

November 8, 2010

VIA COURIER

Ms. Jody Baux
Dane County Ambac Clerk
Dane County Courthouse
215 South Hamilton Street, Room 1000
Madison, WI 53703

Re: In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation, Case No. 10 CV 1576 (Dane County Circuit Court)

Dear Ms. Baux:

We represent Federal National Mortgage Association ("Fannie Mae"). Enclosed for filing please find an original and one copy of Fannie Mae's Notice of Appearance and Notice of Motion and Motion of Fannie Mae to Intervene as a Defendant and the Affidavit of Rodney W. Carter in support of Fannie Mae's Motion to Intervene. Please return the enclosed copies of these documents to our awaiting courier.

If further action to intervene is required on our behalf, please contact me. Alternatively, I would ask that you and all parties please note our appearance in this matter and include us on the distribution list as a party defendant in this matter.

Very truly yours,

Davis & Kuelthau, s.c.


Rodney W. Carter

RWC/lkr

cc: All Counsel of Record, including those on the attached Service List (via email)
The Honorable William D. Johnston, Lafayette County Circuit Court (via courier)
Michael B. Van Sicklen (via courier)
Matthew R. Lynch, Esq. (via courier)
David M. Schlecker, Esq. (via email)
John C. Scalzo, Esq. (via email)
James M. Pacious, Esq. (via email)

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In the Matter of the Rehabilitation of:

Case No. 10-CV-1576

Segregated Account of Ambac Assurance
Corporation

**NOTICE OF APPEARANCE AND
NOTICE OF MOTION AND MOTION
FOR LEAVE OF FEDERAL NATIONAL MORTGAGE ASSOCIATION
("FANNIE MAE") TO INTERVENE AS A DEFENDANT**

To: All Parties-in-Interest

PLEASE TAKE NOTICE, that the Federal National Mortgage Association ("Fannie Mae"), and its attorneys, Davis & Kuelthau, s.c. by Rodney W. Carter, hereby moves this Court to enter an order permitting Fannie Mae to intervene as a defendant in the above action.

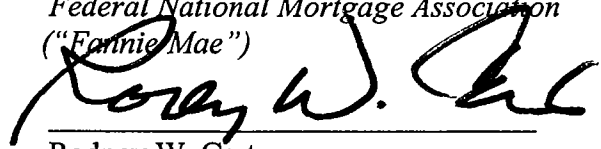
IN SUPPORT THEREFORE, the Court is respectfully referred to the Affidavit of Rodney W. Carter filed contemporaneously herewith and all the records, files and proceedings herein. To the extent the motion is granted, the undersigned demands that copies of all pleadings subsequently filed be served on them at the address shown below.

This motion is made pursuant to Wis. Stat. § 803.09.

Dated at Brookfield, Wisconsin, this 8th day of November, 2010.

DAVIS & KUELTHAU, S.C.
Federal National Mortgage Association
("Fannie Mae")

By:



Rodney W. Carter
State Bar No. 1001258
Steven W. Laabs
State Bar No. 1068937

P.O. Address:

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In the Matter of the Rehabilitation of:

Case No. 10-CV-1576

Segregated Account of Ambac Assurance Corporation

**AFFIDAVIT OF RODNEY W. CARTER
IN SUPPORT OF MOTION TO INTERVENE**

STATE OF WISCONSIN)
) ss.
WAUKESHA COUNTY)

RODNEY W. CARTER, being duly sworn, deposes and states:

1. Your affiant, Rodney W. Carter, is one of the attorneys for Federal National Mortgage Association (“Fannie Mae”) in the above-captioned matter. I am a shareholder in the law firm of Davis & Kuelthau, s.c.

2. I make this affidavit in support of Fannie Mae’s Motion to Intervene in the above-captioned matter.

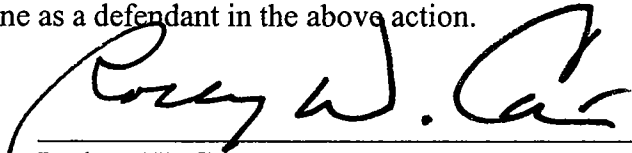
3. Fannie Mae is the owner of approximately \$1.39 billion in residential mortgage backed securities (“RMBS”) insured by policies issued by Ambac Assurance Corporation (“Ambac”).

4. The RMBS policies are included in the segregated rehabilitation account of Ambac which is the subject of this action.

5. Fannie Mae objects to the pending Rehabilitator’s Motion for Confirmation of the Plan of Rehabilitation which is pending in this matter.


6. Fannie Mae's interest, objections and claims in this matter arise out of the same facts and circumstances giving rise to the objections raised by the other defendants in this matter.

7. Disposition of this action without Fannie Mae's participation may impede or impair its ability to protect its interest. However, Fannie Mae's interest in this action is distinguishable from that of the existing parties. Therefore, Fannie Mae moves the court to enter an order permitting Fannie Mae to intervene as a defendant in the above action.

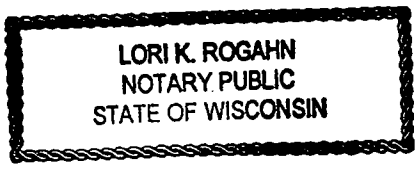


Rodney W. Carter

Subscribed and sworn to before me
this 8th day of November, 2010.



Notary Public, State of Wisconsin
My Commission: 9-4-11



November 8, 2010

VIA COURIER

Ms. Jody Baux
Dane County Ambac Clerk
Dane County Courthouse
215 South Hamilton Street, Room 1000
Madison, WI 53703

Re: In the Matter of the Rehabilitation of Segregated Account of Ambac Assurance Corporation, Case No. 10 CV 1576 (Dane County Circuit Court)

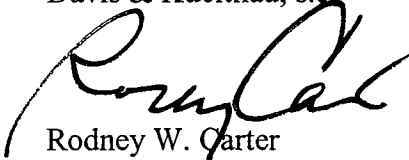
Dear Ms. Baux:

We represent Federal National Mortgage Association ("Fannie Mae").

Consistent with the Scheduling Order in this matter, enclosed for filing please find an original and one copy of the Objection of Federal Mortgage Association to Rehabilitator's Motion for Confirmation of the Plan of Rehabilitation and Affidavit of Robert Bowes. Please file this document and return the file stamped copy to the awaiting messenger.

Very truly yours,

Davis & Kuelthau, s.c.


