ACP's default on payments under the CDS Agreements. There were two separate sets of transactions with two separate entities that created two separate types of obligations. The form and substance of those transactions cannot be ignored simply because doing so advances the

¹³ The LVM Bondholders do not cite a single statute or case in Wisconsin or elsewhere to support their contention that the transactions at issue here are not "insurance." Instead, they cite an amicus brief submitted by ISDA in *Aon Financial Products, Inc. v. Société Générale*, 476 F.3d 90 (2d Cir. 2006). The *Aon* case involved only stand-alone credit default swaps, however, not credit default swap obligations insured by financial guaranty insurance policies. The LVM Bondholders' failure to acknowledge that financial guaranty insurance policies, rather than credit default swaps, are at issue here is disingenuous at best.

LVM Bondholders' self-serving argument.¹⁴ Indeed, as described below, everyone involved has said the Policies are "insurance" policies under Wisconsin law and has treated them accordingly.

First, the OCI has expressly concluded that the Policies are insurance policies and has consistently treated them as such. Before entering into any of the transactions at issue here, AAC asked the OCI to review a hypothetical arrangement entailing the issuance of insurance policies by AAC with respect to the obligations of an affiliate (such as ACP), which would act as a seller of credit protection in connection with certain credit derivative transactions. The OCI approved that arrangement in 1998, stating that AAC insurance policies issued under those circumstances would constitute "insurance contracts entered into in the ordinary course of the insurer's business" under Wis. Admin. Code. § Ins. 40.03(3)(c)(4). (Letter from Brian Hogan, Insurance Examiner Supervisor, Financial Analysis and Examinations Bureau, the OCI, to Stephen D. Cooke, Senior Vice President, General Counsel and Secretary of AAC (Apr. 29, 1998) (attached as Ex. B).)

More recently, in a compliance examination of AAC, the OCI acknowledged that AAC wrote "policies [that] guarantee the obligations of [ACP], an affiliate, to its counterparties in structured credit derivative transactions." (Report of the Examination of AAC, at 6-7 (Dec. 31, 2006) (attached as Ex. C).) Other insurance regulators have reached similar conclusions with respect to policies covering credit default swaps entered into by subsidiaries of an insurance

¹⁴ An analogy to surety law, which is the basis for financial guaranty insurance, proves the absurdity of the LVM Bondholders' argument. In a surety arrangement in the construction context, for example, there are always two transactions—the transaction between the general contractor and the insured, and the transaction between the surety and the insured—with the surety guaranteeing the obligation of the general contractor. Such an arrangement does not result in the surety being deemed to be the general contractor merely because it guarantees the general contractor's obligation to perform.

company. For example, the New York Insurance Department¹⁵ has specifically approved such policies and has consistently treated them as insurance,¹⁶ like the OCI has done here.

Second, AAC's representations and course of conduct make clear that the Policies are "insurance" policies. The Policies expressly provide that they are "Financial Guaranty Insurance Polic[ies]." (*E.g.*, Financial Guaranty Insurance Policy (attached as Ex. F).) AAC issued the Policies in the "ordinary course of business" as a "Wisconsin-domiciled stock *insurance* corporation." (Letter from Stephen D. Cooke, Senior Vice President, General Counsel and Secretary of AAC, to Brian J. Hogan, Insurance Examiner Supervisor, Bureau of Financial Analysis and Examinations, the OCI, at 1 (Apr. 3, 1998) (attached as Ex. G) (emphasis added).) At the time of issuance, AAC's General Counsel's Office provided opinion letters stating that the Policies were valid, binding, and enforceable obligations of AAC, "a stock *insurance* company . . . duly qualified to conduct an *insurance* business . . ." (*E.g.*, Letter from Lee Ann Duffy, Vice President and Assistant General Counsel of AAC, at 1 (Apr. 13, 2005) (attached as Ex. H) (emphasis added).) Furthermore, AAC has accounted for the Policies like it has for all of its other financial guaranty insurance policies for purposes of the statutory accounts required under Wisconsin law. The foregoing representations and course of conduct leave no doubt that the Policies are, in fact, "insurance" policies.

¹⁵ Because AAC is licensed to do business in New York as a financial guarantor, it is also subject to regulation by the New York State Insurance Department ("NYID"). (*See* Ex. A, at 31.)

¹⁶ *See, e.g.*, Letter from Bruce E. Stern, General Counsel and Managing Director of Financial Security Assurance Inc., to Paul M. De Robertis, Supervising Insurance Examiner, Property/Casualty Bureau, NYID (Nov. 20, 1998), *and* Letter from Kenneth Gingrass, Principal Insurance Examiner, Property Bureau, NYID, to Bruce Stern (Apr. 8, 1999) (attached as Ex. D). The New York State Legislature subsequently amended N.Y. Ins. Law Art. 69 in order to codify the NYID's approval of such arrangements. *See, e.g.*, N.Y. Ins. Law § 6905(a)(1) ("[P]olicies may insure amounts payable under a credit default swap . . ."). That the NYID presently treats financial guaranty insurance as "insurance" is beyond dispute. *See, e.g.*, NYID Report on Organization of Syncora Capital Assurance Inc., at 2 (July 15, 2009), *available at* http://www.ins.state.ny.us/exam_rpt/OF7687f09.pdf (last visited May 20, 2010) (attached as Ex. E) (acknowledging that Syncora Capital Assurance Inc. will assume "insurance policies covering existing credit default swaps between affiliates of [its] Parent and certain financial counterparties").

B. The Bank Insureds Have An “Insurable Interest” In ACP’s Performance Under The CDS Agreements.

Despite an abundance of authority to the contrary, the LVM Bondholders contend that the Bank Insureds do not have an “insurable interest” and, therefore, should be subordinated to other policyholders. (LVM Bondholders’ Emergency Mot. 16.) This argument is premised on the assertion that the Bank Insureds do not own the reference obligations underlying the CDS Agreements. *Id.* However, as noted below, the Policies do not insure the reference obligations but rather ACP’s obligations to the Bank Insureds under the CDS Agreements.¹⁷ In any event, the LVM Bondholders’ argument is flawed for the following reasons.

