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

REHABILITATOR'S SUPPLEMENTATIONS TO OCTOBER 8, 2010 DISCLOSURE STATEMENT IN SUPPORT OF CONFIRMATION OF THE REHABILITATOR'S PLAN OF REORGANIZATION
(Written Responses to Written Questions)

Dated this 12th day of November, 2010.

FOLEY & LARDNER LLP

Michael B. Van Sicklen, SBN 1017827
Matthew R. Lynch, SBN 1066370
FOLEY & LARDNER LLP
150 East Gilman Street
Post Office Box 1497
Madison, Wisconsin 53701
Telephone: (608) 257-5035
Facsimile: (608) 258-4258

Kevin G. Fitzgerald, SBN 1007444
Frank W. DiCastri, SBN 1030386
Andrew A. Oberdeck, SBN 1052308
FOLEY & LARDNER LLP
777 East Wisconsin Avenue
Milwaukee, Wisconsin 53202
Telephone: (414) 271-2400
Facsimile: (414) 297-4900

Attorneys for Wisconsin Office of the Commissioner of Insurance and the Commissioner of Insurance of the State of Wisconsin, as the Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

INTRODUCTION

At the October 14, 2010 duly noticed hearing to schedule proceedings in regard to confirmation of the Rehabilitator's Plan of Reorganization, there was a recommendation to the Court that it might facilitate a more orderly presentation of information to the Court and reduce the need for lengthy oral testimony if parties-in-interest submitted written factual questions for OCI to consider and respond to either in advance of the confirmation hearing or during the hearing. The Court adopted the suggestion as set forth at ¶ 2-c of the Court's October 18, 2010 Confirmation Scheduling Order.

Commencing on November 8, 2010, various parties-in-interest submitted various styles and types of written questions to the Rehabilitator. Certain of those questions were argumentative or legal in nature, or were crafted as statements, not questions, but, as to the rest, the Rehabilitator has endeavored to provide written responses as set forth below, organized by topic (with an indication of the source of the question). The Rehabilitator submits these questions and responses as a supplement to his October 8, 2010 Disclosure Statement in lieu of offering oral testimony on these points. This supplementation was prepared at the request, and under the direction of, the Office of the Wisconsin Commissioner of Insurance, and is true and correct to the best of OCI's ability given the large number of the questions and short time to respond. The Rehabilitator reserves the right to supplement, edit or expand the following responses as and when time permits and additional information warrants.

TABLE OF CONTENTS TO QUESTIONS AND RESPONSES

1. **<u>Background Information About Ambac</u>**

a. How have AAC's practices, standards, and personnel changed since the initiation of rehabilitation proceedings? RMBS Question 36.

<u>Answer</u>: Since rehabilitation commenced, AAC's services pertaining to the Segregated Account have been subject to the Plan of Operation and related agreements such as the Management Services Agreement and Cooperation Agreement and greater day-to-day oversight and interaction with OCI and the Rehabilitator. There has been some attrition of personnel.

b. Did AAC and/or OCI consider including a Segregated Account policyholder representative on the Board of Directors of AAC? RMBS Question 40.

<u>Answer</u>: OCI cannot speak for AAC as to this or any of the later questions, but OCI did give consideration to including a Segregated Account policyholder representative on the AAC Board but concluded that each of those policyholders had narrow self-interested perspectives as to its own policy and would not be a well suited board member. Instead, OCI was involved in the selection and retention of the four outside independent board members. Additionally, the Rehabilitator selected and has been consulting with a Special Advisors' Council consisting of independent non-AAC-affiliated qualified individuals to consult and advise with the Rehabilitator on matters pertaining to the rehabilitation.

2. **<u>Background Information About the Rehabilitation Plan</u>**

a. What measures, whether contained in the Plan or elsewhere, has OCI put in place to ensure uniform and consistent treatment of policyholders regarding, but not limited to, payments on the Segregated Account notes, General Account notes and CDS Bank notes, and evaluation of pending claims, regardless of when these issues arise? RMBS Question 35.

<u>Answer</u>: The overarching framework for OCI's regulatory duties regarding fair and equitable treatment is set forth in Wisconsin statutory and case law, as well as in the extensive documentation OCI and the Rehabilitator have implemented in connection with this proceeding commencing with the first-day orders on March 24, 2010, the Plan of Operation and affiliated documents, the decision-making guidelines, the physical presence of senior OCI management on a regular basis at AAC, implementation of protocols and committees for advising the Rehabilitator and OCI about business issues, strategies and the like, which has been fully disclosed to the Court in this proceeding, including the Rehabilitator's Report to the Court on Administration and periodic filings and presentations in open court. Additionally, the Plan was crafted to promote the fair and equitable treatment of policyholders, creditors and the public consistent with Wisconsin law.

> b. What communications has OCI had with other state insurance regulators regarding (a) the formation of the Segregated Account; and (b) the proposed Plan? RMBS Question 41.

Answer: OCI's communications with other state insurance regulators on this or other subjects is privileged, confidential and not probative of any fact issue in this matter.

> c. Please disclose and provide detail concerning any Alternative Resolutions currently being contemplated (if any). LVM Question 10.

Answer: The details of current negotiations about Alternative Resolutions are confidential and protected by written FRE 408 and Wis. Stat. § 904.08 protections. If settlements are reached in final form, the Rehabilitator shall handle them in terms of disclosure and court approval consistent with the terms of the Plan.

> d. How do AAC and OCI intend to use the discretion they are granted under the terms of the Plan? Please identify any standards, practices, or guidelines to be adopted in discharging Plan implementation and claim adjudication responsibilities. RMBS Question 34.

Answer: It is difficult to answer this inquiry because OCI does not understand what the questioner considers to be the areas of uncertain discretion granted under the Plan. The Rehabilitator intends to carry out Plan implementation and claim adjudication responsibilities consistent with Wisconsin law and the terms of the Plan in a fair and equitable manner. Details about the process for implementation of the Plan and claim adjudication are set forth in the Disclosure Statement.

OCI intends to use the discretion it is granted under the Plan and its statutory authority to implement decisions that (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

3. The Establishment of the Segregated Account

a. In the view of OCI and in the view of AAC, was AAC insolvent at any time prior to the formation of the Segregated Account and is AAC currently insolvent? RMBS Questions 14-17.

Answer: Again, OCI does not speak for AAC on this or any other response herein. The term "insolvent" as used in the question is vague. ACC's financial positions at different points in time are reflected in its publicly available statutory and other financial statements. Extensive information regarding OCI's perspective on the financial condition of ACC is set forth in the Disclosure Statement and the other posted documents on the website.

b. Identification of documents utilized by the Commissioner or Ambac in authorizing the approval of the Segregated Account. ALL Lloyds Question 1.

Answer: As the regulator, and by virtue of its broad contractual and statutory confidentiality protections, OCI had the unique regulatory right to full and free access to all documents and information at AAC, as well as documents it prepared or that were prepared by its advisors, regarding approval of the Segregated Account. Extensive information about OCI's decisions in regard to the Segregated Account is detailed in the First Affidavit of Roger Peterson on file in this proceeding, as well as in the Disclosure Statement and related documents submitted in connection with the confirmation process. OCI objects as unduly burdensome to specifically identifying every document, on a document-by-document basis it may have considered or utilized in making its regulatory decisions. Certain of the information it considered is privileged.

c. Identification of documents prepared by or on behalf of the Commissioner or Ambac which contained any analyses or conclusions by the Commissioner or Ambac regarding the decision to establish the Segregated Account. For example, the identification of pre-March 25, 2010 documents of Ambac or the Commissioner's analysis and conclusions about how the Segregated Account had, on or about March 24, 2010, "an adequate amount of capital and surplus," as required by Wis. Stat. § 611.24(3). ALL Lloyds Question 11.

Answer: *See* foregoing answer, which is incorporated here by reference. Additional information and details regarding the adequacy of the capital of the surplus account is set forth in the briefs and affidavits submitted in this proceeding by the Rehabilitator.

d. All alternatives analyzed by the Commissioner or Ambac before determining to utilize the Segregated Account. ALL Lloyds Question 2.