Rodney W. Carter

RWC/lkr

cc: All Counsel of Record, including those on the attached Service List (via email)
The Honorable William D. Johnston, Layfayette County Circuit Court (via courier)
Michael B. Van Sicklen (via courier)
Matthew R. Lynch, Esq. (via courier)
David M. Schlecker, Esq. (via email)
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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

**OBJECTION OF FEDERAL NATIONAL MORTGAGE ASSOCIATION TO
REHABILITATOR'S MOTION FOR CONFIRMATION OF
THE PLAN OF REHABILITATION**

DAVIS KUELTHAU, s.c.

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The Federal National Mortgage Association (“Fannie Mae”), in Conservatorship, by and through their attorneys, respectfully submits this objection to the Rehabilitator’s Motion for Confirmation of the Plan of Rehabilitation:

PRELIMINARY STATEMENT

Fannie Mae is the owner of approximately \$1.25 billion in residential mortgage-backed securities (“RMBS”) insured by policies issued by Ambac Assurance Corporation (“Ambac”), the US bond insurer that once provided AAA guarantees on debt and is now struggling to stay solvent. Earlier this year, the Office of the Commissioner of Insurance of the State of Wisconsin (the “OCI”) approved the creation of a segregated account for certain materially impaired policies of Ambac, including the Fannie Mae RMBS policies, and announced that it had placed the segregated account into rehabilitation under Chapter 645 of the Wisconsin statutes. Policies that lacked material projected impairments were allocated by the OCI to Ambac or the so-called general account. The OCI now moves for confirmation of the plan of rehabilitation for the segregated account of Ambac. That motion should be denied for four reasons:

First, the disclosure statement submitted by the OCI lacks critical information necessary to meaningfully assess the plan of rehabilitation. The information included in a disclosure statement is essential to an insured’s evaluation of a rehabilitation plan. Although not formally required under Chapter 645, as the OCI correctly recognizes, submission of a disclosure statement is consistent with its statutory mandate to protect the interests of insureds, such as Fannie Mae. Because the disclosure statement lacks information that is essential to Fannie Mae in making an informed judgment about the plan and whether the segregated account will compensate it fairly, the plan should not be confirmed.

Second, what information can be gained from the disclosure statement suggests that the plan does not provide Fannie Mae with the equivalent of what it would receive in liquidation – which is the amount Fannie Mae is entitled to under *Carpenter v. Pac. Mut. Life Ins. of Cal.*, 74 P.2d 761 (Cal. 1937) (en banc), *aff'd sub nom. Neblett v. Carpenter*, 305 U.S. 297 (1938). In *Carpenter*, which the OCI cites more than *twenty* times in its brief, the California Supreme Court held that a rehabilitation plan, to be a valid exercise of discretion, must provide every group of policyholders with the liquidated value of their claims. In a liquidation scenario, segregated account policy holders would receive an immediate cash payment of almost 60% of their claims and more than 80% of their total claims within seven years. Under the OCI's rehabilitation plan, however, segregated account policyholders receive 25 cents on the dollar in cash for their claims and the rest in subordinated and unsecured notes of questionable value and with a maturity date of 2020. This cash/note split does not appear to satisfy the minimum requirement of liquidation value under *Carpenter*.

Third, in addition to treating its policyholders unfairly, the segregated account also violates state and federal law. The segregated account violates the terms of and the intent behind Wisconsin's segregated account statute by (i) segregating policies, including the Fannie Mae RMBS policies, based on claim status rather than type of insurance, and (ii) inadequately capitalizing the segregated account with a secured note and reinsurance agreement of questionable or no value. Moreover, the allocation of policies to the segregated account is both an actual and constructive fraudulent transfer under the Wisconsin Uniform Fraudulent Transfer Act, because the admitted intent of the OCI in such allocation is to hinder creditors and Ambac has "small capital," as that term is defined under Wisconsin law. Further, the continuation of the

segregated account under the plan violates both the United States Constitution and the Constitution of the State of Wisconsin.

Lastly, the plan should not be confirmed based on the additional applicable arguments raised by any other parties filing objections.

BACKGROUND

I. The Parties

A. Ambac

1. Ambac is a Wisconsin-domiciled insurance company regulated by the OCI. (Disclosure Statement Accompanying Plan of Rehabilitation (“Discl. St.”) at 3.) While its traditional business was to insure municipal bonds, more recently Ambac began to guaranty structured finance obligations, including RMBS, collateralized debt obligations of asset backed securities, and credit default swaps. (*Id.*) In 2008, as the structured financial investments that it insured began to fail, Ambac’s projected future liabilities grew, leading to the downgrade of its AAA credit rating and a dangerous reduction in capital. (*Id.* at 3-4.) This prompted the commencement of the instant rehabilitation proceedings. (*Id.* at 4.)

B. Fannie Mae

2. Fannie Mae was established as a federal agency in 1938, and was chartered by Congress in 1968, to provide liquidity, stability and affordability to the U.S. housing and mortgage markets. (Affidavit of Robert Bowes dated November 5, 2010 (“Bowes Aff.”) ¶ 2.)¹ Fannie Mae operates in the U.S. secondary mortgage market. (*Id.*) Rather than

¹ On September 6, 2008, Director James Lockhart of the Federal Housing Finance Agency (“FHFA”) appointed FHFA as conservator of Fannie Mae pursuant to Section 1145(a) of the Federal Housing Finance Regulatory Reform Act of 2008, Pub. L. 110-289, 122 Stat. 2654 (codified at 12 U.S.C. § 4617). (Bowes Aff. ¶ 5.)

making home loans directly to consumers, Fannie Mae works with mortgage bankers, brokers and other primary mortgage market partners to help ensure they have funds to lend to home buyers at affordable rates. (*Id.*) Fannie Mae funds its mortgage investments primarily by issuing debt securities in the domestic and international capital markets. (*Id.*)

3. Fannie Mae has three lines of business – Single-Family, Housing and Community Development, and Capital Markets – that provide services and products to lenders and a broad range of housing partners. (*Id.* at ¶ 3.) Together, these businesses contribute to the company’s chartered mission to increase the amount of funds available in order to make homeownership and rental housing more available and affordable. (*Id.*) In support of this mission, Fannie Mae securitizes mortgage loans originated by lenders in the primary mortgage market into Fannie Mae mortgage-backed securities or purchases mortgage loans and mortgage-related securities in the secondary market for its own portfolio. (*Id.*)