First, the LVM Bondholders’ reliance on Wis. Stat. § 631.07 is misplaced. Wis. Stat. § 631.07 is not relevant to a rehabilitation or liquidation under chapter 645. Indeed, the concept of “insurable interest” is not mentioned anywhere in chapter 645. Thus, the absence of an

¹⁷ Furthermore, the Bank Insureds’ ownership of the underlying obligations is not ultimately relevant to the Court’s analysis of the “insurable interest” issue. The expectation of payment is an “insurable interest” regardless of whether the policyholder holds legal or equitable title to the underlying property. *See, e.g., Prince v. Royal Indem. Co.*, 541 F.2d 646, 649 (7th Cir. 1976) (“All that is necessary is an interest in property by the existence of which the insured receives a benefit [C]ourts have held that an insurable interest exists in a variety of situations in which the insured lacks either title or possession, or both.”) (citations, quotation marks, and alteration omitted); *Commerce Bank, N.A., v. Amco Ins. Co.*, No. 08-cv-669-JPG, 2009 WL 702220, at *4 (S.D. Ill. Mar. 17, 2009) (“Generally speaking, a person has an insurable interest in property whenever he would profit by or gain some advantage by its continued existence and suffer loss or disadvantage by its destruction.”) (quotation marks omitted).

“insurable interest,” however that term is defined, should not in any way affect the priority scheme established in Wis. Stat. § 645.68.¹⁸

Second, even if Wis. Stat. § 631.07 were relevant to the priority analysis under Wis. Stat. § 645.68, the case law flatly contradicts the LVM Bondholders’ narrow definition of “insurable interest.” For example, the U.S. District Court for the Eastern District of Wisconsin recently defined an “insurable interest” as “one where a person would reasonably expect to suffer a loss from its destruction or derive a benefit from its continued existence.” *Bankr. Estate of Lake Geneva Sugar Shack, Inc. v. Gen. Star Indem. Co.*, No. 91-C-0163, 2000 WL 1048789, at *5 (E.D. Wis. July 26, 2000) (citing *Stebane Nash Co. v. Campbellsport Mut. Ins. Co.*, 27 Wis. 2d 112, 118-20, 133 N.W.2d 737 (Wis. 1965)). Other courts in Wisconsin and elsewhere have taken a similarly expansive view of what constitutes an “insurable interest.”¹⁹

The “insurable interest” here—for which the Bank Insureds paid handsomely—is the Bank Insureds’ entitlement to payment under the CDS Agreements in accordance with their terms. In other words, the financial guaranty insurance provided under the Policies insures

¹⁸ The LVM Bondholders appear to acknowledge this flaw in their argument when they state that Wis. Stat. § 631.07(4) only “*suggest[s]* the subordination of such claims to policyholder claims.” (LVM Bondholders Emergency Mot. 16 n.8 (emphasis added).) Of course, Wis. Stat. § 631.07(4) does not even “suggest” the subordination of such claims to policyholder claims; it merely addresses the appropriate recipient of payments related to policyholder claims. One need look no further than this Court to recognize that the punitive interpretation of Wis. Stat. § 631.07(4) asserted by the LVM Bondholders is unsupported as a matter of law. *See Wis. Office of Comm’r of Ins. v. Wis. Office of Comm’r of Ins.*, No. 02 CV 2398, 2003 WL 25694424, slip op. at 14-15 (Dane County Cir. Ct. Aug. 4, 2003) (“[T]he best way to discourage insurers from issuing insurance policies to persons without insurable interest is to make them pay if they do, not to permit them freely to issue such policies knowing that they have a good public policy defense that lets them off the hook whenever a loss occurs.”) (quoting Legislative Comment to Laws 1975, c. 375, § 41); *see also* Wis. Stat. § 631.07(4) (“No insurance policy is invalid merely because the policyholder lacks insurable interest”); *Milwaukee Metro. Sewage Dist. v. Sedgwick of Ill., Inc.*, No. 05-C-1352, 2008 WL 927571, at *11 (E.D. Wis. Apr. 4, 2008) (“Wisconsin law is clear that, although an insurable interest is a prerequisite for coverage, any coverage extended in violation of this statutory requirement remains valid”) (citation omitted).

¹⁹ *See also Prince*, 541 F.2d at 649 (“That the person may suffer loss is a sufficient foundation for his claim to an insurable interest.”) (quotation marks omitted); *Ben-Hur Mfg. Co. v. Firemen’s Ins. Co. of N.J.*, 18 Wis. 2d 259, 262, 118 N.W.2d 159 (Wis. 1962) (stating that, in order for Wisconsin courts to find an insurable interest, “[i]t is sufficient if a person’s relationship to the property is such he would reasonably be expected to suffer a loss by the destruction of the property or to derive a benefit from its continued existence.”).

against ACP's "failure to pay" the Bank Insureds on the CDS Agreements. That "insurable interest" is present regardless of whether a given Bank Insured owns the obligations referenced in a given CDS Agreement because that Bank Insured still has an "insurable interest" in the CDS Agreement itself (*i.e.*, the performance of ACP under that CDS Agreement).²⁰

C. The Bank Insureds Have Billions Of Dollars Of Potential "Losses" That Are Insured By The Policies.

Without citing any authority, the LVM Bondholders also contend that the Bank Insureds do not have a "loss" within the meaning of Wis. Stat. § 645.68(3) and, therefore, are not entitled to policyholder priority. This contention lacks merit for several reasons.

First, Wis. Stat. § 645.68 is directly applicable only in a liquidation proceeding. *See Belongia v. Wis. Ins. Sec. Fund (In re Midland Ins. Co.)*, 195 Wis. 2d 835, 847, 537 N.W.2d 51 (Ct. App. 1995) (stating that "§ 645.68(3) excludes from the class of loss claims payable in a liquidation" a portion of certain losses not relevant here) (emphasis added).

