COPY

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

DISCLOSURE STATEMENT ACCOMPANYING PLAN OF REHABILITATION

The Commissioner of Insurance of the State of Wisconsin, as the Court-Appointed Rehabilitator of the Segregated Account of Ambac Assurance Corporation

2010 OCT -8 AM 10:40
DANE CO. CIRCUIT COURT

DATE: October 8, 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

DISCLAIMER

This Disclosure Statement, the Plan, and the rehabilitation proceeding (the "Proceeding") pertain solely to the Segregated Account and to the policies, rights, equity ownership interests, and liabilities specifically allocated to the Segregated Account in accordance with Wis. Stat. § 611.24. Pursuant to Wis. Stat. § 611.24(3)(e), the Segregated Account is a separate insurer. Ambac Assurance Corporation ("AAC" or the "General Account") is not in rehabilitation as a part of the Proceeding or otherwise. Neither this Disclosure Statement nor the Plan is intended to, or shall be deemed to, affect AAC or its General Account except as specifically stated herein or in the Plan.

Unlike a disclosure statement and plan of reorganization submitted to a bankruptcy court under title 11 of the United States Code, chapter 645 of the Wisconsin Statutes does not contemplate or permit voting on a plan of rehabilitation. Under Wis. Stat. § 645.33(5), the only approval required is that of the Dane County Circuit Court (the "Court"). Consequently, neither this Disclosure Statement nor the Plan is submitted for the purpose of facilitating voting, or for any purpose other than to provide information that tends to promote a full understanding of the Plan and the Proceeding generally. Although the disclosure contained herein is not required by the Wisconsin Statutes, the Rehabilitator views this Disclosure Statement to be consistent with his statutory mandate to protect the interests of insureds, creditors, and the public generally.

This Disclosure Statement summarizes and describes certain key components of the Plan, but is not a substitute for the Plan. The terms of the Plan will govern in case of any inconsistency between the Plan and this Disclosure Statement. A copy of the Plan is available on the Website. Capitalized terms used, but not otherwise defined, in this Disclosure Statement have the meanings ascribed to them in the Plan.

Neither the Plan nor this Disclosure Statement is required to be prepared in accordance with federal or state securities laws or other applicable law. None of the Securities and Exchange Commission ("SEC"), any state securities commission, or any similar public, governmental or regulatory authority has approved this Disclosure Statement or the Plan, or has passed on the accuracy or adequacy of the statements contained herein. Persons trading in or otherwise purchasing, selling or transferring securities of the Segregated Account should evaluate the Plan and this Disclosure Statement in light of the purpose for which it was prepared, and should also consider other publicly available information, including the materials on file with the SEC prepared by Ambac Financial Group, Inc. ("AFGI").

No registration statement under the Securities Act of 1933, as amended (the "Securities Act"), or any other federal or state securities or "blue sky" laws has been filed with the SEC or any other agency by the Rehabilitator or the Segregated Account with respect to the Surplus Notes and the Junior Surplus Notes that will be issued under the Plan. In conjunction with the Plan, the Segregated Account has submitted a letter to the SEC requesting a No-action Letter confirming the exemption of the issuance of the Surplus Notes from registration under Section 3(a)(10) of the Securities Act. The Segregated Account will also submit letters to the securities law administrator of each of the fifty states of the United States, the District of Columbia and the Commonwealth of Puerto Rico (collectively, the "Jurisdictions") requesting no-action letters or

written confirmation of the availability of securities registration exemptions for the issuance of Surplus Notes.

Except as specifically and expressly stated herein, this Disclosure Statement does not reflect any events that may occur subsequent to the date hereof. Such events may have a material impact on the information contained in this Disclosure Statement. The Rehabilitator does not intend to update the summary projections and underlying assumptions used by it to prepare its projected operating and financial results for AAC and the Segregated Account for the period from June 30, 2010 to December 31, 2050, (the "Rehabilitator's Financial Projections"), which are qualified by, and subject to, the assumptions set forth herein and the other information contained in this Disclosure Statement. The Rehabilitator's Financial Projections were not prepared with a view toward 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 the State of Wisconsin Office of the Commissioner of Insurance ("OCI"). The most recent SAP financial statements of AAC and the Segregated Account are available on the Website.