4. To increase the supply of money available for mortgage lending and the availability of funding for new home purchases, Fannie Mae actively manages its retained portfolio. (*Id.* at ¶ 4.) Fannie Mae’s portfolio investments include RMBS and mortgage revenue bonds (“MRB”). (*Id.*) Ambac has insured more than \$3.6 billion worth of securities and municipal bonds owned by Fannie Mae. (*Id.*) In particular, Fannie Mae owns approximately \$1.25 billion in RMBS insured by policies issued by Ambac (the “Fannie Mae RMBS Policies”) and approximately \$2.35 billion in MRB that are insured by Ambac policies (the “Fannie Mae MRB Policies”). (*Id.*) The insurance of then AAA-rated Ambac was instrumental to their issuance, and Ambac has received substantial premium payments on the policies. (*Id.*)

II. The Creation of the Segregated Account and the Commencement of Rehabilitation Proceedings

5. On March 24, 2010, Ambac's Board of Directors (the "Board"), with approval of the OCI, established a segregated account (the "Segregated Account"), and had allocated to that account approximately 1,000 policies and other liabilities that were considered to have "material impairments," including the Fannie Mae RMBS Policies. (Discl. St. at 9.) The same day, the OCI commenced rehabilitation proceedings with respect to the Segregated Account by filing a Verified Petition for Order of Rehabilitation. (*Id.*) In support of its Petition, the OCI stated that the condition of the Segregated Account was such that any further transaction of business "would be financially hazardous to many policyholders." (Br. in Supp. of Entry of Order for Rehabilitation at 8.) The Segregated Account was purportedly established for "the primary purpose of conducting an orderly run-off and/or settlement of the policies and other liabilities allocated to the Segregated Account." (Discl. St. at 9.)

6. The Segregated Account has two principal assets: (1) a \$2 billion non-marketable note (the "Secured Note") secured by the future premiums received by Ambac under policies allocated to the Segregated Account; and (2) an aggregate excess-of-loss reinsurance policy (the "Reinsurance Agreement"). (*See id.* at 9.) Both the Secured Note and the Reinsurance Agreement are issued by Ambac and payable out of its General Account. (*Id.* at 13-14.) The OCI had allocated to that account more than 14,000 policies representing \$267 billion in net par value that "lacked material projected impairments" (Docket Entry No. 137 ¶ 31), including the Fannie Mae MRB Policies. (Bowes Aff. ¶ 6.)

7. Importantly, Ambac's obligations to the Segregated Account under both the Secured Note and the Reinsurance Policy are subordinated to all of Ambac's other obligations. Ambac is obliged to make payments under the Secured Note and Reinsurance

Agreement only so long as the General Account continues to have a surplus equal to at least \$100 million or such higher amount as the OCI may determine. (*See* Discl. St. at 14.) As a result, Ambac will have no payment obligations to the Segregated Account in the event that the General Account's statutory surplus falls below \$100 million – meaning the Segregated Account's ability to make payments to its policyholders will cease before policyholders in the General Account face any prospect of non-payment.

8. Policies allocated to the Segregated Account run a substantial risk of non-payment by virtue of that account's subordinated status. The obligations allocated to the Segregated Account are approximately \$67 billion of net par value exposure, according to Ambac. (*Id.* at 10) It is uncertain at best and doubtful at worst whether Ambac will be able to satisfy these obligations without its surplus dropping below \$100 million, in which case its payments to the Segregated Account will cease altogether. (*Id.* at 14.) Indeed, the \$100 million minimum surplus amount is uncertain as well, since the OCI is expressly authorized to increase that threshold at any time. (*Id.*) Recognizing this uncertainty, the OCI's proposed plan of rehabilitation for the Segregated Account calls for claims under policies in the Segregated Account to be paid only 25% in cash, with the remainder to be satisfied by the issuance of "surplus notes" subordinate to Ambac's other obligations. (*Id.* at 40-41.) To boot, the Plan would permit the OCI to reduce this low-cash payment percentage at any time prior to the Plan confirmation, and even after the Plan is confirmed. (*Id.* at 33.)

III. The Credit Default Swap Settlement

9. At around the same time as the establishment of the Segregated Account, Ambac announced that the General Account intended to enter into a \$4.6 billion settlement agreement with seventeen financial institutions that held certain credit default swap ("CDS")

contracts (the “Bank Group”). (Docket Entry No. 137 ¶¶ 2, 7, 14.) Ambac guaranteed the CDS contracts indirectly. (*Id.* at ¶ 2.) Ambac’s non-insurance subsidiary, Ambac Credit Products LLC (“ACP”), entered into the CDS contracts to protect the counterparties from defaults of the underlying issuer. (*Id.*) Ambac guaranteed certain obligations of its subsidiary. (*Id.*) Under the CDS settlement, Ambac would pay \$2.6 billion cash from the General Account and issue \$2 billion of surplus notes to the Bank Group. (*Id.* at ¶ 14.) The OCI approved the CDS settlement, notwithstanding the fact that it depleted the Segregated Account’s principal source of funding and benefited owners of CDS contracts over other creditors in violation of Wisconsin law.²

IV. The Plan of Rehabilitation

10. On October 8, 2010, the OCI filed the Plan of Rehabilitation (the “Plan”) and the Disclosure Statement Accompanying the Plan of Rehabilitation (the “Disclosure Statement”), and a Motion for Confirmation of Plan of Rehabilitation. Two weeks later, on October 21, 2010, the OCI filed its Brief in Support of Motion for Confirmation of the Plan of Rehabilitation (the “Rehabilitator’s Brief”). For the reasons discussed below, the Court should deny confirmation of the Plan.

² If Ambac’s obligation to the CDS settlement counterparties was to general creditors, not insurance policyholders, as others have argued, then the CDS claims are subordinate to the policyholders of Ambac and the disbursement of \$4.6 billion in cash and notes from the General Account constituted preferential treatment to the Bank Group in violation of Wisconsin law.