Second, even if Wis. Stat. § 645.68 were dispositive in a rehabilitation proceeding, the LVM Bondholders' assertion that "any 'mark-to-market' termination damages claimed by the Bank Insureds beyond actual pecuniary losses" are "penalties or forfeitures" under Wis. Stat. § 645.68(5) is simply wrong. (LVM Bondholders' Emergency Mot. 15 n.7.) "Penalties and forfeitures," as used in Wis. Stat. § 645.68(5) and other Wisconsin statutes, refers to punishment meted out by governmental authorities, not to contractual remedies agreed to by two private

²⁰ Again, the surety analogy is illustrative. Surety bondholders, like the Bank Insureds, have an "insurable interest" in the performance of a third party under a separate contract. There is no doubt that surety bonds are "insurance" under Wisconsin law. *See* Wis. Stat. § 600.3(25)(a)(2) ("Insurance" includes . . . [c]ontracts of guaranty or suretyship . . ."); *see also Highlands Ins. Co. v. Hobbs Group, LLC*, 373 F.3d 347, 352 (3d Cir. 2004) ("[S]urety bondholders are equivalent to insurance policyholders.") (citations omitted). Similarly, there should be no doubt that the Policies are "insurance" under Wisconsin law.

parties.²¹ The priority status of governmental authorities seeking enforcement of an order imposing civil or criminal penalties clearly has nothing to do with the priority status of the Bank Insureds.

Third, the assertion embedded in the LVM Bondholders' argument—that the Wisconsin State Legislature intended to provide priority status only to those claimants who had pure pecuniary loss policies as opposed to investment-related policies—does not hold water. Indeed, that assertion is undermined by Wis. Stat. § 645.68 itself, which expressly grants priority to claimants for “investment values” under life insurance and annuity policies. Wis. Stat. § 645.68(3). By treating investment values under these types of insurance policies as policyholder losses, the Wisconsin State Legislature made clear that it did not intend to limit priority treatment under Wis. Stat. § 645.68 to pure pecuniary loss policies.²²

²¹ See *State v. Block Iron & Supply Co., Inc.*, 183 Wis. 2d 357, 367, 515 N.W.2d 332 (Ct. App. 1994) (“When construing a statute we give the words their common and ordinary meaning which may be established by their definition in a recognized dictionary. Webster’s Third New International Dictionary . . . defines ‘penalty’ as ‘punishment for crime or offense.’”); *id.* (holding that the state may seek civil forfeitures from a company after issuing an administrative order); Wis. Stat. § 939.12 (stating that “[c]onduct punishable only by a *forfeiture* is not a crime”) (emphasis added).

²² Even if the Bank Insureds' claims exceed their actual pecuniary losses under the CDS Agreements, they still would be entitled to policyholder priority under Wis. Stat. § 645.68, as would many other types of policyholders. For example, a home insurance policy that provides for replacement value may well provide the insured with an amount in excess of the actual pecuniary loss of the home in the event that the home is destroyed. Yet, there is no doubt that the holder of that type of policy would be entitled to policyholder priority under Wis. Stat. § 645.68 for the entire replacement value claim. Similarly, the Bank Insureds have policies that provide for the replacement value of the billions of dollars of reference obligations underlying the CDS Agreements. And, similarly, they are entitled to policyholder priority under Wis. Stat. § 645.68 for the entire value of those claims.

CONCLUSION

For the reasons stated above, and based on the entire record in this action, the Bank Insureds, as amicus curiae, respectfully request that this Court deny the Emergency Motions.

Dated this 24th day of May 2010.

Respectfully submitted,
GODFREY & KAHN, S.C.

By: 

James A. Friedman, State Bar #1020756
Brady Williamson, State Bar #1013896
Anthony G. Gaughan, State Bar #1056509
One East Main St., Suite 500
Post Office Box 2719
Madison, Wisconsin 53701-2719
Tel: (608) 257-3911

Attorneys for the Bank Insureds

Of Counsel:
DAVIS POLK & WARDWELL LLP
Donald S. Bernstein
Michael P. Carroll
Avi Gesser
450 Lexington Avenue
New York, New York 10017
Tel: (212) 450-4000

5004849_1

EXHIBIT A

Morningstar® Document Research™

Form 10-K

AMBAC FINANCIAL GROUP INC - ABK

Filed: April 09, 2010 (period: December 31, 2009)

Annual report which provides a comprehensive overview of the company for the past year

Item 1. Business.

INTRODUCTION

Ambac Financial Group, Inc. (“Ambac” or the “Company”), headquartered in New York City, is a holding company incorporated in the state of Delaware. Ambac was incorporated on April 29, 1991. Ambac, through its subsidiaries, provided financial guarantees and financial services to clients in both the public and private sectors around the world. The long-term senior unsecured debt of Ambac is rated CC with a negative outlook by Standard & Poor’s Ratings Service (“S&P”), and C by Moody’s Investors Services, Inc. (“Moody’s”). See “Rating Agencies” for more information regarding Ambac’s ratings. As a holding company, Ambac is largely dependent on dividends from Ambac Assurance Corporation (“Ambac Assurance”), its principal operating subsidiary, to pay principal and interest on its indebtedness and to pay its operating expenses. Ambac Assurance was unable to pay dividends to Ambac in 2009 and will be unable to pay dividends in 2010 absent special approval from the Office of the Commissioner of Insurance of the State of Wisconsin (“OCI”), which is not expected, thus constraining Ambac’s principal source of liquidity for paying its operating expenses and debt service obligations. See “Insurance Regulatory Matters—Wisconsin Dividend Restrictions” section and “Management’s Discussion and Analysis—Liquidity and Capital Resources” located in this Item 1 and Part II, Item 7, respectively, for further information. Furthermore, Ambac Assurance’s ability to pay dividends has been significantly restricted by the creation, and subsequent rehabilitation, of the Segregated Account (as hereinafter defined and described in more detail below). In addition, Ambac Assurance’s ability to pay dividends would be further restricted pursuant to the terms of the Proposed Settlement (as hereinafter defined) with counterparties of CDO of ABS transactions, if consummated. See “Recent Developments” located in this Item 1.