Answer: OCI considered all of the regulatory alternatives available to it under Wis. Stat. Chapter 645, and otherwise under Wisconsin law including, but not limited to, summary orders, use of multiple segregated accounts, rehabilitation of the General Account or full liquidation. Its analysis of alternatives is detailed in various submissions on file in this proceeding, including the First Affidavit of Roger Peterson, the Court's May Findings of Fact and Conclusions of Law and the Disclosure Statement and related materials submitted in support of confirmation. OCI does not speak as to what alternative Ambac may have internally considered.

e. Identification of documents prepared by or on behalf of Ambac or the Commissioner relating to their decision to allocate what the Disclosure Statement describes as the "fewer than 1,000 policies (representing approximately $67 billion in net par outstanding)" to the Segregated Account prior to its approval of the Segregated Account. ALL Lloyds Question 6.

Answer: *See* response at 3-b. As the regulator, and by virtue of its broad contractual and statutory confidentiality protections, OCI had full and free access to all documents at AAC, as well as documents it prepared or that were prepared by its advisors regarding approval of the Segregated Account. Extensive information about OCI's decisions in regard to the Segregated Account is detailed in the First Affidavit of Roger Peterson on file in this proceeding, as well as in the Disclosure Statement and related documents submitted in connection with the confirmation process. OCI objects as unduly burdensome to specifically identifying every document, on a document-by-document basis it may have considered or utilized in making its regulatory decisions.

f. Identification of documents prepared by or on behalf of Ambac or the Commissioner relating to their decision to keep what the Disclosure Statement describes as the "14,000 policies (representing over $300 billion in net par outstanding)" in the General Account. ALL Lloyds Question 7.

Answer: *See* response to foregoing question.

g. Please describe any analyses prepared by OCI or Ambac regarding the feasibility of the Plan of Rehabilitation. LVM Question 12.

Answer: OCI's analysis regarding the feasibility of the Plan is set forth in the Disclosure Statement and related materials submitted by the Rehabilitator in support of confirmation. OCI and the Rehabilitator object on the grounds of work product and attorney-client privilege to describing drafts or other analyses which OCI may have prepared at some time.

4. The Segregated Account Generally

a. Anticipated timeline for implementation of proposed rehabilitation Plan if approved by the Court. DEPFA Question J, Sean Dilweg, DEPFA Question M, Roger Peterson, DEPFA Question G, Cathleen Matanle.

Answer: The Rehabilitator will strive to commence implementation of the Plan as rapidly as possible following approval by the Court. The Disclosure Statement describes with specificity the process for the implementation and effectuation.

b. Please summarize the policies included in the Segregated Account, including size, exposure and any analyses on estimated losses and reserves under these policies. LVM Question 1.

Answer: The Disclosure Statement summarizes the exposures in the Segregated Account. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

c. Why were the liabilities transferred to the Segregated Account but not their accompanying assets, and what was the legal basis for doing so? RMBS Question 12.

Answer: This legal argument has been addressed by the Rehabilitator in multiple briefs and affidavits; those discussions are incorporated by reference. OCI does not understand what is meant by the "accompanying assets." All assets and claims paying resources of the General Account above the disclosed threshold statutory licensing minimum are subject to the Secured Note and Excess of Loss Reinsurance Agreement in favor of the Segregated Account. As has been explained in person to representatives of the RMBS questioner by the Rehabilitator, certain cash recoveries on remediation lawsuit claims, or the like were not allocated outright to the Segregated Account for several reasons, such as to avoid collateral damage from contractual prohibitions in various policies in the General Account against transfer or assignments of assets.

d. What consideration has the Segregated Account received in exchange for the transfer to the General Account of remediation recoveries, reimbursements, and insurance premiums associated with policies allocated to the Segregated Account? RMBS Question 38.

Answer: This question is inaccurate because recoveries, reimbursements and premiums were not transferred to the General Account. They existed there in the first instance and were not transferred or allocated. Details regarding the capital support and claims paying resources for the Plan are detailed in great length in the Disclosure Statement. All of the resources of the General Account above the statutory licensing minimum requirement provide the consideration for the creation of the Segregated Account. *See* the discussion in Rehabilitator's Brief dated August 17, 2010 at pages 18-21 regarding the adequacy of the capital.

> e. Please detail all evidence supporting the statements in the Disclosure Statement that "The Commissioner has determined that the capital and surplus of the Segregated Account provided through the Secured Note and Reinsurance Agreement is adequate and constitutes fair consideration within the meaning of Wis. Stat. § 645.03(d)." ALL Lloyds Question 18.

Answer: This issue was discussed at length in the Rehabilitator's prior briefs and affidavits; *see*, in particular, his August 17, 2010 submissions on this subject.

> f. What is OCI/AAC's plan for Everspan in connection with the rehabilitation of the Segregated Account? How will that plan be carried out? RMBS Question 13.

Answer: OCI's present plan for Everspan is to leave it in a dormant condition. If circumstances change in the future in regard to Everspan in a manner that materially affects or involves the Segregated Account, the Rehabilitator would bring the matter to this Court for review pursuant to the guidelines set forth in the Plan. If additional value could be generated through the use of Everspan in the future, that will have the beneficial effect of improving the claims-paying resources available to the Segregated Account claimants pursuant to the Secured Note and Reinsurance Agreement.

Any plan to capitalize Everspan to facilitate the writing of new financial guarantee business would depend on a number of factors, including AAC's financial condition and overall industry conditions, and would need to (i) be reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and be equitable to the interests of AAC and Segregated Account policyholders generally.

g. Identification of any and all "certificates of authority" of the Segregated Account. ALL Lloyds Question 22.

Answer: The Segregated Account has a Wisconsin certificate of authority.

h. Documents containing specific analyses and conclusions regarding the reasons the three ALL Student Loan policies were allocated to the Segregated Account. ALL Lloyds Question 37.

Answer: These internal analyses and conclusions are confidential and privileged. The criteria by which assessments and allocation decisions pertaining to these three policies were detailed in the court filed disclosures regarding the Student Loan policies. *See also* the Second Matanle Affidavit and Fourth Peterson Affidavit on file, and the Rehabilitator's briefs in opposition to the Lloyds/ALL motions that were denied by the Court.

i. Please identify the financial information pertaining to the Segregated Account that the Commissioner will make available on a going-forward basis. For example, will policyholders have an opportunity to review expense allocations? LVM Question 27.

Answer: The Rehabilitator has not yet determined the details as to specific types of information which will be set forth in the annual reports to the Court described in the Plan and Disclosure Statement, but plans to make the reports as complete and helpful as is practical and appropriate.

5. The Liquidation Value of the Segregated Account

a. What actions has OCI taken or what analysis has OCI done that ensures the Plan meets the legal requirements that policyholders receive at least a liquidation value for their claims, and where are those actions summarized or where is that analysis contained in the Plan and its accompanying documents? RMBS Question 11.

Answer: OCI disputes that there is any legal requirement that policyholders receive at least the liquidation value for their claims. If such a standard were applicable, however, *see, e.g.,* Disclosure Statement at page 8 and the accompanying liquidation analysis in

Amendment No. 1 to Disclosure Statement, which considers the possible recoveries under a hypothetical liquidation commencing on March 24, 2010.

b. Did OCI, AAC, or their financial consultants calculate the liquidation value of AAC as of the date of the creation of the Segregated Account, or as of any other date? If yes, what is the liquidation value that was calculated? RMBS Questions 25-26; also ALL Lloyds Question 8.

Answer: *See* accompanying liquidation analysis in Amendment No. 2 to Disclosure Statement.

c. Did the Commissioner or Ambac make a determination as to whether there would have been the same assignment rights in liquidation as are set out in the Plan? ALL Lloyds Question 9.