This Disclosure Statement may not be relied upon for any purpose other than to obtain information about the Plan and the Proceeding generally. Nothing contained herein will constitute an admission of any fact or of any liability by any party with regard to any claim or litigation, including, but not limited to, any proceeding involving the Rehabilitator, the Segregated Account or any other party, or any proceeding with respect to any legal effect of the rehabilitation of the Segregated Account or the transactions contemplated by the Plan and this Disclosure Statement.

None of AAC, the General Account, the Segregated Account or the Rehabilitator makes any warranty, express or implied, as to the accuracy or completeness of the information contained herein. In particular, events and forces beyond the control of the Rehabilitator may alter the assumptions upon which the disclosures in this Disclosure Statement are based.

This Disclosure Statement may contain statements that are, or may be deemed to be, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include those regarding consummation of the transactions contemplated by the Plan. Although the Rehabilitator believes that any such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Any such forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance or achievements of the Segregated Account to be different from any future results, performance and achievements expressed or implied by these statements.

TABLE OF CONTENTS

DISCLAIMER I

TABLE OF CONTENTS III

LIST OF EXHIBITS IX

KEY DOCUMENTS AVAILABLE ON THE WEBSITE X

I. INTRODUCTION 1

A. General Background 1

B. Ambac Assurance Corporation 1

C. Summary of AAC's Corporate Structure 2

D. Executive Summary of the Plan 2

II. BACKGROUND AND EVENTS LEADING TO REHABILITATION 3

A. Ambac's Deteriorating Financial Condition 3

B. The Commissioner's Response 4

C. Options Considered 5

1. OCI Objectives 5
a. Providing an Effective Solution 5
b. Narrowly Tailoring the Solution 6
c. Preventing Avoidable Losses and Unintended Consequences 6
d. Providing an Equitable Solution 6
e. Preserving Flexibility to Address Unknown Contingencies 7
2. Rehabilitating a Segregated Account 7
3. Rejecting the Complete Rehabilitation Option 8
4. Rejecting the Liquidation Option 8

D. Establishment of the Segregated Account and Filing of Petition for Rehabilitation 9

III. THE SEGREGATED ACCOUNT 10

A. The Plan of Operation 10

1. Allocations to the Segregated Account 10
a. Assessment Process for Student Loans 12
b. The One State Street Lease 13

2. Provision for Capital and Surplus 13
a. The Secured Note 13
b. The Reinsurance Agreement 14
c. Collateral Security 14
3. Other Rules of the Segregated Account 15

B. The Management Services Agreement 15

C. The Cooperation Agreement 16
1. Decision-Making and Shared Authority 16
2. Information Sharing 16
3. Tax Compliance 17
4. Allocation of Expenses 17

IV. SIGNIFICANT POST-PETITION ACTIONS 17

A. Entry of Order for Temporary Injunctive Relief 17

B. Formation of Ambac Rehabilitation Advisor Council 19

C. The Bank Group Settlement 19
1. Background 19
2. The BlackRock Appraisals 20
3. The Settlement 21
4. Objections by RMBS and LVM Movants 22

D. The Weinstein Settlement 23

E. Commutation of AUK Reinsurance Agreement 24

F. Other Commutations and Settlements 24

V. DETAILED SUMMARY OF THE PLAN 25

A. Implementation of the Plan 25
1. Continuation of the Segregated Account 25
2. Administration of the Plan 25

B. Treatment of Claims 26
1. Administrative Claims 26
2. Policy Claims 26
3. General Claims 26

C. Claims Administration 26
1. Claims Administration Responsibility 26
2. Submission of Administrative Claims 26

3. Submission of Policy Claims ... 27
4. Submission of General Claims ... 27
5. Evaluation of Pending Claims ... 27
6. Procedures for Treating and Resolving Disputed Claims ... 28
7. Alternative Resolutions of Claims ... 28