Ambac’s activities are divided into two business segments: (i) Financial Guarantee and (ii) Financial Services. Ambac provided financial guarantee insurance for public and structured finance obligations through Ambac Assurance. While Ambac Assurance historically had AAA financial strength ratings, its ratings have been downgraded multiple times, beginning in 2008. As a result, Ambac Assurance currently has a Caa2 financial strength rating on review for possible upgrade from Moody’s and an R (Regulatory Intervention) financial strength rating from S&P.

Through its financial services subsidiaries, Ambac provided financial and investment products, including investment agreements, funding conduits, interest rate, currency and total return swaps, principally to the clients of its financial guarantee business. Ambac Assurance has insured all of the obligations of its subsidiaries which wrote financial services business. As of December 31, 2009, all total return swaps have been terminated and settled. The interest rate swap and investment agreement businesses are in active runoff, which may result in transaction terminations, settlements, restructurings, assignments and scheduled amortization of contracts. In the process of running off these businesses, we may execute hedging transactions to mitigate risks in the respective books of business to the extent that we are able to do so; however, the Segregated Account Rehabilitation Proceedings (as hereinafter defined) and the financial condition of Ambac Assurance will make execution of any such hedging transactions more difficult. To the extent we are unable to hedge such risks, adverse financial impacts may result.

Financial information concerning our business segments for each of 2009, 2008 and 2007 is set forth in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and the notes thereto, included elsewhere in this Annual Report on Form 10-K. Our Internet address is www.ambac.com. We make available free of charge, on or through the investor relations section of our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission. Our Investor Relations Department can be contacted at Ambac Financial Group, Inc., One State Street Plaza, New York, New York 10004, Attn: Investor Relations, telephone: 212-208-3222.

Table of Contents

years for municipal bonds and 15 years for all other obligations. Such contributions may be discontinued if the total reserve established for all categories exceeds the sum of the stated percentages contained therein multiplied by the unpaid principal balance. This reserve must be maintained for the periods specified above, except that the guarantor may be permitted to release reserves under specified circumstances in the event that actual loss experience exceeds certain thresholds or if the reserve accumulated is deemed excessive in relation to the guarantor's outstanding guaranteed obligations, with notice to or approval by the insurance commissioner. Under the Wisconsin Administrative Code, a municipal bond insurer is required to establish a contingency reserve consisting of 50% of earned premiums on policies of municipal bond insurance. The only exemption is when another jurisdiction in which the insurer is licensed requires a larger contingency reserve than required by the Wisconsin Administrative Code. Accordingly, Ambac Assurance and Everspan calculate contingency reserves based on the above noted rules as well as other jurisdictions that have contingency reserve regulations, such as California, and record the highest contribution amount.

Ambac Assurance requested and received approvals from OCI to release contingency reserves in both 2008 and 2009. The 2008 approval allowed for Ambac Assurance to (a) release its non-municipal contingency reserves (including contingency reserves for credit default swap contracts issued by Ambac Assurance's subsidiary, Ambac Credit Products) in consideration of incurred losses in excess of 65% of earned premiums resulting in a release \$1.2 billion of contingency reserves; and (b) cease making further contributions to the contingency reserves with respect to such insurance policies. The 2009 approval allowed for Ambac Assurance to (a) release contingency reserves of \$1.6 billion for municipal financial guarantee insurance policies to reduce such reserves to \$336.1 million, which represents our estimate of expected losses on non-defaulted municipal financial guarantee insurance policies; and (b) cease making further contributions to the contingency reserves with respect to expired or defaulted municipal financial guarantee insurance policies. Ambac will continue to compute expected losses on non-defaulted municipal financial guarantee insurance policies and is required to ensure that contingency reserves will not be less than expected losses.

New York Financial Guarantee Insurance Law and Financial Guarantee Insurance Regulation in Other States

New York's comprehensive financial guarantee insurance law defines the scope of permitted financial guarantee insurance and governs the conduct of business of all financial guarantors licensed to do business in New York, including Ambac Assurance. Financial guarantors are also required to maintain case basis credit loss and loss expense reserves and unearned premium reserves on a basis established by the statute.

The New York financial guarantee insurance law establishes single risk limits with respect to obligations insured by financial guarantee insurers. Such limits are specific to the type of insured obligation (for example, municipal or asset-backed). The limits generally compare the insured principal amount outstanding and/or average annual debt service on the insured obligations, net of reinsurance and collateral, for a single risk to the insurer's qualified statutory capital, which is defined as the sum of the insurer's policyholders' surplus and contingency reserves. As a result of decreased statutory capital resulting from the significant losses experienced by Ambac Assurance and terminations of reinsurance arrangements and related recaptures of previously reinsured exposures, Ambac's net insured exposure under a significant number of policies exceeded the applicable single risk limits prescribed by New York State Insurance Law. Ambac Assurance will seek to reduce its exposure to no more than the permitted amounts.

Aggregate risk limits are also established on the basis of aggregate net liability and policyholders' surplus requirements. "Aggregate net liability" is defined as the aggregate of the outstanding insured principal, interest and other payments of guaranteed obligations, net of reinsurance and collateral. Under these limits, policyholders' surplus and contingency reserves must at least equal a percentage of aggregate net liability that is equal to the sum of various percentages of aggregate net liability for various categories of specified obligations. The percentage varies from 0.33% for municipal bonds to 4.00% for certain non-investment grade obligations.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

Ambac Financial Group, Inc. Liquidity. Ambac's liquidity and solvency, both on a near-term basis (for the next twelve months) and a long-term basis, is largely dependent upon: (i) Ambac Assurance's ability to pay dividends or make other payments to Ambac; (ii) dividends, returns of capital or other proceeds from subsidiaries other than Ambac Assurance; (iii) cash on hand; (iv) external financing; and (v) the residual value of Ambac Assurance.