Answer: Assignment of rights would differ materially because liquidation would effect a termination of the policies.

d. Does the Commissioner believe that he has the right in liquidation to take the collateral of Lloyds on the ALL polices to the same extent as in the Plan? ALL Lloyds Question 10.

Answer: The manner in which collateral, claims payment or other aspects of dealing with policies pursuant to a Plan of Rehabilitation would be different in liquidation because liquidation effects a termination of the policies, with the accompanying problems and losses detailed in the accompanying liquidation analysis.

e. Potential liquidation recoveries for creditors in a liquidation or AAC or in a liquidation of the Segregated Account. One State Street Question L, Sean Dilweg.

Answer: *See* the accompanying liquidation analysis.

6. Surplus Notes and the Payment of Claims

a. Discussion of Section 10.04 of the proposed rehabilitation Plan and whether it would allow for reduction in cash payment below the 25% margin if changes in financial circumstances so warranted. DEPFA Question GG, Sean Dilweg and DEPFA Question KK, Roger Peterson.

Answer: The percentage of cash payments may be adjusted in future years pursuant to the annual review process specified in the Plan, as and when changes in circumstances so warrant it. As detailed in the Disclosure Statement, the ability to pay policyholder claims in full pursuant to the Plan, with payments in full on the surplus notes, will depend on future circumstances.

b. Is the Segregated Account able to pay policyholders' claims in full? RMBS Question 18.

Answer: Under the Plan, the combination of cash and surplus notes paid to Segregated Account policyholders constitutes payment in full of policyholder claims. The ability of AAC to pay interest and principal on the surplus notes in full will depend on many factors, including but not limited to (i) loss development, (ii) amount and timing of remediation recoveries, (iii) investment portfolio performance, (iv) operating expense levels, and (v) the consummation of Alternative Resolutions. In the Projections incorporated in the Disclosure Statement (which do not incorporate Alternative Resolutions), AAC is expected to have sufficient resources to pay interest and principal on all surplus notes in full in Scenario One, while other scenarios incorporated in the Disclosure Statement do not contemplate that surplus note interest and principal will be paid in full.

c. Has OCI or AAC prepared a pay-out schedule for the Surplus Notes that will be issued by the Segregated Account? RMBS Question 22.

Answer: OCI has not provided for a pay-out schedule for the Surplus Notes that will be issued by the Segregated Account. As provided for in the Plan, changes in the Cash-Note Split, payment of any accrued but unpaid Surplus Note interest, and redemption of Surplus Note principal will be considered on an annual basis.

d. If there is cash available in the General Account over and above the statutory minimum surplus, is it AAC's and OCI's intention to pay the principal and interest on the Surplus Notes issued by the Segregated Account? RMBS Question 23.

Answer: The existence of available cash in the General Account over and above the statutory minimum surplus at any given point in time is a necessary but not sufficient condition to allow for the payment of interest and principal on the Surplus Notes.

> e. What protections exist in the proposed Plan to ensure that the principal and interest on the Surplus Notes issued by the Segregated Account will be paid so long as cash is available in the General Account over and above the statutory minimum surplus? RMBS Question 24.

Answer: As OCI does not believe that the existence of available cash in the General Account over and above the statutory minimum surplus at any given point in time is a sufficient condition to allow for the payment of interest and principal on the Surplus Notes, the Plan does not require such payments.

> f. How will Segregated Account policyholders' claims be treated in the following scenarios: (1) AAC's surplus falls below $100 million but AAC as a whole is not put into rehabilitation or liquidation; and (2) AAC's surplus falls below $100 million and AAC as a whole is put into rehabilitation or liquidation? RMBS Question 29.

Answer: As described in the Disclosure Statement, the maximum liability that the Segregated Account may cede to the General Account is limited to the amount that would cause the surplus of the General Account to be equal to $100 million. This means that Segregated Account liabilities alone cannot cause the surplus of the General Account to fall below $100 million; should the surplus of AAC fall below $100 million for any reason, OCI would evaluate and take action in the interests of policyholders, creditors, and the public.

> g. What protections exist in the proposed Plan or otherwise to ensure that no value, including dividends or use of AAC's net operating losses ("NOLs"), will be upstreamed from AAC to its parent, AFG, prior to the time when all policyholders in the Segregated Account have been paid in full on Permitted Claims, including principal and interest on Surplus Notes issued by the Segregated Account? RMBS Question 31.

Answer: OCI is not relying upon terms in the various AAC policies/agreements about dividends; rather, as detailed in prior submissions, OCI shall handle any future requests for dividends in accordance with its regulatory duties and Wisconsin law.

With respect to dividends, any determination to permit AAC to remit dividends to AFG will be based on OCI's consideration of AAC's financial condition at that time, and whether such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

With respect to NOLs, there are certain actions that AFG can take, or that may occur in a chapter 11 reorganization or a chapter 7 proceeding, that could impair the existing NOLs. OCI is exploring ways to ensure that AAC will have sufficient access to existing and/or future NOLs in order to lend added support for the rehabilitation of the Segregated Account.

h. What terms in various AAC policies/agreements prevent OCI from agreeing, as part of the Plan, not to allow AAC to issue dividends to AFG while policyholders in the Segregated Account are impaired? RMBS Question 39.

Answer: Any determination by OCI to permit AAC to remit dividends to AFG will be made in accordance with Wisconsin law and will be based on OCI's consideration of AAC's financial condition at that time, and whether such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

i. Under what circumstances would OCI permit AAC to remit dividends to AFG while policyholders in the Segregated Account are not being paid in full? RMBS Question 33.

Answer: *Id.*

j. Please explain the rationale for including balances of Bank Settlement Notes, Segregated Account Surplus Notes and Junior Surplus Notes in calculation of Total Surplus. Further discuss why PIK interest on Surplus Notes is excluded from balances for the purposes of calculating Total Surplus. LVM Question 2.

Answer: As noted in the Disclosure Statement, the projections were not prepared with a view towards compliance with published guidelines of the SEC, the American

Institute of Certified Public Accountants, Accounting Principles Generally Accepted in the United States of America ("GAAP") or in accordance with U.S. Statutory Accounting Principles ("SAP") prescribed or permitted by OCI.. Nonetheless, the projections were guided by certain SAP standards to, among other reasons, provide a link to AAC's June 30, 2010 statutory statements and allow for comparability to other statutory statements issued by AAC. Under general SAP guidelines, surplus notes (Bank Settlement Notes, Segregated Account Surplus Notes and Junior Surplus Notes) are accounted for as Surplus and PIK interest is not.

k. Please describe in detail the subordinated nature of the Surplus Notes and the Junior Surplus Notes, including a discussion surrounding the ability to pay cash interest or principal on those Notes while future Policy Claims remain unresolved. LVM Question 13.

Answer: AAC may be able to pay interest and/or principal on Surplus Notes if OCI believes such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

As per Section VII.D. of the Disclosure Statement, the payment of principal and interest on the Junior Surplus Notes is expressly subordinate in right of payment to the prior payment in full of all Indebtedness (including that evidenced by Surplus Notes), Policy Claims, and Prior Claims, and no payment of interest on or principal of the Junior Surplus Notes will be made until all existing and future Indebtedness, Policy Claims and Prior Claims have been paid in full.

l. Please explain what happens if the Commissioner decides to lower the cash percentage pay-out of claims. Would the lower percentage only apply to future claims? If so, would that be a preference for claims that have already been paid? LVM Question 28.

Answer: As described in Section IX.E of the Disclosure Statement, the Rehabilitator determined that the best way to ensure equitable treatment for all policyholders and avoid the consequences of having to subsequently lower the cash percentage was to set the cash percentage at a level low enough to withstand an outcome worse than any of the Rehabilitator's financial projections.

m. Does the submission of a claim under the Rehabilitation Plan and the approval of same require the policyholder to release and dismiss its pending appeals in this matter? LVM Question 29.

Answer: No.

n. If the Segregated Account is placed into liquidation, please explain whether the Surplus Notes would have a lower priority than policy claims. LVM Question 30.