D. Distributions ... 29

1. Cash Distributions ... 29
2. Distributions of Surplus Notes ... 29
3. Distributions of Junior Surplus Notes ... 30
4. Subsequent Adjustments ... 31
5. Amendments to Cash Percentage and Surplus Note Percentage ... 31
6. Interest on Claims ... 31
7. Setoffs ... 31
8. Withholding and Reporting Requirements ... 31

E. Recoveries and Reimbursements on Policy Claims ... 32

F. Assignment of Rights ... 32

G. Annual Reports to Court ... 32

H. Matters Relating to Plan Confirmation ... 33

1. Conditions to Effectiveness of Plan ... 33
2. Amendment and Modification of the Plan ... 33
3. Revocation of the Plan ... 34

I. Effect of Plan Confirmation ... 34

1. Discharge of Claims; Permanent Injunction ... 34
2. Retention of Court Jurisdiction ... 35
3. Releases; Indemnification ... 36
4. Preservation of Certain Causes of Action ... 36
   a. Remediation Claims Relating to RMBS ... 37

J. Prior Orders and Agreements ... 37

K. Applicability of Federal and Other Securities Laws ... 37

1. Issuance of Surplus Notes Under the Plan ... 37
2. Transfers of Surplus Notes ... 38

L. Termination of Rehabilitation ... 38

VI. THE SURPLUS NOTES ... 38

A. Maturity and Interest; No Sinking Fund ... 38

B. Optional Redemption ... 39
C. Restrictions on Payment ... 39
D. Subordination ... 40
E. No Restrictive Covenants ... 42
F. Affirmative Covenants ... 42
G. Remedies ... 43
H. Meetings; Certain Rights of the Holders ... 43
I. Modification of the Fiscal Agency Agreement and Waiver ... 44
J. Merger, Consolidation or Sale by the Segregated Account ... 45
K. Book-Entry, Delivery and Form ... 45
L. Payments and Paying Agents ... 45
M. Governing Law ... 46
N. Fiscal Agent ... 46
O. Risks Relating to the Surplus Notes ... 47
VII. THE JUNIOR SURPLUS NOTES ... 47
A. Maturity and Interest; No Sinking Fund ... 47
B. Optional Redemption ... 48
C. Restrictions on Payment ... 48
D. Subordination ... 48
E. No Restrictive Covenants ... 50
F. Remedies ... 50
H. Risks Relating to the Junior Surplus Notes ... 51
VIII. RECOVERY ANALYSIS ... 52
A. General Account Assets Available to Pay Segregated Account (and other) Liabilities ... 52
1. Investment Portfolio Holdings ... 52

a. Market Liquidity of Investment Portfolio 54
2. Installment Premiums 54
3. Intercompany Loans 55
a. ACFI Intercompany Loans 55
b. AFS Intercompany Loans 55
4. Investment in Subsidiaries 56
5. Miscellaneous 56
a. Reinsurance Settlements 57
b. Accrued Interest and Cash 57
c. Certain Tax Attributes 57

B. Policy Liabilities of the General Account and the Segregated Account 57

1. Summary of Liabilities 57
2. General Account Exposures 57
a. Overview 57
b. Credit Profile 58
c. Loss Reserves 58
d. Prospective Losses 59
3. Segregated Account Exposures 59
a. Overview 59
b. Credit Profile 60
c. Loss Reserves 61
d. Prospective Losses 61
4. R&W Remediation Recoveries 62

C. Rehabilitator's Financial Projections 64

1. Principal Assumptions for the Rehabilitator's Financial Projections 64
a. General 64
b. Methodology 65
c. Plan Consummation and Pro Forma Balance Sheet 65
d. Other Assumptions 65
2. Description of Rehabilitator's Financial Projections Scenarios 65
a. Overview 65
b. Scenario One 66
c. Scenario Two 66
d. Scenario Three 66
e. Scenario Four 66
3. Recovery of Surplus Note Principal and Interest under the Rehabilitator's Financial Projections 66
a. Scenario One 67
b. Scenario Two 67
c. Scenario Three 67
d. Scenario Four 68