As a result of the events described in Item 1. Business—Recent Developments, it is highly unlikely that Ambac Assurance will be able to make dividend payments to Ambac for the foreseeable future. Based on the holdings of cash, short term investments and bonds of \$136.5 million as of December 31, 2009, management believes that Ambac will have sufficient liquidity to satisfy its needs through the second quarter of 2011, but no guarantee can be given that Ambac will be able to pay all of its operating expenses and debt service obligations including maturing debt obligations in the amount of \$142.5 million in August 2011. Ambac's principal uses of liquidity are for the payment of principal and interest on its debt, its operating expenses, and capital investments in, and loans to, its subsidiaries. Operating expenses include legal and other professional fees; trust and stock transfer/listing fees; compensation costs, etc. Total operating expenses for 2009 equaled \$13.1 million. Further, other contingencies (e.g., an unfavorable outcome in the outstanding class action lawsuits against the Company) could cause additional liquidity strain. While the Company does not believe the Segregated Account Rehabilitation Proceedings constitute an event of default under its debt indentures, the occurrence of an event of default with respect to Ambac's debt could result in the acceleration of principal of such debt in the amount of \$1,642.5 million. Ambac may consider, among other things, a negotiated restructuring of its outstanding debt through a prepackaged bankruptcy proceeding or may seek bankruptcy protection without agreement concerning a plan of reorganization with major creditor groups. No assurance can be given that the Company will be successful in executing any or all of these strategies.

Ambac did not pay any dividends on its common stock in 2009 and will be unable to pay any dividends in 2010, absent special approval by the OCI, which is not expected. Beginning August 15, 2009, Ambac elected to defer interest payments on its \$400 million of Directly Issued Subordinated Capital Securities Due 2087 (the "DISCS"). By deferring interest payments on the DISCS, Ambac reduced its 2010 cash debt service requirements by \$24.6 million to \$88.7 million. Under the terms of the DISCS, Ambac may defer interest for up to ten years without giving rise to an event of default. Deferred interest accumulates additional interest at an annual rate equal to that on the DISCS.

The following table includes aggregated information about contractual obligations for Ambac and its subsidiaries. These contractual obligations impact Ambac's and its subsidiaries' short- and long-term liquidity and capital resource needs. The table includes information about payments due under specified contractual obligations, aggregated by type of contractual obligation, including claim payments, principal and interest payments of Ambac's long-term debt obligations, investment agreement obligations, payment agreement obligations and payments due under operating leases.

(\$ in millions)	Contractual Obligations by Year					
	2010	2011	2012	2013	2014	Thereafter
Long-term debt obligations ⁽¹⁾⁽²⁾	\$ 88.7	\$ 204.9	\$ 51.6	\$ 51.6	\$ 51.6	\$ 4,767.6
Investment agreement obligations ⁽²⁾	475.1	162.1	86.5	33.9	175.7	646.6
Payment agreement obligations	12.4	3.5	3.6	24.3	2.0	52.5
Operating lease obligations	10.8	10.3	9.0	9.2	9.5	47.1
Purchase obligations ⁽³⁾	7.2	0.6	0.2	1,210.9	—	507.8
Post retirement benefits ⁽⁴⁾	0.2	0.3	0.3	0.3	0.4	2.5
Loss and loss expense reserves ⁽⁵⁾⁽⁶⁾	2,337.8	1,585.9	753.7	563.2	366.4	3,738.0
Impairment on credit default swaps ⁽⁶⁾⁽⁷⁾	4.8	11.3	30.9	40.3	55.0	18,080.6
Other ⁽⁷⁾	—	—	—	—	—	22.8
Total	<u>\$ 2,937.0</u>	<u>\$ 1,978.9</u>	<u>\$ 935.8</u>	<u>\$ 1,933.7</u>	<u>\$ 660.6</u>	<u>\$ 27,865.5</u>

Table of Contents

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	December 31,	
	2009	2008
<i>(Dollars in Thousands, Except per Share Data)</i>		
Assets:		
Investments:		
Fixed income securities, at fair value (amortized cost of \$8,131,512 in 2009 and \$11,080,723 in 2008)	\$ 8,098,517	\$ 8,537,676
Fixed income securities pledged as collateral, at fair value (amortized cost of \$164,356 in 2009 and \$277,291 in 2008)		
	167,366	286,853
Short-term investments (amortized cost of \$962,007 in 2009 and \$1,454,229 in 2008)	962,007	1,454,229
Other (cost of \$1,278 in 2009 and \$13,956 in 2008)	1,278	14,059
Total investments	9,229,168	10,292,817
Cash and cash equivalents	113,230	107,811
Receivable for securities sold	3,106	15,483
Investment income due and accrued	77,195	116,769
Premium receivables	3,718,158	28,895
Reinsurance recoverable on paid and unpaid losses	78,115	157,627
Deferred ceded premium	500,804	292,837
Subrogation recoverable	902,612	10,088
Deferred taxes	11,250	2,127,499
Current taxes	421,438	192,669
Deferred acquisition costs	279,704	207,229
Loans (includes \$2,428,352 at fair value in 2009)	2,716,371	798,848
Derivative assets	605,905	2,187,214
Other assets	229,311	723,887
Total assets	\$ 18,886,367	\$ 17,259,673
Liabilities and Stockholders' Equity:		
Liabilities:		
Unearned premiums	\$ 5,687,114	\$ 2,382,152
Losses and loss expense reserve	4,771,684	2,275,948
Ceded premiums payable	291,843	15,597
Obligations under investment and payment agreements	1,177,406	3,244,098
Obligations under investment repurchase agreements	113,527	113,737
Long-term debt (includes \$2,789,556 at fair value in 2009)	4,640,184	1,868,690
Accrued interest payable	50,607	68,806
Derivative liabilities	3,536,858	10,089,895
Other liabilities	248,715	279,616
Payable for securities purchased	2,074	10,256
Total liabilities	20,520,012	20,348,795
Stockholders' equity:		
Preferred stock, par value \$0.01 per share; authorized shares—4,000,000; issued and outstanding shares—none		
Common stock, par value \$0.01 per share; authorized shares—650,000,000 at December 31, 2009 and 2008; issued and outstanding shares—294,378,282 at December 31, 2009 and 2008	2,944	2,944
Additional paid-in capital	2,172,656	2,030,031
Accumulated other comprehensive loss	(24,827)	(1,670,198)
Accumulated deficit	(3,878,015)	(3,550,768)
Common stock held in treasury at cost, 6,780,093 shares at December 31, 2009 and 7,138,800 shares at December 31, 2008	(560,543)	(594,318)
Total Ambac Financial Group, Inc. stockholders' deficit	(2,287,785)	(3,782,309)
Noncontrolling interest	654,140	693,187
Total stockholders' deficit	(1,633,645)	(3,089,122)
Total liabilities and stockholders' deficit	\$ 18,886,367	\$ 17,259,673