ARGUMENT

I. THE DISCLOSURE STATEMENT LACKS CRITICAL INFORMATION AND THE PLAN AS INADEQUATELY DESCRIBED APPEARS UNFAIR

A. The Disclosure Statement Provides Inadequate Information

11. The information included in a disclosure statement is essential to a creditor's evaluation of a rehabilitation plan. In the bankruptcy context, a court may not approve a disclosure statement submitted in connection with a proposed plan of rehabilitation unless it contains adequate information. 11 U.S.C. §1125(b). Under Chapter 11, information contained in a disclosure statement is adequate only when it is of a kind and in sufficient detail that would enable a creditor to make an informed judgment about the plan. *Id.* at §1125(a)(1). Although not required under Wisconsin law, *see generally* Wis. Stat. §§ 645 et seq., a disclosure statement is necessary to ensure that all interested parties are provided with adequate information to enable them to make an informed judgment regarding the rehabilitation plan. (*See* Discl. St. at i (stating that the Disclosure Statement is “consistent with [the OCI’s] statutory mandate to protect the interests of insureds, creditors, and the public generally”).)

12. Here, the Disclosure Statement lacks critical information necessary to meaningfully assess the Plan.³ Among other things, the forecasts are presented as if the two parts of Ambac – the General Account and the Segregated Account – are combined. In order to determine cash flows and losses on claims, separate financial forecasts for each of the General Account and Segregated Account are essential. (Bowes Aff. ¶ 8.) Moreover, by combining the financial projections of the General Account and Secured Account, the OCI has obscured the unique operating performance and financial condition of each account. (*Id.*)

³ Notably, neither an independent fairness opinion of the Plan nor an independent appraisal of the Surplus Notes is provided.

13. In addition, the Disclosure Statement presents claims losses in the aggregate rather than on a claim-by-claim basis and it fails to disclose the assumptions underlying the aggregate figures. (*Id.* at ¶ 9.) These assumptions are critical to Fannie Mae in making an informed judgment about the propriety of the Plan. (*Id.*) For it to be fully transparent, the Disclosure Statement should have provided bond-by-bond and even policyholder-by-policyholder claim losses by year for base case and stress case along with the assumptions driving the forecasts. (*Id.*)

14. The Disclosure Statement is also missing key economic terms regarding the Management Services Agreement and Cooperation Agreement, both dated March 24, 2010 (the “Agreements”). (*Id.* at ¶ 10.) By way of example, and not as a limitation, the Disclosure Statement fails to disclose the amounts being paid out of policyholder funds under the Agreements. (*Id.*) This information is critical in determining whether Ambac can provide adequate assurance of future performance to the policyholders in and beneficiaries of the Segregated Account. (*Id.*)

15. Absent this and other information, Fannie Mae cannot meaningfully assess the attributes and deficiencies of the Plan. A preliminary assessment based on the Disclosure Statement and other Plan documents is that policyholders in the Segregated Account are being treated far worse than other Ambac policyholders, and they are being paid less than the amount they are entitled to receive under well established law. Because the Disclosure Statement lacks information that is critical to Fannie Mae and other creditors of Ambac in making an informed judgment about the Plan and the ability of the company to rehabilitate, the Plan should not be confirmed.

B. The Plan As Inadequately Described In The Disclosure Statement Is Not A Well-Reasoned Exercise of The OCI's Discretion

1. The Plan Does Not Provide Fannie Mae Liquidated Value

16. The OCI argues that its distinction between policyholders in the General and Segregated Accounts is a well-reasoned exercise of its discretion. (Rehabilitator's Br. at 6-13.) In support of this argument, the OCI relies heavily on *Carpenter v. Pac. Mut. Life Ins.* To the extent *Carpenter* is even applicable,⁴ it suggests the opposite – that the OCI abused its discretion by failing to provide policyholders in the Segregated Account with at least the value they might receive had the OCI opted to liquidate Ambac.

17. *Carpenter* involved an insurance carrier, Pacific Mutual, which was engaged in the business of life, health, and accident insurance. Pacific Mutual became insolvent by virtue of the fact that it had issued a large number of non-cancellable accident and health policies for which it charged insufficient premiums, causing an inability to maintain lawful reserves backing the policies. *Carpenter*, 74 P.2d at 767. The insurance commissioner of the state of California began conservation proceedings against Pacific Mutual and eventually instituted a plan of reorganization. *Id.* at 769. Pursuant to the reorganization plan, all life policies would be reinsured by a newly formed company under the same terms as issued, and all non-cancellable policies would be reinsured at existing premium rates, but disability payments

⁴ *Carpenter* is a 73-year-old California Supreme Court decision applying California insurance law. Unlike the OCI in this case, the insurance commissioner in *Carpenter* was *required* under California insurance law to first attempt to rehabilitate the business of Pacific Mutual by entering into reinsuring or rehabilitation agreements. *Carpenter*, 74 P.2d at 775. Only if the commissioner failed to accomplish reinsurance or rehabilitation and further efforts proved futile, was he allowed to seek a wholesale liquidation of the company. *Id.* Such is not the case under Wisconsin law. Wis. Stat. § 645 sets forth the grounds for either liquidation or rehabilitation, but does not mandate which should be pursued by the Rehabilitator under what circumstances. Rather, the OCI is to exercise its discretion to decide what relief to seek depending on the specific facts of the individual case. *Id.*

on the policies would be assumed on a reduced basis. *Id.* at 768. Any policyholder could opt out of the plan by filing a claim with the commissioner in order to receive the liquidated value of his policy. *Id.*

18. Certain policyholders of Pacific Mutual appealed from the order of the trial court confirming the plan. *Id.* at 766. On appeal, the Supreme Court of California held, as to dissenters to the plan, that “the law requires” they receive “the equivalent of what [they] would receive on liquidation.” *Id.* at 778. Although the record was silent as to the amount policyholders would have received in liquidation, in affirming the plan, the court “assum[ed] that evidence was introduced on these vital points, and that such evidence demonstrated that dissenters under the plan will receive *as much, or more, as they would have received on liquidation.*” *Id.* (emphasis added.) Contrary to the OCI’s argument – which is buried in a footnote at the back of its brief, *see* Rehabilitator’s Br. at 14 n. 14 – implicit in *Carpenter*’s holding is that a rehabilitation plan, to be a valid exercise of discretion, must provide every group of policyholders with “the liquidated value of [their] contract rights without unreasonable delay.” *Carpenter*, 74 P.2d at 778.