Answer: *See* Wis. Stat. § 645.68 and the accompanying Liquidation Analysis.

7. **Maturity Date for Surplus Notes**

a. Please explain why the Commissioner selected June 7, 2020 as the maturity date for the Surplus Notes. LVM Question 21.

Answer: The June 7, 2020 maturity date was chosen so the Surplus Notes being issued pursuant to the Plan have the same maturity date as the Bank Settlement Notes and Weinstein Notes, which are also scheduled to mature on June 7, 2020.

b. Please explain and provide detail concerning whether the Commissioner intends to pay the principal amount of the Surplus Notes on June 7, 2020. LVM Question 22.

Answer: The payment of Surplus Note interest and principal will be determined by OCI based upon its consideration of AAC's financial condition at that time. In its review, OCI will consider if such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

c. If the Commissioner does not intend to pay the principal amount of the Surplus Notes on June 7, 2020, then please explain why the Commissioner selected that as the maturity date. LVM Question 23.

Answer: OCI has made no determination at this time as to whether the Surplus Notes will be redeemed in whole or in part on June 7, 2020. Any such determination made by OCI will be based upon its consideration of AAC's financial condition at that time. In its review, OCI will consider if such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

d. If the Commissioner does intend to pay the principal amount of the Surplus Notes on June 7, 2020, then please explain why the Commissioner modeled the payouts for the Surplus Notes to occur in 2050. LVM Question 24.

Answer: OCI has made no determination at this time as to whether the Surplus Notes will be redeemed in whole or in part on June 7, 2020. As noted on Page 65 of the Disclosure Statement, the Rehabilitator's Financial Projections are not intended to project the timing of any (i) change in the Cash Percentage or (ii) partial or full redemption of the Surplus Notes issued under the Plan, as such issues will be determined on an annual basis in accordance with the Plan.

e. If the Commissioner is undecided regarding whether he intends to pay the principal amount of the Surplus Notes on June 7, 2020, then please explain and provide detail regarding the standard the Commissioner will use to determine whether to do so. LVM Question 25.

Answer: Any such determination made by OCI will be based upon its consideration of AAC's financial condition at that time. In its review, OCI will consider if such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

f. Documents containing specific analysis (including, for example, alternate scenarios) and conclusions regarding the scheduled payment of the principal amount of the Surplus Notes on or about June 7, 2020. ALL Lloyds Question 38.

Answer: No specific analyses have been created regarding the payment of the Surplus Notes on or about June 7, 2020, nor has OCI reached a conclusion regarding the payment of Surplus Notes at that time. Any payment of Surplus Notes will be based on OCI's consideration of AAC's financial condition at that time, and whether such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

8. Policy Claims Maturing after June 7, 2020

a. How does the Plan provide for claims arising after June 1, 2020? RMBS Question 30.

Answer: In the event and at such time as the Rehabilitator determines that rehabilitation of the Segregated Account is not likely to be accomplished by June 1, 2020, he will seek prior approval of the Court to modify or amend the Plan and Plan Documents in accordance with Section 10.04 of the Plan to provide for the administration and settlement of claims arising after June 1, 2020, including appropriate specificity as to the terms of any surplus notes to be issued in connection therewith.

b. Please explain and provide detail concerning how the Commissioner intends to address Policy Claims maturing after June 7, 2020. For example, what process would policyholders use for submitting claims after that date? Would those policyholders receive Surplus Notes with a new maturity date? If so, what would be the maturity date for those post- 2020 claims? LVM Question 26.

Answer: *See* response above.

9. Remediation Claims, Defenses, Offsets and Credits

a. What analysis did OCI, AAC, or their respective financial consultants perform regarding the value or anticipated value, including the calculation and timing thereof, of the current or future remediation claims, defenses, offsets, and/or credits with respect to the policies allocated to the Segregated Account, and what did that analysis show? RMBS Question 2.

Answer: OCI and its advisors have considered (i) the calculation and timing of prospective remediation recoveries as incorporated in the Company's financial statements and (ii) potential defenses, offsets and considerations that may affect recoveries. OCI generally believes that AAC has valid claims in these matters, although the recoveries that may be achieved through these efforts are subject to numerous uncertainties. In its role as Rehabilitator of the Segregated Account, OCI intends to pursue such remediation claims until more clarification develops regarding the recoveries that may result from these efforts.

b. What cash proceeds do OCI and AAC estimate will be received through remediation efforts? RMBS Question 3.

Answer: OCI believes that the amount and timing of any benefits that may be received from representation and warranty remediation efforts is subject to numerous uncertainties and, as such, is difficult for OCI to estimate with any certainty at this time. In its role as Rehabilitator of the Segregated Account, OCI intends to pursue such remediation claims until more clarification develops regarding the recoveries that may result from these efforts.

c. What provisions, if any, does the Plan provide to ensure that cash proceeds from remediation efforts are in fact paid to policyholders in the Segregated Account? RMBS Question 4.

Answer: Any cash recoveries received from the remediation litigation or other efforts are subject to the lien set forth in the Secured Note and Aggregate Excess of Loss Reinsurance Agreement, and that Secured Note and Aggregate Excess of Loss Reinsurance Agreement provide for payment of claims pursuant to the terms of the Plan.

d. Please provide estimates and timing of subrogation recoveries from R&W remediation efforts. Please provide and summarize any reports or analyses detailing the size of the potential recoveries along with a discussion of the merits/probability of success of the litigation. LVM Question 3.

Answer: OCI believes that the amount and timing of any benefits that may be received from representation and warranty remediation efforts is subject to numerous uncertainties and, as such, is difficult for OCI to estimate with any certainty at this time. In its role as Rehabilitator of the Segregated Account, OCI intends to pursue such remediation claims until more clarification develops regarding the recoveries that may result from these efforts.

Notwithstanding the foregoing, Scenarios One and Three incorporate remediation recoveries that are in line with those contemplated by the Company's statutory reserves. As shown on page 13 of both Exhibits D and F, such remediation recoveries are estimated at $909 million in 2011 and $1,377 million in 2013.

10. Bank Notes; Credit Default Swaps Claims

a. How are the CDS Bank notes expected to operate, including but not limited to any expected or estimated payments, redemptions, and details of AAC's call options? RMBS Question 7.

Answer: As disclosed in SEC filings, call options have been negotiated with certain of the Bank Counterparties pursuant to which, with the prior consent of OCI, Ambac Assurance may repurchase Ambac Assurance Surplus Notes from such Counterparties. As of the date hereof, Ambac Assurance has options to call an aggregate of $940 million in principal amount of Ambac Assurance Surplus Notes at a weighted average call price of $0.22 per $1.00 face amount. At June 30, 2010, these options have a weighted average maturity of approximately 29 months.

At this time, OCI has not provided for a pay-out schedule for the CDS Bank Notes and has not approved the use of AAC's funds to exercise these call options. Any determination to redeem the CDS Bank Notes, pay interest on the CDS Bank Notes, or exercise the call options will be subject to OCI approval. OCI will consider if such payments (i) are reasonable and fair to the interests of AAC and the Segregated Account at that time, and (ii) protect and are equitable to the interests of AAC and Segregated Account policyholders generally.

> b. Are there any potential circumstances under which part or all of the CDS Settlement Agreement could be undone or unwound [by the Rehabilitator or this Court], and what would the resulting impact on the General Account, the Segregated Account and the Plan of Rehabilitation be? RMBS Question 8.

Answer: This issue is the subject of briefing in the first appeal arising out of this proceeding before the Wisconsin Court of Appeals. The Bank Settlement Agreement was lawfully consummated after the rehabilitation court and the Wisconsin Court of Appeals each denied the motions for preliminary injunctive relief prosecuted unsuccessfully by the RMBS and LVM Funds and the Rehabilitator submits that neither this Court nor the Rehabilitator has the authority to unwind that fully consummated transaction. The positive effect of that settlement on the General Account, Segregated Account and Plan is detailed in the Disclosure Statement, the Rehabilitator's briefs and affidavit on the issue, the Liquidation Analysis, and the Findings of Fact and Conclusions of Law issued by this Court in May 2010. This response is from the perspective of the Rehabilitator and this proceeding. Although outside the scope of the specific question, to the extent another person or entity like the RMBS Funds were injured by the Bank Settlement and could identify a legally cognizable claim, it would have an adequate remedy at law, given that the Bank Group members are clearly collectible.