See accompanying Notes to Consolidated Financial Statements.

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Dollar Amounts in Thousands, Except Share Amounts)

Ambac UK

Pursuant to the Amended and Restated 1997 Reinsurance Agreement between Ambac UK and Ambac Assurance (the "AUK Reinsurance Agreement"), Ambac Assurance reinsures on a quota share basis 90% of the liabilities under policies issued by Ambac UK, and reinsures on an excess of loss basis Ambac UK policy liabilities in excess of £500,000. Ambac UK has sent Ambac Assurance notices of termination with respect to the AUK Reinsurance Agreement in which Ambac UK demands payment of unearned premium reserves, loss reserves and loss adjustment expense reserves related to the reinsured policies, less ceding commissions and certain adjustments. Ambac Assurance has not agreed or accepted that the purported termination of the AUK Reinsurance Agreement was valid.

Pursuant to the Segregated Account Rehabilitation Proceedings, the liabilities of Ambac Assurance under the AUK Reinsurance Agreement have been allocated to the Segregated Account; as such, the rehabilitator of the Segregated Account will determine the actions, if any, to be taken in respect of the AUK Reinsurance Agreement.

Impact on Ambac

Ambac's liquidity and solvency, both on a near-term basis and a long-term basis, is largely dependent on dividends and other payments from Ambac Assurance and on the residual value of Ambac Assurance. Ambac's principal uses of liquidity are for the payment of principal (including maturing principal in the amount of \$142,500 in August 2011) and interest on its debt (including annual interest expense of approximately \$88,700, after taking into account the deferral of interest on the DISCs), its operating expenses, and capital investments in and loans to its subsidiaries. Further, other contingencies (e.g., an unfavorable outcome in the outstanding class action lawsuits against the Company) could cause additional strain on its capital. As a result of the Segregated Account Rehabilitation Proceedings and the Proposed Settlement (if consummated), it is highly unlikely that Ambac Assurance will be able to make dividend payments to Ambac for the foreseeable future.

Under the terms of the proposed Segregated Account Rehabilitation Plan, Ambac Assurance will issue surplus notes to policyholders of the Segregated Account. The aggregate amount of these surplus notes could be substantial, and the surplus notes will rank senior to Ambac's equity investment in Ambac Assurance. Therefore, the issuance of the surplus notes will reduce Ambac's equity investment in Ambac Assurance, as any residual value of Ambac Assurance will likely be for the benefit of holders of surplus notes. In addition, as a consequence of the Segregated Account Rehabilitation Proceedings, the rehabilitator retains significant decision-making authority with respect to the Segregated Account and has the discretion to oversee and approve certain actions taken by Ambac Assurance in respect of assets and liabilities which remain in Ambac Assurance, and such decisions will be for the benefit of policyholders and will not take into account the interests of securityholders of Ambac. Actions taken by the rehabilitator could further reduce the equity value of Ambac Assurance.

While Ambac does not believe that the Segregated Account Rehabilitation Proceedings constitute an event of default under its debt indentures, debt holders may assert that the Segregated Account Rehabilitation Proceedings constitute an event of default and may seek to accelerate the debt. In addition, Ambac may consider, among other things, a negotiated restructuring of its outstanding debt through a prepackaged bankruptcy proceeding or may seek bankruptcy protection without agreement concerning a plan of reorganization with major creditor groups. No assurance can be given that Ambac will be successful in executing any or all of these strategies.

While management believes that Ambac will have sufficient liquidity to satisfy its needs through the second quarter of 2011, no guarantee can be given that it will be able to pay all of its operating expenses and debt service obligations thereafter, and its liquidity may run out prior to the second quarter of 2011. Further, Ambac may decide prior to the third quarter of 2010 not to pay interest on its debt.

EXHIBIT B



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE



Tommy G. Thompson
Governor

Randy Blumer
Commissioner (Acting)

April 29, 1998

121 East Wilson Street
P.O. Box 7873
Madison, Wisconsin 53707-7873
(608) 266-3555

http://badger.state.wi.us/agencies/oci/oci_home.htm

MR STEPHEN D COOKE
SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY
AMBAC ASSURANCE CORPORATION
ONE STATE STREET PLAZA
NEW YORK NY 10004

Re: Issuance of Insurance Contracts in the Ordinary Course of Business
with Respect to the Obligations of an Affiliate.

Dear Mr. Cooke:

This is in response to your filing of April 3, 1998, related to the issuance of insurance contracts by Ambac with respect to the obligations of an affiliate which would act as a seller of credit protection in connection with certain credit derivatives transactions.