19. Here, the Plan does not appear to provide the Segregated Account policyholders with the amount they would receive in a liquidation of Ambac. The Disclosure Statement provides that on the Effective Date of the Plan, the Segregated Account policyholders will receive a cash payment of 25% of their claims and Surplus Notes to cover the remaining 75%. (Discl. St. at 3.) This payment split is insufficient under *Carpenter*. To begin with, the Surplus Notes are to be paid nearly a *decade* from now on June 7, 2020. (Rehabilitator’s Br. at 2.) In addition, the Surplus Notes are subordinate to Ambac’s other obligations and of questionable value and perhaps even worthless. (Discl. St. at 40-41.) Indeed, there is no market

currently for the Surplus Notes and there is no guarantee there will be a market for them in the future. The Plan also permits the OCI to reduce the 25% cash percentage after the Plan is confirmed, subject only to the Court's approval, which has yet to be withheld. (*Id.* at 33.) Put bluntly, the offer to pay 25% in cash (subject to reduction) and 75% on unsecured, non-marketable subordinated Surplus Note appears to be an empty promise.⁵

20. By contrast, the limited information in the Disclosure Statement suggests that Ambac is capable of paying 59% of all stress claims today in cash and 81% of such claims within seven years of the Effective Date, if part or all of the company is liquidated. (Bowes Aff. ¶ 11.) In other words, based on the OCI's own estimates for a worst-case liquidation scenario, Segregated Account policyholders would receive an immediate cash payment of almost 60% of their claims (as opposed to 25% under the Plan) and more than 80% of their total claims within seven years (as opposed to 75% on Surplus Notes of questionable or no value). (*Id.*) This appears to be a more favorable outcome to Segregated Account policyholders than a 25% cash payment with the balance secured by subordinated non-marketable notes maturing in ten years. (*Id.*) Because the Plan does not appear to provide the Segregated Account policyholders the equivalent of what they would receive on liquidation, the Plan should be rejected under *Carpenter*.

C. Further Issues With The Disclosure Statement And The Plan

21. In addition to ostensibly depriving Segregated Account policyholders of their legal right to receive the liquidated value of their claims, the Plan should not be confirmed for several additional reasons. First, the Plan is unreasonable to the extent that it allocates risks

⁵ There is no reason for the initial cash position in the Segregated Account to be at 25%; for reasons discussed *infra*, it should be at least 59% based on Ambac's own statement of claims-paying resources and worst-case projection of claims losses.

from outside the regulated insurer itself (Ambac) to include unregulated or non-insurance risks from entities such as ACP and Ambac Financial Services, LLC (“AFS”). For example, the interest rate swaps business of AFS with approximately \$6.4 billion of notional risk does not constitute insurance activities subject to the authority of the OCI. Yet, the OCI allocated this risk to the Segregated Account to the detriment of that account’s policyholders. (*See* Discl. St. at 55-56.) Nor should the Student Loan policies have been allocated by the OCI to the Segregated Account, as they were never part of Ambac’s liabilities. (*See id.* at 12.) The OCI should be shielding the Segregated Account policyholders from – not subjecting them to – these external risks.

22. Relatedly, the Plan protects roughly \$1.1 billion in intercompany loans and approximately \$511 million of investments in subsidiaries at the expense of Segregated Account policyholders. (*See id.* at 55-56.) Liquidation of these assets loans would perhaps allow a substantial amount of additional cash payments to be made to the Segregated Account policyholders.

23. Second, the Plan contains possible accounting errors. For instance, the projected financial and operating results of Ambac are aided by a \$1.8 billion release of loss reserves held in respect of the deferred portion of the Segregated Account policyholders’ claims, *i.e.*, the 75% portion secured by the Surplus Notes. (*See* Discl. St. at 61 and Projected Financial and Operating Results Exhibits.) Ambac, however, is only issuing approximately \$1.4 billion in Surplus Notes, thereby manufacturing roughly \$400 million in equity. The release of reserves should be known by and made available to Segregated Account policyholders, and Surplus Notes should be issued in the exact amount as the released loss reserve. (Bowes Aff. ¶ 11.)

24. Third, Ambac's total claims-paying resources amounted to approximately \$6.8 billion as of June 30, 2010, according to Ambac. (*See* Discl. St. 52.) Therefore, the OCI's argument for suppression of the immediate cash component of the Plan is unavailing. Since the net present value of future installment premiums is stated to be \$1.0 billion, with at least \$5.8 billion in cash, the Plan could easily and comfortably pay more than half of claims in the worst case scenario. (*See id.*)

25. Fourth, in discussing the CDS settlement, the Disclosure Statement asserts that the "OCI projected that the ABS CDO exposures would experience the greatest losses of all AAC exposures – materially greater than even the troubled RMBS book." (Discl. Stat. at 20.) Contrary to this assertion, however, the financial projections provided elsewhere in the Disclosure Statement show that the ABS CDO losses would have been less than those of the RMBS risks. (*Compare id.* at 21 (estimating the base case and stress case valuation on the ABS CDO losses at \$7.7 billion and \$9.2 billion, respectively) *with* Discl. St. Exs. D & E (estimating the base case valuation on the RMBS losses at \$9.8 billion) and Discl. St. Exs. F & G (estimating the stress case valuation on the RMBS losses at \$11.8 billion).)

26. Finally, other aspects of the Plan are disquieting. The mechanics of the claims filing process are uncertain under the Disclosure Statement, and in any event, appear to vest too much power in the OCI. (*See* Discl. St. at 28-29.) The lack of transparency in the proposed settlement process makes it virtually impossible for policyholders with Disputed Claims to assess whether the OCI has abused its discretion – as it appears to have done with the Plan itself. Moreover, given that "the Plan does not limit the ability of the [OCI] to resolve any Claim" through any number of different methods, there is a real likelihood of disparate treatment of similarly situated policyholders. (*Id.* at 28.)

27. In short, the inconsistencies and other issues with the Plan militate against its confirmation.

III. THE PLAN'S TREATMENT OF THE FANNIE MAE RMBS POLICIES IS UNLAWFUL

28. The Plan's proposal to continue the existence of the Segregated Account, to which the Fannie Mae RMBS Policies have been allocated, is not only unfair and inequitable, but also violates state and federal law. First, the Plan violates the terms of and the intent behind Wis. Stat. § 611.24 ("Section 611.24"), Wisconsin's segregated account statute by:

(i) segregating policies, including the Fannie Mae RMBS Policies, based on claim status rather than type of insurance; and (ii) inadequately capitalizing the Segregated Account. Second, the allocation of policies to the Segregated Account is both an actual and constructive fraudulent transfer under Wisconsin law. Third, the continuation of the Segregated Account under the Plan also violates both the United States Constitution and the Constitution of the State of Wisconsin. Thus, the Plan should not be confirmed.