IX. RATIONALE FOR CASH AND SURPLUS NOTE PERCENTAGES 68

A. Loss Development 69

B. Uncertain Outcome of R&W Remediation Recoveries 69

C. Preservation of Claims-Paying Resources for the Benefit of all Policyholders... 69

D. Sensitivity Analysis on Initial Cash Percentage 69

E. Conclusion 70

X. TAX CONSEQUENCES IF THE PLAN IS CONFIRMED... 71

A. Classification of the Notes and the Segregated Account 72

B. Tax Consequences to AAC and the Segregated Account.................................... 73

C. Tax Consequences to U.S. Holders... 74

1. Satisfaction of Claims 74
2. Accrual of Interest... 74
3. Disposition of Notes 74
4. Backup withholding and information reporting....................................... 75

XI. CONCLUSION... 75

INDEX OF DEFINED TERMS.. 1

LIST OF EXHIBITS

Exhibit A: Corporate Organizational Chart

Exhibit B: Risk Classifications

Exhibit C: Discussion of the Rehabilitator's Financial Projections, Assumptions and Methodologies

Exhibit D: Projected Financial and Operating Results Associated with Scenario One

Exhibit E Projected Financial and Operating Results Associated with Scenario Two

Exhibit F: Projected Financial and Operating Results Associated with Scenario Three

Exhibit G: Projected Financial and Operating Results Associated with Scenario Four

KEY DOCUMENTS AVAILABLE ON THE WEBSITE

www.ambacpolicyholders.com

The following key documents, among other important documents and pleadings from the Proceeding, are (or will be) available on the Website, as indicated.

Key Documents Currently Available

1. Plan of Rehabilitation

   Exhibits: Form of Fiscal Agency Agreement
   Form of Surplus Note
   Form of Proof of Policy Claim Form
   Form of Junior Surplus Note

2. Disclosure Statement

   Exhibits: Corporate Organizational Chart
   Risk Classifications
   Discussion of the Rehabilitator's Financial Projections, Assumptions and Methodologies
   Projected Financial and Operating Results Associated with Scenario One
   Projected Financial and Operating Results Associated with Scenario Two
   Projected Financial and Operating Results Associated with Scenario Three
   Projected Financial and Operating Results Associated with Scenario Four

3. List of Policy and CUSIP Numbers Allocated to the Segregated Account as of October 8, 2010

4. Plan of Operation for the Segregated Account

5. Management Services Agreement (Exhibit A to the Plan of Operation)

6. Cooperation Agreement (Exhibit B to the Plan of Operation)

7. Assumed Reinsurance Agreements Allocated to the Segregated Account (Exhibit F to the Plan of Operation)

8. Secured Note (Exhibit G to the Plan of Operation)

9. Aggregate Excess of Loss Reinsurance Agreement (Exhibit H to the Plan of Operation)

10. Order for Rehabilitation

11. Order for Temporary Injunctive Relief
12. Quarterly Statement of the Segregated Account as of and for the three months ended March 31, 2010
13. Quarterly Statement of the Segregated Account as of and for the six months ended June 30, 2010
14. Audited Statutory Financial Statements of AAC as of and for the year ended December 31, 2009
15. Annual Statement of AAC as of and for the year ended December 31, 2009
16. Quarterly Statement of AAC as of and for the three months ended March 31, 2010
17. Quarterly Statement of AAC as of and for the six months ended June 30, 2010

Key Documents Forthcoming

18. No-Action Letter Request
19. No-Action Letter
20. OCI letter approving issuance of Surplus Notes and Junior Surplus Notes
21. Notice of Effective Date of the Plan

I. INTRODUCTION

A. General Background

SEAN DILWEG, the duly appointed and confirmed Commissioner of Insurance of the State of Wisconsin (the "Commissioner"), in his capacity as the duly appointed Rehabilitator of the Segregated Account (the "Rehabilitator"), submits this Disclosure Statement, dated October 8, 2010 (the "Disclosure Statement"), to accompany the Plan of Rehabilitation (the "Plan") for the Segregated Account of Ambac Assurance Corporation (the "Segregated Account").