We concur with your conclusion that, under the circumstances described in your filing and provided AMBAC charges similar rates and uses similar underwriting criteria in insuring this affiliate as would be applied to non-affiliates transacting similar business, this would constitute "insurance contracts entered into in the ordinary course of the insurer's business" under s. Ins 40.03(3)(c)4., Wis. Adm. Code, and would not require prior reporting to this office under either chapter Ins 40 or chapter 617, Wis. Stat.

We hereby grant your request to maintain the materials submitted as confidential due to the proprietary nature of the information contained therein and will not disclose this information without providing Ambac notice and the opportunity to protest.

Please contact me if you require any additional information.

Sincerely,

Brian Hogan, CPA
Insurance Examiner Supervisor
Financial Analysis and Examinations Bureau

EXHIBIT C

Report
of the
Examination of
Ambac Assurance Corporation
New York, New York
As of December 31, 2006

The company's financial guaranty business is conducted in three primary markets: the U.S. public finance market; the U.S. structured finance and asset-backed securities market; and the international market.

- The U.S. public finance market includes taxable and tax-exempt bonds, notes, and other debt obligations issued by states, political subdivisions (including cities, counties, towns, and villages), water, sewer, and other utility districts, higher educational institutions, hospitals, transportation, housing authorities, and other jurisdictional authorities and agencies. Public finance obligations are typically supported by the taxing authority of the issuer or by the issuer's authority to realize a revenue stream through the levy of fees and assessments related to public sector services or facilities projects.
- The U.S. structured finance and asset-backed securities market entails issuance of debt securities that are secured by a specific pool of financial or other cash flow generating assets. The underlying assets supporting the securities include pools of mortgage loans and home equity loans, pooled credit card receivables, trade receivables, and other forms of third-party financial obligations. Debt securities in the structured finance market include collateralized debt obligations supported by corporate or asset-backed debt, equipment-enhanced trusts secured by specific tangible equipment assets, and asset-backed commercial paper transactions.
- The international market is comprised of non-U.S. credit issuers including sovereign and sub-sovereign governmental authorities, utilities, structured and asset-backed obligation issuers, and other securities issuers that use financial guaranty products. The company has established a subsidiary in the United Kingdom that serves as a vehicle for company participation in the financial guaranty markets in the United Kingdom and in Western Europe. During 2000 the company entered into a business alliance with a Japanese insurer. The company is currently seeking entrance into Mexico and is exploring means by which to enter the Canadian market.

The company is rated triple-A by the nationally recognized securities rating agencies and is one of only seven triple-A rated U.S. financial guaranty insurers. The company's superior rating enables it to be a significant competitive participant within the industry. The ratings provided by the rating agencies are based on their evaluation of the company's book of business and ongoing assessment of the company's capitalization and claims paying ability.

The following table is a summary of the net insurance premiums written by the company in 2006. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
New Issue/Secondary Market	\$426,907,837	\$ 1,329,594	\$ 29,503,040	\$398,734,391
Asset-Backed Securities	376,537,354	180,548,143	73,908,888	483,176,609
Structured Credit Derivatives	16,773,243	-	1,482,537	15,290,706
Investment & Repurchase Agreements	8,383,393	-	-	8,383,393
Interest Rate & Total Return Swaps	7,231,031	-	-	7,231,031
Portfolio Insurance Products	<u>206,524</u>	<u>-</u>	<u>5,871</u>	<u>200,653</u>
Total All Lines	<u>\$836,039,382</u>	<u>\$181,877,737</u>	<u>\$104,900,336</u>	<u>\$913,016,783</u>

- **New Issue** insurance policies guarantee the timely payment of principal and interest when due on debt securities issued in the U.S. public finance market.
- **Secondary Market** business entails issuance of guarantees with respect to previously issued municipal bonds. Insurance is typically purchased by investors to facilitate the sale of the bonds to other investors who prefer to purchase insured bonds.
- **Asset-Backed Securities** insurance policies guarantee principal and interest on debt instruments backed by pools of financial assets (e.g., mortgage notes, auto loan notes, credit card receivables, trade receivables) and/or other cash flow generating assets.
- **Structured Credit Derivative** policies guarantee the obligations of Ambac Credit Products, LLC (ACP), an affiliate, to its counterparties in structured credit derivative transactions. ACP writes credit default swaps with respect to similar types of asset-backed securities that are insured directly by Ambac.
- **Investment & Repurchase Agreements** policies guarantee the obligations of Ambac Capital Funding, Inc. (ACFI). In these investment agreements and repurchase agreements written by ACFI, issuers of debt obligations invest the proceeds of their debt issues with ACFI and ACFI agrees to pay a guaranteed interest rate on the invested monies and agrees to repay the invested amount at a specific time.
- **Interest Rate & Total Return Swaps** policies guarantee the obligations of Ambac Financial Services, LLC, (AFS) to its counterparties in interest rate swap transactions. An interest rate swap is an agreement to exchange, with a counterparty, a stream of periodic payments calculated by reference to agreed upon interest rates, indices and notional amounts. The insurance guarantees the contractual performance of AFS to the swap agreement counterparties. Ambac also issues policies insuring the obligations of Ambac Capital Services, LLC, (ACS) in total return swap transactions. Total return swap transactions involve exchanges of cash flows wherein one party, ACS, pays the total return on a specific reference security to a counterparty in return for which the counterparty pays a fixed amount or fee.
- **Portfolio Insurance Products** policies guarantee the payment of principal and interest on obligations held in a Unit Investment Trust or a Mutual Fund. The company previously guaranteed obligations held in individual portfolios, but this coverage was discontinued in 1984.

EXHIBIT D



Financial Security Assurance Inc.