A. The Continued Existence Of The Segregated Account Under The Plan Violates Wisconsin Law

1. The Plan Violates Section 611.24 Of The Wisconsin Statutes

29. Section 611.24 of the Wisconsin Statutes, entitled "Segregated accounts in general," allows for, and in some circumstances requires, the creation of segregated accounts for certain types of insurance. Section 611.24(1) provides that "[a] corporation shall establish segregated accounts for the following classes of insurance business, if it also does other classes of insurance business:" mortgage guaranty insurance; financial guaranty insurance, in certain circumstances; and life insurance. Wis. Stat. § 611.24(1). Section 611.24(2) goes on to provide that "[w]ith the approval of the commissioner, a corporation may establish a segregated account for any part of its business. The commissioner shall approve unless he or she finds that the

segregated account would be contrary to the law or to the interests of any class of insureds.”

Wis. Stat. § 611.24(2).

30. As these provisions of Wisconsin’s segregated account statute abundantly make clear, segregated accounts must be created according to *types* of insurance. Thus, Section 611.24(1), which deals with mandatory segregated accounts, refers to the creation of segregated accounts for specific “*classes* of insurance business.” *Id.* (emphasis added). Likewise, Section 611.24(2), the permissive provision, states that a segregated account may be created “for any *part* of [a corporation’s] business” unless such an account “would be contrary...to the interests of any *class* of insureds.” *Id.* (emphasis added). Indeed, the Official Commentary to Section 611.24 demonstrates that the Wisconsin Legislature intended to permit segregation by type of insurance, based on “the notion that the fortunes of policyholders in hazardous and secure *types* of insurance should be separated.” Wis. Stat. § 611.24, Comments at L. 1971, C 260 § 72 (emphasis added).

31. The Segregated Account does exactly the opposite of what is required under Wisconsin law. As acknowledged in the Disclosure Statement, allocations to the Segregated Account were not determined by the type of insurance at issue, but rather based on *claim status*. (See Discl. St. at 11.) In other words, the Disclosure Statement makes plain that policies were targeted if the projected claims payments on those policies were considered substantial enough in the short-term to pose a significant threat to Ambac’s financial condition. (See *id.* (stating that certain policies were singled out because “the actual and projected claims payments” were “substantial and relatively short term”); see also *id.* at 12 (noting that policies with “one of the highest projected individual deal losses” were put into the Segregated Account).) Allocating policies to a segregated account on such grounds is unlawful, violate both

the terms and express purpose of Section 611.24 of the Wisconsin Statutes, and defeats the fundamental purpose of the insurance statutes, *i.e.*, “[t]o ensure that policyholders... are treated *fairly and equitably*.” Wis. Stat. § 601.01(2) (emphasis added).

2. The Segregated Account Is Not Adequately Capitalized in Violation of Wisconsin Law

32. Section 611.24 of the Wisconsin Statutes provides, in relevant part, that a segregated amount such as the one underlying the Plan must “have and maintain an adequate amount of capital and surplus....” Wis. Stat. § 611.24(3)(a). As noted in the Official Commentary, adequate capitalization is “indispensable if the account is to be expected to function and survive like a separate corporation.” Wis. Stat. § 611.24, Comments at L. 1971, C 260 § 72. Thus, a segregated account may be established only if “it is *adequately capitalized to make it independently viable*, and the commissioner approves its creation.” *Id.* (emphasis added).

33. The OCI asserts that this statutory requirement has been satisfied regarding the Segregated Account based on the two credit backstop arrangements that the General Account of Ambac is providing to the Segregated Account: the Secured Note and the Reinsurance Agreement. (*See* Discl. St. at 13-15.) The Secured Note, with a cap of \$2 billion and a maturity date of March 24, 2050, and the Reinsurance Agreement, which attaches only after payment of all principal and accrued interest under the Secured Note, appear to be of questionable or no value. Indeed, the Secured Note may never be paid because payments on the note are required only so long as the General Account continues to have a surplus equal to at least \$100 million or such higher amount as the OCI may determine. Therefore, these purported assets do not appear to be sufficient to support the \$67 billion in liabilities that have been

transferred to the Segregated Account, and should not be eligible for booking as an admitted asset of the Segregated Account under statutory accounting principles.

B. The Allocation Of The Fannie Mae RMBS Policies To The Segregated Account Is A Fraudulent Transfer

34. Wisconsin Statute § 242.04, entitled “Transfers fraudulent as to present and future,” governs the fraudulent transfers of property to avoid present creditors and those reasonably likely to become creditors. *Id.* Section 242.04(1)(a) provides that a transfer is actually fraudulent if made “with actual intent to hinder, delay or defraud a creditor.” *Id.* There is no question as to the intent of the allocation of the Fannie Mae RMBS Policies to the Segregated Account. The pleadings filed by Ambac with this Court expressly state that the allocations to the Segregated Account are intended to slow and prevent recourse of creditors like Fannie Mae against the remaining assets that are being left in the General Account. This restraint on Fannie Mae’s recourse amounts to a fraudulent transfer under Section 242.04 and may be avoidable.

35. In addition, Section 242.04(1)(b) provides that a transfer is constructively fraudulent if made when the debtor (i) is insolvent or has unreasonably small capital, and (ii) does not receive back reasonably equivalent value. *Id.* The OCI’s allocation of the Fannie Mae RMBS Policies to the Segregated Account satisfies both prongs of Section 242.04(1)(b). The term “small capital” is defined as the situation in which an entity, even if not insolvent, faces severe liquidity problems. *See, e.g., Boyer v. Crown Stock Distrib., Inc.*, 587 F.3d 787, 795 (7th Cir. 2009). Naturally, the severe liquidity problems of Ambac are exactly what caused the OCI to establish the Segregated Account.

36. With respect to the second prong, the OCI’s analysis of fair consideration depends on the backstop arrangements from the General Account – namely, the Secured Note

and the Reinsurance Agreement. As set forth above, however, the Secured Note and the Reinsurance Agreement are of questionable or no value. Thus, from the insured's perspective of Fannie Mae, the Segregated Account does not appear to have received fair consideration or reasonably equivalent value, as required under Section 242.04(1)(b).