> c. Explain why non-settling claims relating to credit default swaps ("CDS Claims") are being treated as Policy Claims under the Plan. LVM Question 31.

Answer: The Rehabilitator's position in regard to this question is detailed in his Reply Brief in Support of Confirmation submitted this same date. The LVM Funds who have pressed this issue have never been able to point to a single judicial decision which supports their speculative argument on this point. *See also* the arguments contrary to the LVM Funds' argument in the Amicus Brief filed in this matter by the Bank Group in connection with the May 2010 hearings on approval on the Bank Settlement.

d. Please provide us with an estimate of the projected amount of the CDS Claims. LVM Question 32.

Answer: Loss estimates for the Segregated Account CDS exposures:

- None of the Segregated Account CDS deals has stat reserves, but three do have GAAP reserves (totaling about $3.5 million as of 6/30).
- As per Disclosure Statement Projections:
    - Base Case Loss Estimates for these three deals are approximately $5 million to $6 million
    - Stress Case Loss Estimates for these three deals are approximately $18 million to $20 million

e. Provide detail concerning the factual issues bearing on the entitlement *vel non* of the holders of CDS Claims to policyholder priority, including but not limited to (i) the assets and liabilities of Ambac Capital Products at all times since it entered into agreements with these claimants and (ii) what losses, if any, have been suffered by each of these claimants. LVM Question 33.

Answer: *See* response above to Question 10(c).

f. Describe in detail the nature and results of any investigation undertaken by Ambac and/or the Commissioner of any legal or factual issues bearing on the entitlement *velnon* of the holders of CDS Claims to policyholder priority. LVM Question 34.

Answer: *Id.*

11. Releases and Indemnifications

a. Provide detail concerning the merits of the claims against Ambac, its directors, officers or other representatives, or other parties that the Plan would release or enjoin, or for which the Plan would provide immunity, including without limitation any claims arising out of (i) Ambac's payment of dividends on its common or preferred stock, or (ii) Ambac's transfers of assets, whether in the form of loans, securities purchases or capital contributions, to Ambac Capital Funding, Inc., Ambac Financial Services, LLC, Ambac Capital Services, LLC, Ambac Investments, Inc., Ambac Credit Products, LLC or other affiliates. This discussion should include a complete description of (a) Ambac's financial condition at the time of each of these dividend payments or other transfers; (b) the financial condition of each of the affiliates to which Ambac made loans, and the terms of each such loan; (c) the value of the securities that Ambac purchased from its affiliates; (d) the extent and nature of the benefits that Ambac. received as a result of its transfers to affiliates; (e) the positions at Ambac Financial Group or at any affiliate held by each Ambac officer and director who approved or otherwise participated in any of these transfers; and (f) the common stock of Ambac Financial Group held by each Ambac officer and director who approved or otherwise participated in any of these dividend payments, as well as any other compensation to which such officers and directors were entitled that was based on the value of the common stock of Ambac Financial Group. LVM Question 35.

Answer: The Rehabilitator is not aware of any viable present claims being released. Ambac's transactions with affiliates, including AFGI, now a debtor-in-possession, are detailed in their past publicly available SEC disclosures and statements, and more recently in connection with the AFGI bankruptcy. The Rehabilitator has taken steps, as noticed to all parties-in-interest in this proceeding, to protect AAC and the Segregated Account to the extent possible and practical from claims emanating from AFGI or the IRS respecting prior tax refunds received from AFGI. *See* Amendment One to the Plan of Operation.

b. Describe in detail the nature and results of any investigation undertaken by Ambac and/or the Commissioner of any of the claims against Ambac, its directors, officers or other representatives, or other parties that the Plan would release or enjoin, or for which the Plan would provide immunity, including without limitation the claims just noted. LVM Question 36.

Answer: *Id.*

12. Loss Estimates for the Segregated Account

a. What analysis did OCI, AAC, or their respective financial consultants perform regarding loss expectation, including the calculation and timing thereof, for the financial guaranty insurance policies and surety bonds allocated to the Segregated Account, and what did that analysis show? RMBS Question 1.

Answer: The total amount of unpaid claims in the Segregated Account which have accumulated due to the temporary claims-paying moratorium and the commencement of this rehabilitation on March 24 through September 30, 2010 was approximately $856 million. Those results comported generally with OCI's expectations based on prior analysis.

OCI and its advisors have closely tracked loss development trends at AAC since the first quarter of 2008. A variety of analyses were performed at various times prior to March 24, 2010, including but not limited to the following:

- ABS CDO collateral performance
- Delinquency and severity trends for certain AAC- wrapped RMBS transactions
- Review of RMBS and ABS CDO modeling assumptions, and development and/or review of sensitivity analyses created to demonstrate the impact of changes in certain assumptions on loss development
- Consideration of claim payments versus projections at a category and policy level
- Review of other stressed credits and/or categories, including TWC, LVM, and Student Loan exposures.

These analyses indicated that consummating a settlement with the bank counterparties alone was insufficient to ensure the equitable treatment of short-tail and long-tail policyholders, and that further regulatory action was required to protect the interests of policyholders generally.

b. What were the expected estimated losses and loss reserves for all exposures allocated to the Segregated Account when the Segregated Account was created, and how have those expected estimated losses and loss reserves changed since the creation of the Segregated Account? RMBS Question 6.

Answer: Pro forma for subsequent commutations, statutory reserves for exposures allocated to the Segregated Account increased by about $500 million from March 31, 2010 to June 30, 2010. Loss expectations, which are distinct from statutory reserves, generally increased for both RMBS and Student Loans during that time period.

c. All analyses performed by the Commissioner or Ambac of the current and future losses on (1) the ALL policies, (2) all other policies allocated to the Segregated Account, and (3) all other policies not allocated into the Segregated Account, including paid, case reserve and IBNR reserve losses, before determining to allocate those policies into the Segregated Account. ALL Lloyds Questions 3-5.

Answer: For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed. Furthermore, OCI objects as unduly burdensome to provide every analysis regarding current and future losses it may have considered or utilized in making its regulatory decisions.

d. Please detail the losses behind the allegation on p.59 of the Disclosure Statement that the RMBS Policies represent the largest category of Segregated Account exposures, accounting for 45% of all Policies and 63% of all net par outstanding allocated to the Segregated Account. ALL Lloyds Question 27.

Answer: As per page 62 of the Disclosure Statement, RMBS losses are expected to range from $4.8 billion to $6.3 billion, with breakouts by category (first lien and second lien). For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

e. Please detail the losses behind the allegation on p.59 of the Disclosure Statement that the student loan exposures represent 19% of all Segregated Account Policies and 24% of Segregated Account net par outstanding. ALL Lloyds Question 28.

Answer: As per page 62 of the Disclosure Statement, losses in respect of student loan Policies are expected to range from $298 million to $1.1 billion. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

f. Please detail the total statutory loss reserves associated with defaulted Segregated Account Policies, as of June 30, 2010, of approximately $1.7 billion, net of $2 billion of benefits related to projected R&W Remediation recoveries relating to ongoing representation and warranty breaches in certain RMBS transactions, implying total Policy Claims associated with such Policies of $3.8 billion, as alleged on p.61 of the Disclosure Statement. ALL Lloyds Question 29.

Answer: Category-level information for total statutory reserves associated with Segregated Account Policies is found on page 61 of the Disclosure Statement. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

g. Please detail the basis for the Segregated Account Base and Stress Case Loss Estimates as alleged in the Disclosure Statement. ALL Lloyds Question 30-31.