Unlike a disclosure statement and plan of reorganization submitted to a bankruptcy court under title 11 of the United States Code, chapter 645 of the Wisconsin Statutes does not contemplate or permit voting on a plan of rehabilitation. Under Wis. Stat. § 645.33(5), the only approval required is that of the Court. Consequently, neither this Disclosure Statement nor the Plan is submitted for the purpose of facilitating voting, or for any purpose other than to provide information that tends to promote a full understanding of the Plan and the Proceeding generally. Although the disclosure contained herein is not required by the Wisconsin Statutes, the Rehabilitator views this Disclosure Statement to be consistent with his statutory mandate to protect the interests of insureds, creditors, and the public generally.

The Plan is being filed with the Court simultaneously with this Disclosure Statement, and is available online at www.ambacpolicyholders.com (the "Website"). Copies of other pleadings and papers filed in the Proceeding can also be found on the Website.

AAC established the Segregated Account pursuant to section 611.24(2) of the Wisconsin Statutes (2007-08, as amended) (hereinafter, "Wis. Stat.") with the approval of the Commissioner and in accordance with the Plan of Operation for the Segregated Account (the "Plan of Operation"). Pursuant to the Plan of Operation, specified policies, rights, and liabilities, together with the limited liability member interests held by AAC in Ambac Credit Products, LLC ("ACP"), Ambac Conduit Funding, LLC, Juneau Investments, LLC, and Aleutian Investments, LLC (collectively, the "Allocated Subsidiaries"), have been allocated to the Segregated Account. Wisconsin law treats the Segregated Account as a separate insurer within the meaning of Wis. Stat. § 645.03(1)(f) for the purposes of an insurance delinquency proceeding such as the Proceeding.

B. Ambac Assurance Corporation

AAC is a Wisconsin-domiciled insurance company. It was incorporated under the laws of Wisconsin as CMI Credit Insurance, Inc. on February 25, 1970, and is a wholly-owned subsidiary of AFGI, a corporation headquartered in New York City, the stock of which is publicly traded on the New York Stock Exchange. NEITHER AAC NOR ITS GENERAL ACCOUNT, NOR ANY OF THE POLICIES, CONTRACTS, ASSETS, EQUITY OWNERSHIP INTERESTS AND RIGHTS OR LIABILITIES IN THE GENERAL ACCOUNT, IS IN REHABILITATION AS PART OF THE PROCEEDING OR OTHERWISE.

AAC provided financial guarantees and, through its subsidiaries, financial services to entities in both the public and private sectors around the world (AAC and its subsidiaries are collectively referred to herein as "Ambac"). As a result of negative rating agency actions, as well as investor concern with respect to these actions, AAC has not written a meaningful volume of financial

guarantee business since November 2007 and no new business since mid-2008. Ambac's principal business strategy is to increase the residual value of its financial guarantee business by mitigating losses on poorly performing transactions and maximizing the yield on its investment portfolio.

AAC offered financial guaranty insurance on investment-grade municipal debt and structured-finance debt obligations, such as municipal bonds and residential mortgage-backed securities ("RMBS"). Financial guaranty insurance provides a guarantee that protects the holder of a fixed-income obligation against non-payment of principal and interest when due. AAC also guaranteed some structured-finance debt obligations indirectly, whereby ACP, a wholly-owned subsidiary of AAC, would enter into a credit-default swap ("CDS") with a counterparty that protected the counterparty from the non-payment of principal and interest when due on an underlying reference obligation, and AAC would, in turn, guarantee the financial obligations of its subsidiary.

C. Summary of AAC's Corporate Structure

Attached as Exhibit A is a Corporate Organizational Chart for AFGI depicting the relationships between it, AAC and their various subsidiaries and affiliates as of the date of this Disclosure Statement.

D. Executive Summary of the Plan

Set forth below is an executive summary of the Plan, which is qualified in its entirety by reference to the provisions of the Plan itself. For a detailed summary of the Plan, see Section V. of this Disclosure Statement. Capitalized terms not otherwise defined in this section have the meanings ascribed to them in the Plan.