C. The Continued Existence Of The Segregated Account Violates The Constitutions Of The United States And The State of Wisconsin

1. The Transfer Of The Fannie Mae RMBS Policies To The Segregated Account Was A Taking

37. The OCI's actions in allocating the Fannie Mae RMBS Policies to the inadequately capitalized Segregated Account constituted a constitutionally unlawful taking. Where, as here, an individual or entity's property is taken for public use without providing just compensation, an unconstitutional taking occurs. U.S. Const. amend. V, cl. 5; Wis. Const. art. I, § 13.

38. Fannie Mae has a legitimate and constitutionally protected property interest in the Fannie Mae RMBS Policies with Ambac. *See, e.g., U.S. Trust Co. of N.Y. v. N.J.*, 431 U.S. 1, 19 n.16 (1972) ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid."). Moreover, the OCI has acknowledged that the Segregated Account was created for the use and benefit of the public, in line with "his statutory mandate to protect the interests of insured, creditors, and the public generally." (Discl. St. at 1.) Thus, the Rehabilitator's approval of the Segregated Account without adequate capitalization, and the subsequent transfer of the Fannie Mae RMBS Policies to the Segregated Account, constituted a taking as contemplated by the U.S. and Wisconsin Constitutions. *See, e.g., Zinn v. State*, 112 Wis. 2d 417, 334 N.W.2d 67 (1983) (holding that ruling by Department of Natural Resources that had the effect of converting two-hundred acres

of plaintiff's property to public land constituted a "taking" which triggered the "just compensation" clause of the State Constitution).

39. Because the OCI's actions constituted a taking, the OCI was required to provide Fannie Mae with "just compensation." *See U.S. Trust Co of N.Y.*, 431 U.S. at 19 n.16 ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid."). Rather than providing such "just compensation," however, the OCI accomplished the opposite by substituting Fannie Mae's contractual rights against the General Account with new contracts requiring Fannie Mae to make claims only against the inadequately capitalized Segregated Account (which, as detailed in the Plan and Disclosure Statement, will not pay the full amount of Fannie Mae's claims in cash). As such, the Segregated Account violates the Constitutions of the United States and Wisconsin, and thus, the Plan should not be confirmed.

2. The Transfer of the Fannie Mae RMBS Policies to the Segregated Account Without Notice and an Opportunity to Be Heard Violated Fannie Mae's Due Process Rights

40. In general, the due process clauses of the Constitutions of the United States and Wisconsin requires advance notice and an opportunity to be heard prior to the deprivation of one's property rights. *See* U.S. Const. amend. XIV, § 1, Wis. Const. art. I, § 1. Fannie Mae, however, was given no such notice or opportunity prior to the transfer of the Fannie Mae RMBS Policies to the Segregated Account. Therefore, the Rehabilitator violated Fannie Mae's due process rights by transferring the Fannie Mae RMBS Policies to the inadequately capitalized Segregated Account, and any post-deprivation hearing is constitutionally inadequate. *See Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 436, (1982) (stating that "absent 'the

necessity of quick action by the State or the impracticality of providing any predeprivation process,' a post-deprivation hearing...would be constitutionally inadequate" (citations omitted)).

III. FANNIE MAE ADOPTS AND INCORPORATES BY REFERENCE THE APPLICABLE ARGUMENTS RAISED BY ANY OTHER PARTIES FILING AN OBJECTION TO THE PLAN

41. Fannie Mae joins in and adopts the applicable arguments raised by any other parties filing an objection to the Plan. Those arguments will not be repeated here, but are adopted and incorporated by reference as if fully set forth herein.

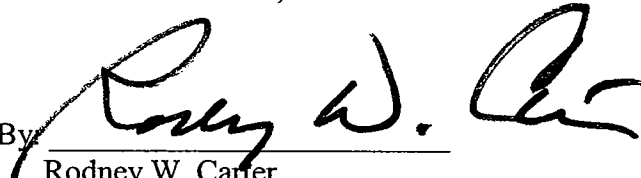
CONCLUSION

For the foregoing reasons, Fannie Mae respectfully requests that this Court: (i) deny the Rehabilitator's Motion for Confirmation of the Plan of Rehabilitation; and (ii) grant such other and further relief as is just and proper.

Dated this 8th day of November, 2011

Respectfully submitted,

DAVIS KUELTHAU, s.c.

By 

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In the Matter of the Rehabilitation of:

Segregated Account of Ambac Assurance Corporation

Case No. 10 CV 1576

AFFIDAVIT OF ROBERT BOWES

I, Robert Bowes, being first duly cautioned and sworn, state as follows based on personal knowledge:

1. I am the Director of Counterparty Risk Management of Federal National Mortgage Association ("Fannie Mae"). I submit this affidavit in support of Fannie Mae's Brief in Opposition to Rehabilitator's Motion for Confirmation of the Plan of Rehabilitation. The statements made herein are based on my personal knowledge or upon information and belief after appropriate investigation.

2. Fannie Mae was established as a federal agency in 1938, and was chartered by Congress in 1968, to provide liquidity, stability and affordability to the U.S. housing and mortgage markets. Fannie Mae operates in the U.S. secondary mortgage market. Rather than making home loans directly to consumers, Fannie Mae works with mortgage bankers, brokers and other primary mortgage market partners to help ensure they have funds to lend to home buyers at affordable rates. Fannie Mae funds its mortgage investments primarily by issuing debt securities in the domestic and international capital markets.

3. Fannie Mae has three lines of business – Single-Family, Housing and Community Development, and Capital Markets – that provide services and products to lenders and a broad range of housing partners. Together, these businesses contribute to the company's

chartered mission to increase the amount of funds available in order to make homeownership and rental housing more available and affordable. In support of this mission, Fannie Mae securitizes mortgage loans originated by lenders in the primary mortgage market into Fannie Mae mortgage-backed securities or purchases mortgage loans and mortgage-related securities in the secondary market for its own portfolio.

4. To increase the supply of money available for mortgage lending and the availability of funding for new home purchases, Fannie Mae actively manages its retained portfolio. Fannie Mae's portfolio investments include residential mortgage-backed securities ("RMBS") and mortgage revenue bonds ("MRB"). Ambac Assurance Corporation ("Ambac") has insured more than \$3.6 billion worth of securities and municipal bonds owned by Fannie Mae. In particular, Fannie Mae owns approximately \$1.25 billion in RMBS insured by policies issued by Ambac (the "Fannie Mae RMBS Policies") and approximately \$2.35 billion in MRB that are insured by Ambac policies (the "Fannie Mae MRB Policies"). On information and belief, the insurance of then AAA-rated Ambac was instrumental to their issuance, and Ambac has received substantial premium payments on the policies.