Answer: Per page 62 of the Disclosure Statement, the primary components of Segregated Account losses are first lien RMBS, second lien RMBS, and Student Loans. The following describes difference in base and stress case losses by category.

FIRST LIEN RMBS

Loss estimates for first lien RMBS are developed using a regression based loan-level model which estimates the effect of home price appreciation/depreciation, unemployment and interest rates on individual mortgage loans based on their specific characteristics. The model variables are derived from an analysis of approximately two million mortgage loans and are updated on a monthly basis.

Projections from Moody's Economy.com are used to forecast certain macro economic variables including home price appreciation and unemployment. The base case scenario generally uses Moody's Economy.com Baseline economic assumptions which reflect a rebound in confidence and a stronger recovery. The stress case scenario generally employs Moody's Economy.com S3 economic assumptions.

For each insured transaction, the performance of every single mortgage loan is simulated 300 times to determine each loan's expected performance. The individual mortgage loan results are then aggregated to develop the credit performance for the entire loan pool and input into deal specific Intex cash-flow models which estimate the losses on the insured securities. AAC continually refines and updates its analyses.

SECOND-LIEN RMBS

Estimates for second lien RMBS products are determined using a monthly roll-rate methodology which is applied on a deal specific basis. For each insured deal, the historical rate at which delinquent loans shift or roll into later delinquency categories along with the most current delinquency information is used to project a default curve for the life of the transaction. The lifetime prepayment and loss severity for each deal are also projected by examining historical data.

Delinquency roll rates and loss severity assumptions are run under more stressful conditions to estimate stress case losses. AAC continually refines and updates its analyses.

STUDENT LOANS

When developing the base and stress case loss scenarios for the student loan portfolio, projected losses were calculated on a deal-by-deal basis using issuer specific collateral data and performance information. Projections for macro economic variables and interest rates were then incorporated with the issuer specific data and liability structures to estimate expected losses.

The base case losses were premised upon models developed by the Company that employ (i) collateral loss estimates using issuer specific performance data and (ii) the then-prevailing forward LIBOR curve. Stress case losses reflect more significant collateral loss estimates and interest rates above the forward LIBOR curve. In addition, these loss estimates took into consideration the successful completion of certain active and consummated commutation negotiations. AAC continually refines and updates its analyses.

h. For both the Base Case and the Stress Case, please provide a detailed description of the schedules/assumptions regarding estimates of future defaults and payments under insurance policies in the Segregated Accounts. LVM Question 4.

Answer: Assumptions regarding future defaults and payments are described in 12.G. above. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

i. Please provide details on the policies in Segregated Account that are expected to produce the greatest amount of claims, as well as the projected amounts of those claims in both the Base Case and Stress Case. LVM Question 5.

Answer: *See* attached Table after signature page titled "Top 20 Policies by PV of Projected Loss."

j. Please discuss what gives rise to the difference in Loss Estimates between the Segregated Account Base Case and Stress Case scenarios ($5.6 billion vs. $8.0 billion). LVM Question 6.

Answer: *Please see* 14(g).

k. For policies in the Segregated Accounts, please provide us with the exposure amortization and policy payouts by asset class and year. LVM Question 7.

Answer: OCI objects as unduly burdensome.

l. Please provide us with detail concerning the Financial Guarantee investment cash receipts, including both principal and interest for the Segregated Account. LVM Question 9.

Answer: All investment portfolio principal and interest receipts are summarized in the cash flow statement of each scenario. OCI objects to providing further detail as unduly burdensome.

13. Loss Estimates for the General Account

a. Please detail the total outstanding paid claims associated with the General Account Policies, as of June 20, 2010. ALL Lloyds Question 32.

Answer: Claims paid associated with General Account Policies from the Filing Date to June 30, 2010 were approximately $9.9 million.

b. Please detail the total statutory loss reserves associated with General Account Policies, as of June 20, 2010. ALL Lloyds Question 33.

Answer: See page 59 of Disclosure Statement. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

c. Please detail the basis for the General Account Base and Stress Loss Estimates as alleged in the Disclosure Statement. ALL Lloyds Questions 34-35.

Answer: AAC uses a variety of methods to estimate potential losses. One of the approaches is a statistical expected loss approach based, which considers the likelihood of all possible outcomes. It considers such factors as: (i) the net par outstanding on the credit; (ii) internally developed historical default information (taking into consideration internal ratings and average life of an obligation); (iii) internally developed loss severities; and (iv) a discount factor. The loss severities and default information are based on rating agency information, are specific to each bond type and are established and approved by Ambac's senior management. Such estimates are further adjusted by the relevant remediation efforts and other material developments or potential developments based on the professional judgment of the surveillance analyst monitoring the credit with the approval of senior management. Another approach entails the use of more precise estimates of expected net cash outflows (future claim payments, net of potential recoveries, expected to be paid to the holder of the insured financial obligation). Ambac's surveillance group will consider the likelihood of all possible outcomes in developing cash flow scenarios.

To account for potential adverse developments in the public finance sector given the substantial amount of exposure insured by the General Account and recent developments in the municipal markets, the Rehabilitator developed a more severe loss scenario that incorporates higher than expected lifetime losses of around $1 billion.

d. For both the Base Case and the Stress Case, please provide a detailed description of the schedules/assumptions regarding estimates of future defaults and payments under insurance policies in the General Accounts. LVM Question 4.

Answer: See 13.c. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

e. Please provide details on the policies in General Account that are expected to produce the greatest amount of claims, as well as the projected amounts of those claims in both the Base Case and Stress Case. LVM Question 5.

Answer: *See* attached Table after signature page titled "Top 5 Policies by PV of Projected Loss."

f. For policies in the General Account, please provide us with the exposure amortization and policy payouts by asset class and year. LVM Question 7.

Answer: OCI objects as unduly burdensome.

g. Please provide us with detail concerning the Financial Guarantee investment cash receipts, including both principal and interest for the General Account. LVM Question 9.

Answer: All investment portfolio principal and interest receipts are summarized in the cash flow statement of each scenario. OCI objects to providing further detail as unduly burdensome.

14. The Reinsurance Agreement

a. What are the estimated liabilities, including the calculation and timing thereof, assumed by AAC as reinsurer under the Reinsurance Agreement? RMBS Question 5.

Answer: Under the Aggregate Excess of Loss Reinsurance Agreement, AAC is responsible for all losses of the Segregated Account in excess of the outstanding principle of the Secured Note, subject to the Minimum Surplus Amount ($100 million).

b. Please state who drafted the Reinsurance Agreement set forth by the Commissioner as part of the Plan that allegedly supports the Plan of Operation. Does the Reinsurance Agreement have a "follow the fortunes" clause? ALL Lloyds Question 19.

Answer: This question does not seek probative information. The Reinsurance Agreement was prepared with the advice of counsel. The provisions of the Reinsurance Agreement speak for themselves; a "follow the fortunes" clause is found at Article IV.

15. The Disclosure Statement

a. Please detail all actions taken and evidence supporting the actions in the section of the Disclosure Statement titled "Preventing Avoidable Losses and Unintended Consequences." This should include all documents that support these steps as well as all details and evidence as to why some policyholders (e.g. Sonic, Hertz) would have lost employees if the actions of the Commissioner were not taken as alleged by the Commissioner and Ambac. ALL Lloyds Question 12.

Answer: This question is argumentative, needlessly burdensome and not likely to lead to probative evidence. The Rehabilitator's efforts have been disclosed at great length in prior briefs and other submissions, including the various Peterson and Matanle Affidavits and the Disclosure Statement.

b. Please detail all actions taken and evidence supporting the actions in the following sections of the Disclosure Statement: (1) Providing an Equitable Solution; (2) Rehabilitating a Segregated Account; (3) Rejecting the Liquidation Option; (4) Assessment Process for Student Loans; and (5) Provision for Capital and Surplus. ALL Lloyds Questions 13-17.