Claims against the Segregated Account will be settled and paid in accordance with the terms and conditions of the Plan. Following confirmation of the Plan, any Holder of a Claim against the Segregated Account (including, in the case of a Policy Claim, the named beneficiary of the related Policy), regardless of when such Claim arises, is limited exclusively to the treatment afforded such Claim under the Plan. The Rehabilitator anticipates that the Segregated Account will exist until its obligations have been extinguished or are of minimal amount.

All claims-paying resources of the General Account will be available to pay Claims, subject to the Minimum Surplus Amount described below in Section III.A.2.a. of this Disclosure Statement. "Claims-paying resources" refers to the economic resources available to AAC to pay operating expenses, obligations under the Secured Note, the Reinsurance Agreement and the Cooperation Agreement, and General Account claims. Claims-paying resources include items quantified on AAC's statutory balance sheet (such as investment portfolio holdings, intercompany loans, investments in subsidiaries and certain miscellaneous assets) and other sources of value (such as the present value of future installment premiums).

Holders of Permitted Administrative Claims will receive, in accordance with the terms and conditions of the Plan, Cash in the full amount of such Claims.

Holders of Permitted Policy Claims will receive, in complete satisfaction of such Claims, a combination of Cash payments and 5.1% interest-bearing, unsecured surplus notes that are

scheduled to mature on June 7, 2020 (the "Surplus Notes"). As of the day on which the Rehabilitator designates the Plan as being effective in accordance with the Plan (the "Effective Date"), the Cash/Surplus Note split will be 25% Cash and 75% Surplus Notes. As a result, the Holder of a Permitted Policy Claim is expected to receive (i) Cash equal to 25% of such Claim and (ii) Surplus Notes with a face value equal to 75% of such Claim.

Holders of Permitted General Claims will receive, in complete satisfaction of such Claims, 5.1% interest-bearing, unsecured junior surplus notes in a principal amount equal to the dollar amount of such Claims (the "Junior Surplus Notes").

Notwithstanding the foregoing, the Rehabilitator retains the flexibility to engage in Alternative Resolutions of Claims where such resolutions are, in the Rehabilitator's sole and absolute discretion, equitable to the Holders of Policy Claims generally.

II. BACKGROUND AND EVENTS LEADING TO REHABILITATION

AAC is a Wisconsin-domiciled insurance company. It was incorporated under the laws of Wisconsin as CMI Credit Insurance, Inc. on February 25, 1970.

AAC was one of the largest "monoline" financial guarantee insurers in the world, meaning that it exclusively wrote financial guarantee insurance policies and did not offer property, casualty, life, disability, or other forms of insurance. AAC provided financial guarantees and, through its subsidiaries, financial services to entities in both the public and private sectors around the world.

Following its incorporation, Ambac's business grew steadily, particularly after it obtained a AAA credit rating from Standard & Poor's Ratings Service, a Standard & Poor's Financial Services LLC business ("S&P"), in 1975 and a Aaa rating from Moody's Investors Services, Inc. ("Moody's") in 1987. Those ratings, combined with some well-publicized municipal defaults in the 1970s and 1980s, increased the demand for AAC's bond insurance policies. In the mid-1990s, Ambac began to diversify its business by offering financial guarantee insurance on "structured finance" investments.

Ambac also expanded many aspects of its business internationally through various affiliates. By 2007, more than 10 percent (or roughly $55 billion) of the par value of indebtedness insured by AAC was internationally based.

A. Ambac's Deteriorating Financial Condition

In 2008, Ambac's financial condition began to be adversely affected by the effects of problems arising from mortgage lending practices in the United States. Ambac underwrote exposure to the U.S. mortgage market primarily in two forms: (1) direct financial guarantees on RMBS and (2) CDS on collateralized debt obligations backed primarily by RMBS ("ABS CDOs"). RMBS and other mortgage financial instruments that Ambac insured or invested in suffered significant actual and expected future losses in 2008. As a result, AAC's projected future liabilities grew, leading to a decline in its financial strength ratings and statutory surplus.