5. On September 6, 2008, Director James Lockhart of the Federal Housing Finance Agency ("FHFA") appointed FHFA as conservator of Fannie Mae pursuant to Section 1145(a) of the Federal Housing Finance Regulatory Reform Act of 2008, Pub. L. 110-289, 122 Stat. 2654 (codified at 12 U.S.C. § 4617).

6. The Office of the Commissioner of Insurance of the State of Wisconsin (the "OCI"), as rehabilitator, has allocated the Fannie Mae MRB Policies to the so-called General Account. The OCI also allocated the Fannie Mae RMBS Policies to the so-called Segregated Account (the "Segregated Account").

7. I have reviewed the Plan of Rehabilitation (the "Plan") and the Disclosure Statement Accompanying the Plan of Rehabilitation (the "Disclosure Statement") filed in this Court on October 8, 2010. Based on my review of the Plan and Disclosure Statement, I believe that the Disclosure Statement lacks key information that is critical to Fannie Mae in making an informed judgment about the Plan and the ability of Ambac to rehabilitate. It also appears, based on my review of the Plan and the Disclosure Statement, that policies allocated to the Segregated Account have been effectively subordinated to policies remaining in the General Account, and Segregated Account insureds such as Fannie Mae are unlikely to receive the liquidated value of their claims, as discussed further below.

8. Among the missing information in the Disclosure Statement is a separate financial forecast for each of the General Account and the Segregated Account. The forecasts provided by the OCI in the Disclosure Statement are presented as if the two distinct parts of Ambac – the General Account and the Segregated Account – are a single combined unit. I assume this was unintentional, as the OCI states in its Disclosure Statement that the Segregated Account is "a separate insurer," pursuant to Wis. Stat. § 611.24(3)(e). (Discl. St. at i.) In any event, for Fannie Mae and perhaps others to determine cash flows and losses on claims, separate financial forecasts for each of the General Account and Segregated Account are critical. Without this information, it is difficult to meaningfully assess whether, as the OCI contends, the capital and surplus of the Segregated Account provided through the Secured Note and Reinsurance Agreement are adequate. Moreover, by combining the financial projections of the General Account and the Secured Account, the OCI has made it difficult to ascertain the unique operating performance and financial condition of each account.

9. In addition to failing to provide separate financial forecasts, the Disclosure Statement also presents claims losses in the aggregate rather than on a claim-by-claim basis and it fails to disclose the assumptions underlying the aggregate figures. These assumptions are critical to Fannie Mae in making an informed judgment about the appropriateness of the Plan. For it to be fully transparent, the Disclosure Statement should have provided bond-by-bond and even policyholder-by-policyholder claim losses by year for base and stress cases along with the assumptions underlying the forecasts.

10. The Disclosure Statement is also missing key economic terms regarding the Management Services Agreement and Cooperation Agreement, both dated March 24, 2010 (the "Agreements"). Among other things, the Disclosure Statement fails to disclose the amounts being paid out of policyholder funds under the Agreements. This information is critical in determining whether Ambac can provide adequate assurance of future performance to insureds under policies allocated to the Segregated Account.

11. Besides the missing information, there also appears to be possible accounting errors in the Disclosure Statement. For instance, the projected financial and operating results of Ambac are aided by a \$1.8 billion release of loss reserves held in respect of the deferred portion of the Segregated Account policyholders' claims, *i.e.*, the 75% portion secured by the Surplus Notes. (See Discl. St. at 61 and Projected Financial and Operating Results Exhibits.) Ambac, however, is only issuing approximately \$1.4 billion in Surplus Notes, thereby manufacturing roughly \$400 million in equity. The release of reserves should be known by and made available to Segregated Account policyholders, and Surplus Notes should be issued in the exact amount as the released loss reserve.

12. Moreover, as discussed above, what information the Disclosure Statement does provide suggests that insureds under policies allocated to the Segregated Account are unlikely to receive the same or similar value they might receive had the OCI opted to liquidate Ambac. The limited information in the Disclosure Statement suggests that Ambac is capable of paying 59% of all stress claims today in cash and 81% of such claims within seven years, if part or all of the company is liquidated. In other words, based on the OCI's own estimates for a worst-case liquidation scenario, Segregated Account policyholders would receive an immediate cash payment of almost 60% of their claims (as opposed to 25% under the Plan) and more than 80% of their total claims within seven years (as opposed to 75% on Surplus Notes of questionable or no value). This appears to be a more favorable outcome to Segregated Account policyholders than a 25% cash payment with the balance secured by subordinated non-marketable notes maturing in ten years.

I declare under penalty of perjury that the foregoing is true and correct.

Dated this 8th day of November, 2010.

Robert B. Bowes
Robert Bowes

District of Columbia: SS

Subscribed and sworn to before me
in my presence, this 8 day of November, 2010.

Michelle Y. Lancaster
Notary Public, D.C.

My commission expires 11-14-2013



MICHELLE Y. LANCASTER
NOTARY PUBLIC DISTRICT OF COLUMBIA
My Commission Expires November 14, 2013

In the Matter of the Rehabilitation of:

Case No. 10-CV-1576

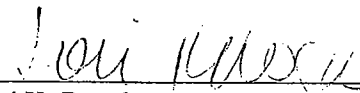
Segregated Account of Ambac Assurance Corporation

AFFIDAVIT OF SERVICE

STATE OF WISCONSIN)
) ss.
COUNTY OF WAUKESHA)

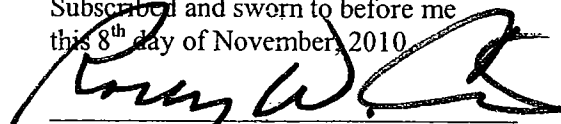
Lori K. Rogahn states that on the 8th day of November, 2010, she emailed the following documents to all parties listed on the attached service list:

1. Objection to Federal Mortgage Association to Rehabilitator's Motion for Confirmation of the Plan of Rehabilitation;
2. Affidavit of Robert Bowes;
3. Notice of Appearance and Notice of Motion and Motion for Leave of Federal National Mortgage Association ("Fannie Mae") to Intervene as Defendant; and
4. Affidavit of Rodney W. Carter.



Lori K. Rogahn

Subscribed and sworn to before me
this 8th day of November, 2010.



Notary Public, State of Wisconsin

My Commission: to term.

Rogahn, Lori K.

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