Answer: The content of the Disclosure Statement speaks for itself. It was prepared with great effort by OCI and its advisors, with able assistance from the Management Services Provider, to be as accurate and complete as practical under the circumstances.

c. Please provide us with the P&I Schedule referenced on page one of Exhibit C to the Disclosure Statement Accompanying Plan of Rehabilitation. LVM Question 8.

Answer: Privileged and confidential; needlessly burdensome and not likely to lead to probative evidence.

d. Please proved detail [sic.] behind "Losses and LAE" and "Operating Expenses" in the Disclosure Statement financials. LVM Question 14.

Answer: Losses and LAE represent changes in Loss and LAE reserves other than through policy payments. Loss and LAE reserves represent the present value of expected losses, per the described scenario, calculated on a policy-by-policy basis net of any recoveries and include loss mitigation expenses such as attorney fees. Loss reserves for a policy are established upon the event of default which gives rise to a claim. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

As per Exhibit C of the Disclosure Statement, Operating Expenses were developed by the Rehabilitator's operational management consultants based upon a review of the Company's estimated 2010 operating cost structure and expectations regarding service levels and cost structure required in a runoff scenario. Year-over-year reductions in operating expenses are assumed to commence in 2012, and continue until a maintenance level of annual operating expenses is reached in 2017, with smaller reductions in operating expenses in future years.

e. Please explain and bridge between the "Income Statement" and "Cash Flow Statement" in the Disclosure Statement financials. LVM Question 15.

Answer: The income statement contains non-cash items, such as earned portions of unearned premium reserve, which would not be reflected on the statement of cash flows. The income statement would also only reflect that portion of investment portfolio principal and interest receipts deemed as income. Additionally, loss and LAE expenses are incurred when establishing loss and LAE reserves, which are based upon the present value of expected payments. Thus, further losses after establishment of the reserve are only incurred to the extent that payment expectations change and the present value of expected payments accretes over time. Other than in the first year a loss payment is made, the claim payment has likely already been expensed via the loss reserve mechanism. Finally, the other income and additional write-downs line item includes certain non-cash addition (reductions) to income such as write-downs of intercompany loans and the income and loss effects of the AUK commutation.

f. Please explain and provide detail behind "Dividends from Everspan" in the Disclosure Statement financials "Cash Flow Statement." LVM Question 16.

Answer: Everspan Financial Guarantee Corp is a subsidiary of AAC that is in possession of certain investment portfolio assets and liabilities, mostly in the form of unearned premium reserve and contingency reserve. For the purposes of the Financial Projections incorporated in the Disclosure Statement, it is assumed that the value of Everspan, recognized as \$173 million as of June 30, 2010 on AAC's balance sheet, will grow at 3% per annum until 2025. At such time most or all of Everspan's liabilities are presumed to have run off or have been released and the assets of Everspan are then assumed to be remitted to AAC via dividend at the end of 2025.

g. Please explain and provide detail behind "Contingency Reserve" in the Disclosure Statement financials "Balance Sheet." LVM Question 17.

Answer: A contingency reserve is created to capture unanticipated adverse developments not already captured by case loss reserves (which reflect anticipated losses). Most of the contingency reserve booked by AAC relates to Public Finance exposures. The methodology that is used to project contingency reserves (which is detailed in "Discussion of the Rehabilitator's Projections, Assumptions and Methodologies" in Exhibit C of the Disclosure Statement) is believed to be generally consistent with Wisconsin INS 3.08.

h. Please explain and provide detail behind the "Unassigned Surplus" line item in the Disclosure Statement financials. LVM Question 18.

Answer: Unassigned Surplus is an accounting construct under statutory accounting principals used by insurance companies that has a function analogous to Retained Earnings under Generally Accepted Accounting Principals. Further information on the general composition of this line item can be found in the Statements of Statutory Accounting Principals No. 72, paragraph 12.

i. Please explain and provide detail behind the calculation of "Loss Reserves", specifically the calculation of the "Statutory Reserves Associated with Segregated Account Policies as of June 30, 20 10" in Section VIII.B.3 .c. of the Disclosure Statement. LVM Question 19.

Answer: Losses and LAE represent changes in Loss and LAE reserves other than through policy payments. Loss and LAE reserves represent the present value of expected losses, per the described scenario, calculated on a policy-by-policy basis net of any recoveries and include loss mitigation expenses such as attorney fees. Loss reserves for a policy are established once first policy payment is made. For reasons of confidentiality and work-product, it is not appropriate to provide policy-by-policy analyses of estimated losses and reserves beyond what has been disclosed.

j. Please explain and provide detail behind the $126 million of "Commutations and Other" in the second half of 2010 as referenced in the Cash Flow Statements in Exhibits D through G of the Disclosure Statement Accompanying Plan of Rehabilitation. LVM Question 20.

Answer: The $126 million of Commutations and Other referenced in the cash flow data for the second half of 2010 reflects cash outflows associated with (i) the TWC commutation, (ii) the pending commutation of certain non-ABS CDO exposures as contemplated by the Bank Group Settlement (see pages 21-22 of the Disclosure Statement), and (iii) certain other commutations.

16. **The Projected Scenarios Under the Disclosure Statement**

> a. Please detail the basis for the four iterations, or scenarios, of the Rehabilitator's Financial Projections as alleged in the Disclosure Statement. ALL Lloyds Question 36.

Answer: OCI and its advisors believe that a broad range of possible outcomes exist in this situation, and that providing interested parties with scenarios that illustrate a relevant range of such possible outcomes was appropriate under the circumstances. OCI believes that the four scenarios incorporated in the Disclosure Statement are reasonable in the aggregate.

> b. Under how many of the projected scenarios in Exhibits D, E, F, and G to the Disclosure Statement are policyholders projected to recover 100% of the value of their claims? RMBS Question 19.

Answer: Under the Plan, the combination of cash and surplus notes paid to Segregated Account policyholders constitutes payment in full of policyholder claims. In Scenario One, AAC is expected to have sufficient resources to pay interest and principal on all surplus notes issued under the Plan in full, while other scenarios do not contemplate that AAC will have sufficient resources to pay surplus note interest and principal issued under the Plan in full.

> c. Have OCI, AAC, or their respective financial consultants determined the likelihood of the scenarios reflected in Exhibits D, E, F, and G to the Disclosure Statement? Does OCI or AAC consider any of the scenarios reflected in Exhibits D, E, F, and G to the Disclosure Statement as the Best Estimate of the outcome under the plan? RMBS Question 20.

Answer: OCI believe that a broad range of possible outcomes exist in this situation, and that providing interested parties with reasonable scenarios that illustrate a relevant range of such possible outcomes was appropriate under the circumstances. No probabilities have been assigned to any of these scenarios, and therefore no one scenario reflects the Best Estimate of outcomes under the Plan.

d. Under each of the projected scenarios in Exhibits D, E, F, and G to the Disclosure Statement, what are the amounts and timing of estimated payments? RMBS Question 21.

Answer: Assuming that "estimated payments" refer to Surplus Note payments, such payments are assumed to occur at the end of the Projection Period in 2050. This assumption is for modeling purposes only and does not reflect OCI's review as to when such payments may be made.

If "estimated payments" refers to cash portion of claim payments under the Plan, please see pages 13 through 16 of Exhibits D, E, F and G, which summarize cash payments made in respect of Segregated Account losses.

17. The Ambac Financial Group Bankruptcy

a. How will the anticipated AFG bankruptcy affect AAC, the Segregated Account and the Plan of Rehabilitation? RMBS Question 9.

Answer: Events will determine this answer, but effects could include (but are not limited to) the following:

- Limitation on usage of existing NOLs due to change in control or elimination of existing NOLs if the AFG Chapter 11 case converts to chapter 7;
- Possible rejection of existing tax sharing agreement; and
- Possible preference action, although the economic effect of such action has been limited by the recent allocation of this contingent claim to the Segregated Account.

b. What claims does OCI anticipate are likely to be filed by AFG against AAC's General Account or Segregated Account in the event of an AFG bankruptcy? RMBS Question 10.