In 2009, Ambac made approximately $1.6 billion in gross claim payments, with the vast majority related to RMBS obligations. (In comparison, Ambac made approximately $177 million in gross

claim payments from 2003 through 2007.) As a result, OCI became concerned with the rate at which such payments were reducing Ambac's claims-paying resources. OCI believed that, based on its review of Ambac's claims projections, absent regulatory intervention, Ambac could be obligated to pay in excess of $2 billion in gross claim payments relating to RMBS obligations in 2010. In addition, Ambac's claims-paying resources decreased as a result of the decline in the fair value of many of its long-term investments, including RMBS. AAC's qualified statutory surplus decreased 83% from $6.4 billion as of December 31, 2007 to $ 1.1 billion as of December 31, 2009. "Qualified Statutory Surplus" means the sum of (i) policyholder surplus (including any surplus notes) and (ii) contingency reserves.

AAC's financial strength ratings from the major credit rating agencies, such as S&P and Moody's, declined from the "AAA" level held at the beginning of 2008 to levels indicating "extremely weak" or "very poor" financial security by mid-2009. These rating downgrades, from the highest possible ratings to some of the lowest possible, triggered certain contractual provisions requiring Ambac to post substantial additional collateral, thus further diminishing Ambac's general claims-paying resources. The financial strength rating downgrades also adversely impacted Ambac's ability to generate new business. As a result, Ambac's principal business strategy is to maximize returns to policyholders by mitigating losses on poorly performing transactions and maximizing the yield on its investment portfolio.

By the end of 2009, OCI believed that the events described above created a hazard for policyholders. As of December 31, 2009, Ambac's investment portfolio assets (excluding intercompany loans) had a fair value of approximately $6.8 billion, and the present value of future installment premiums was expected to be $1.9 billion (inclusive of AAC's assumed reinsurance). Because many of Ambac's investment portfolio assets are currently under-valued, sales today to pay claims could result in realized losses for AAC in a forced sale scenario and result in a net loss of claims-paying resources for policyholders as a whole.

B. The Commissioner's Response

In response to these events, the Commissioner increased his oversight of AAC's capital position, financial health and business activities. In 2008 and 2009, AAC engaged in discussions with various policyholders regarding bilateral restructurings and commutations. Several of those negotiations resulted in successful commutations (that OCI vetted and "non-disapproved" under Wisconsin insurance law) that removed certain troubled policies from AAC's insured portfolio books for a percentage of their projected ultimate losses. AAC made approximately $1.9 billion in commutation payments in 2008, and another $1.4 billion in 2009. While these commutations improved AAC's financial condition, OCI determined that further "one-off" commutation transactions alone would be insufficient to resolve the mounting financial challenges facing the company.

Engaging in such negotiations with all AAC policyholders and beneficiaries was impractical for a number of reasons. AAC had almost 15,000 policies across many distinct exposure categories. There was no practical way to identify the beneficiaries of all policies. Further, any non-confidential discussions with policyholders would have greatly enhanced the risk that parties would have attempted to exercise certain triggers based on Ambac's financial condition contained in their contracts with Ambac, which, if successful, could have materially and adversely affected AAC's financial condition. Therefore, such discussions were generally

limited to policyholders or groups of policyholders that were readily identifiable, well-organized, and willing to conduct all negotiations pursuant to written confidentiality agreements.

As AAC's claims payments and projected losses mounted and its liquid claims-paying resources eroded, it became increasingly clear to OCI that some type of affirmative regulatory action under chapter 645 of the Wisconsin Statutes would be necessary to slow the current and projected short-term outflow of AAC's claims-paying resources and to prevent certain policyholders from attempting to utilize certain triggers based on Ambac's financial condition contained in their contracts. OCI concluded that, absent regulatory action, there was a growing risk that AAC could become insolvent before it satisfied all of its obligations under in-force policies.