Bruce E. Stern
General Counsel
and Managing Director

November 20, 1998

Guaranties of Termination Values under Swap Agreements
Guaranties of Credit Default Swap Obligations
Status of Credit Default Pools as "Asset-backed Securities"

Dear Mr. De Robertis:

On behalf of Financial Security Assurance Inc., a New York financial guaranty insurance corporation ("FSA"), I write to seek clarification from the New York Insurance Department (the "Department") regarding:

- (i) the application of §6905 of the New York Insurance Law (the "NYIL") to guaranties of termination payments ("Termination Payments") under interest rate, currency, credit default or other swap agreements ("Swap Agreements");
- (ii) the application of §6905 of the NYIL to guaranties of obligations under credit default Swap Agreements ("Credit Default Swap Obligations"); and
- (iii) the status of qualifying pools of Credit Default Swap Obligations as "asset-backed securities" for purposes of determining single and aggregate risk limits under §6904 of the NYIL.

As described in more detail below, FSA respectfully submits that (i) guaranties of Termination Payments and Credit Default Swap Obligations do not represent guaranties of acceleration payments prohibited under §6905 of the NYIL, with the understanding that the risk amounts under such guaranties are subject to the "corporate" single risk limits of §6904(d)(5) of the NYIL, and (ii) pools of Credit Default Swap Obligations satisfying the criteria set forth in this letter qualify as "asset-backed securities" for purposes of determining single and aggregate risk limits under §6904 of the NYIL.

Swap Agreements. Swap Agreements are now commonplace in a wide range of municipal and asset-backed transactions. A Swap Agreement generally takes the form of a contract between two parties (each, a "Counterparty" and, collectively, the "Counterparties"), pursuant to which one or more Counterparties agree to pay specified amounts during the term of the Swap Agreement. Swap Agreements have become increasingly standardized, and are generally documented on forms prepared by the International Swap Dealers Association ("ISDA").

Interest Rate Swaps. Interest rate swaps are often used by issuers to convert their obligations from a fixed to floating rate, or vice versa. A typical interest rate Swap Agreement might require that the first Counterparty pay a specified fixed rate of interest (e.g. 7% per annum) to the second Counterparty, while the Second Counterparty pay a specified floating rate of interest (e.g. LIBOR plus 1%) to the first Counterparty, in each case on a specified "notional amount" (e.g. \$100 million).

Currency Swaps. Currency swaps are often used by issuers to access foreign security markets without subjecting themselves to the risk of currency exchange rate fluctuation. A typical currency Swap Agreement might require that the first Counterparty pay U.S. dollars to the second Counterparty, while the second Counterparty pay British pounds to the first Counterparty, in each case at an agreed upon exchange rate on a specified notional amount. For example, a U.S. dollar denominated mortgage-backed security backed by British pound denominated mortgage loans would typically include a currency Swap Agreement swapping the British pound income stream on the mortgage loans into U.S. dollars in order to make the payments on the securities. Absent such a swap that "locks in" a currency exchange rate, there would be a risk that a change in currency exchange rates might result in debt service shortfalls on the dollar denominated securities.

Credit Default Swaps. Credit default swaps are often used by financial institutions to limit risks in their investment portfolios. A typical credit default Swap Agreement presenting opportunities for FSA might cover a portfolio of securities, and require that the first Counterparty pay to the second Counterparty principal and accrued interest on defaulted obligations in excess of a specified number of defaulted obligations (e.g. the portfolio might include 40 specified securities, and the first Counterparty would be required to pay principal and accrued interest on defaulted obligations in excess of a specified dollar amount "deductible" during the term of the Swap Agreement).

Termination Payments. A Swap Agreement, whether insured or uninsured, generally provides for the payment (the "Termination Payment") of a termination value (the "Termination Value") upon the occurrence of specified events ("Termination Events"). Termination Events may include a downgrade of the credit rating of the swap counterparty below a specified level, a payment default by the swap counterparty under the Swap Agreement and the insolvency of the swap counterparty. While Termination Events generally include payment default and insolvency, Termination Events generally also include rating downgrade or other events intended to trigger a Termination Event at a time when each Counterparty has an ability to pay. Termination Events are intended to terminate the Swap Agreement at the then current market value, with the result that one Counterparty will owe a payment to the other Counterparty often equal to the "replacement cost" for the terminated Swap Agreement. Importantly, the defaulting Counterparty may owe a Termination Payment to, or be entitled to receive a Termination Payment from, the non-defaulting Counterparty depending upon general market conditions (unrelated to the default) at the time of the Termination Event.

Credit Default Swap Obligations. A credit default Swap Agreement, whether insured or uninsured, generally provides for payment on one or more defined "reference obligations" upon the occurrence of specified events ("Credit Events") relating to the default or insolvency of the respective obligors on the reference obligations. Upon the occurrence of a Credit Event, the obligor (the "Swap Provider") under a credit default Swap Agreement is generally obligated to pay principal plus accrued interest on the reference obligation. Accordingly, the Swap Provider under a credit default Swap Agreement is providing a product similar to financial guaranty insurance. FSA has been presented with opportunities to insure obligations ("Credit Default Swap Obligations") under credit default Swap Agreements that are substantially similar to asset-backed securities due to the following features: (i) the Swap Provider will be a special purpose entity established for the purpose of the transaction, (ii) the credit default Swap Agreement will cover a pool of reference obligations, none of which will exceed 20% of the aggregate principal amount of the reference obligations or FSA's single risk limit under §6904(d)(5) of the NYIL and (iii) FSA will have the benefit of credit protection ("First Loss Protection") provided by a specified deductible (providing credit protection similar "overcollateralization") or an investment grade entity to cover losses on the reference obligations. To the extent that the First Loss Protection is insufficient, FSA will be obligated to pay principal and accrued interest on those reference obligations in respect of which a Credit Event has occurred.

Non-Acceleration Provisions of §6905 of the NYIL (Policy Forms and Rates). §6905 of the NYIL provides, in relevant part, that "Every such policy shall provide that, in the event of a payment default by or insolvency of the obligor, there shall be no acceleration of the payment required to be made