Answer: Hopefully, none; the Amendment to the Plan of Operation allocates certain alleged avoidance actions that AFGI or its creditors purport to have against AAC to the Segregated Account.

c. What protections exist in the proposed Plan to ensure that Surplus Notes issued by the Segregated Account will be treated pari passu with Surplus Notes issued by the General Account, including the CDS Bank Notes, in the event that the General Account is placed into rehabilitation or liquidation? RMBS Question 27.

Answer: The Surplus Notes provide as follows in Section 10: "Any surplus or contribution notes or similar obligations of Ambac Assurance Corporation will rank *pari passu* with the Notes unless the terms thereof expressly state that such notes are subordinated to the Notes." Accordingly, by their terms, the Surplus Notes rank *pari passu* with the CDS Bank Notes. Similarly, the Disclosure Statement provides in Section IV.C.3 (page 21), Section IV.D (page 23), and Section VI.D (page 40) that the Surplus Notes are *pari passu* with the CDS Bank Notes (and the Weinstein Notes). Finally, in order to remove any lingering uncertainty as to this point, the Form of Surplus Note will be amended prior to the Effective Date of the Plan in order to expressly provide in Section 14(a) that in the event of the rehabilitation, liquidation, conservation or dissolution of the Issuer *or Ambac Assurance Corporation*, the Surplus Notes will immediately mature in full.

d. Pursuant to the terms of the proposed Plan, how will claims by the Segregated Account be treated by the General Account in the event that the General Account is placed into rehabilitation or liquidation in the future? That is, how will claims made pursuant to the Secured Note, the Aggregate Excess of Loss Reinsurance Agreement, and Surplus Notes issued by the Segregated Account be treated vis-à-vis General Account policyholder claims, General Account Surplus Notes claims, and General Account general creditor claims in a rehabilitation or liquidation of the General Account? RMBS Question 28.

Answer: The effect of delinquency proceeding under Chapter 645 with respect to the General Account (or all of Ambac) on the operation of the Secured Note, the Aggregate Excess of Loss Reinsurance or the Surplus Notes issued by the Segregated Account has not been evaluated by the Rehabilitator, however, generally speaking, any actions taken by OCI in such a scenario would be in the interests of policyholders, creditors, and the public.

e. What protections exist in the proposed Plan or otherwise to protect the value of AAC's NOLs in the event that AFG files for bankruptcy protection? RMBS Question 32.

Answer: The Plan is not the appropriate place to create "protections" in regard to protecting the value of AAC's interest in the NOLs held among the consolidated tax filing group pursuant to the AFG/AAC, *et al.* consolidated groups' 1991 Tax Sharing Agreement, as amended from time-to-time. The question is poorly stated because the NOLs are not presently "AAC's NOLs"; their disposition is governed by the consolidated groups' long-standing tax sharing agreement, as may be effected or changed pursuant to tax law, corporate law and the bankruptcy law now governing the AFG chapter 11 proceeding. The Rehabilitator has taken, and will continue to take, whatever steps seem to be prudent and productive at the time on this issue pursuant to the advice of tax and bankruptcy counsel.

18. Other Miscellaneous Questions

a. Please state who drafted the Secured Note set forth by the Commissioner as part of the Plan that allegedly supports the Plan of Operation? ALL Lloyds Question 20.

Answer: The Rehabilitator objects to this question as not being relevant or probative. Subject to the foregoing, it was prepared with the assistance of counsel.

b. What conditions are there in the Secured Note for payment? ALL Lloyds Question 21.

Answer: The conditions of the Note are as stated in the face of the Note. There are no secret conditions or terms.

c. Please disclose the details of any reports prepared by the Rehabilitator's operational management consultants relating to estimates of future operating expenses. LVM Question 11.

Answer: The Rehabilitator believes that the necessary information regarding operating costs are adequately detailed as presently stated in the Disclosure Statement. If any individual party-in-interest has a question about any particular specific cost item, the Rehabilitator, through his advisors, is willing to discuss the matter on an individual basis with the inquirer under appropriate confidentiality protections.

> d. Should the banks which are trustees for certain RMBS policies pay for the costs of obtaining any DTC securities position reports they order in connection with processing the transfer of surplus notes to their insured certificate holders? (Charles Brehm and Kimberly Jacobs affidavits; Wells Fargo and Bank of America, respectively.)

Answer: Based on the information available to it, OCI believes that these costs are *de minimus* (approximately $175 per CUSIP), that most such costs may properly be recovered by the trustees from the payments they are processing to their insured certificate holders, and that the trustees may easily reduce this modest cost by up to 90% by signing up for annual subscriptions. If the trustees wish to revisit this particular DTC-report cost issue in future years because it proves to be more onerous than presently appears to be the case, OCI will work with the trustees at that time as to whether some portion of the report costs the trustees are unable to conveniently recover through their insured certificate holders should be treated as an administrative expense.

Dated this 12th day of November, 2010.

FOLEY & LARDNER LLP

Michael B. Van Sicklen, SBN 1017827
Matthew R. Lynch, SBN 1066370
FOLEY & LARDNER LLP
150 East Gilman Street
Post Office Box 1497
Madison, Wisconsin 53701
Telephone: (608) 257-5035
Facsimile: (608) 258-4258

Kevin G. Fitzgerald, SBN 1007444
Frank W. DiCastri, SBN 1030386
Andrew A. Oberdeck, SBN 1052308
FOLEY & LARDNER LLP
777 East Wisconsin Avenue
Milwaukee, Wisconsin 53202
Telephone: (414) 271-2400
Facsimile: (414) 297-4900

Attorneys for Wisconsin Office of the Commissioner of Insurance and the Commissioner of Insurance of the State of Wisconsin, as the Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

Segregated Account - Top 20 Policies by PV of Expected Losses

		PV, 5.1%, as of 6/30/2010	
	Exposure Description	Base	Stress
1	Bankrupt Transportation Policy	$493,408,781	$504,260,338
2	Home Equity Lines of Credit (HELOC) Policy	$199,596,869	$241,545,077
3	Closed End 2nd Liens Policy	$155,488,597	$198,848,180
4	Closed End 2nd Liens Policy	$152,677,514	$185,116,029
5	Closed End 2nd Liens Policy	$129,348,207	$133,715,788
6	Closed End 2nd Liens Policy	$125,056,975	$149,546,712
7	Home Equity Lines of Credit (HELOC) Policy	$116,433,118	$202,056,498
8	Closed End 2nd Liens Policy	$100,008,285	$105,806,336
9	Negative Amortization Policy	$90,511,744	$106,439,391
10	Negative Amortization Policy	$90,375,969	$106,461,653
11	Interest Only Policy	$89,206,798	$121,210,729
12	Home Equity Lines of Credit (HELOC) Policy	$88,512,588	$116,575,385
13	Interest Only Policy	$84,640,181	$117,130,066
14	Negative Amortization Policy	$83,881,124	$88,778,734
15	Home Equity Lines of Credit (HELOC) Policy	$81,726,176	$120,946,269
16	Home Equity Lines of Credit (HELOC) Policy	$80,609,717	$103,523,105
17	Residential Mortgages - Sub-Prime Policy	$79,611,620	$173,466,638
18	Negative Amortization Policy	$70,984,179	$85,926,384
19	Interest Only Policy	$69,008,068	$85,801,844
20	Negative Amortization Policy	$67,566,810	$83,651,873

Notes:

Excludes claims presented and unpaid through June 30, 2010

Excludes policies with losses calculated under statistical methods

General Account - Top 5 Policies by PV of Expected Losses

	Exposure Description	PV, 5.1%, as of 6/30/2010 Base
1	Public Finance East Region Policy	$26,571,770
2	Public Finance East Region Policy	$17,071,199
3	Public Finance East Region Policy	$13,985,449
4	Public Finance East Region Policy	$10,750,090
5	Structured Credit Policy	$4,064,765

Notes:

See page 59 of Disclosure Statement for description of General Account Stress Case Loss Estimates