To assist OCI in its steadily increasing levels of oversight, OCI retained financial advisors and legal counsel with expertise pertaining to the specialized types of policies written by AAC, the financial guaranty insurance business, restructuring, and Wisconsin insurance law. These professionals helped the Commissioner and his staff engage in a careful, time-consuming monitoring and evaluation of AAC's financial condition, and in their discussions and negotiations with the company and various policyholders and policyholder groups regarding restructurings, commutations, intercompany transactions, and Commissioner non-disapprovals, and related matters.

To avoid having AAC's financial condition continue to deteriorate, or possibly decline in the future into statutory insolvency, the Commissioner and his staff and professional advisors met extensively over many months with AAC and its advisors, with various policyholders and groups of policyholders, and with insurance industry experts in regard to possible restructuring plans for the company. In that time, the Commissioner evaluated and considered various restructuring options.

C. Options Considered

In OCI's view, AAC's condition earlier this year left OCI with two realistic regulatory choices: (1) place all of AAC into a chapter 645 rehabilitation proceeding or (2) request AAC to form a segregated account, and limit the rehabilitation to only the segregated account, while leaving most policies in the General Account. Other options, including complete liquidation of Ambac or a liquidation of a segregated account, were rejected as not being viable alternatives.

1. OCI Objectives

Consistent with its statutory directive to protect the interests of insureds, creditors and the public, OCI applied the following objectives in developing and deciding upon a regulatory solution to AAC's condition.

a. Providing an Effective Solution

First and foremost, OCI determined that any regulatory action needed to be effective in curtailing claims payments on short-dated claims in order to avoid exhausting AAC's claims-paying resources before a fuller understanding of likely policy losses was achieved. Accordingly, OCI concluded that any solution adopted would need to include a temporary claims payment moratorium followed by partial cash payments on claims.

Second, OCI recognized that the solution must address the uncertainty surrounding AAC's significant exposure to ABS CDOs, particularly as it related to the potential claims for accelerated, mark-to-market termination payments in a magnitude exceeding AAC's claims-paying resources. Without a resolution of most of those liabilities, any regulatory solution would have required AAC to hold onto all of its claims-paying resources until a significant degree of certainty could be achieved as to the magnitude and timing of such liabilities. Accordingly, OCI facilitated the settlement of Ambac's ABS CDO exposure with the Bank Group, as discussed in detail in Section IV.C. of this Disclosure Statement.

b. Narrowly Tailoring the Solution

Third, OCI determined that any regulatory solution must be narrowly tailored in order to address the causes of AAC's deteriorating financial condition. At the same time, OCI believed it was important to provide durable coverage with respect to those policies or categories of business that did not threaten AAC's financial condition and to maximize Ambac's ability to actively manage certain books of business to remediate risks and prevent deterioration.

c. Preventing Avoidable Losses and Unintended Consequences

Fourth, OCI determined that its regulatory solution should avoid exacerbating the financial distress of AAC, and the resulting incremental harm that such distress could cause for its policyholders and the public. In many instances, the contracts and instruments governing transactions insured by Ambac contain "trigger provisions" which could, in response to a rehabilitation of AAC, cause financings guaranteed in whole or in part by Ambac to suffer financial distress, give rise to losses or cause losses to increase or to become accelerated. These developments, as well as the potential for impairment of AAC's transactional control rights, made it more likely that policy claims would arise and/or reduce or eliminate AAC's ability to recover all or a portion of amounts paid in claims, all of which would harm AAC's policyholders. Though the potential increase in claims is difficult to quantify because it involves many contingencies and subjective evaluations, taking into consideration solely a subset of commercial asset-backed deals, where the size of the deal, its structure, or credit quality suggests that these concerns could be particularly relevant, OCI concluded that a potential increase in claims of $1 billion or more was possible. Accordingly, OCI sought a solution that avoided these risks to the greatest extent possible by keeping the majority of AAC's policies outside of a rehabilitation proceeding.

d. Providing an Equitable Solution

OCI recognized that given its objectives to (i) narrowly tailor any rehabilitation to preserve the durable coverage provided by AAC, (ii) preserve claims-paying resources so that payments on claims maturing at different times would be substantially equal, and (iii) avoid new or increased losses by keeping the majority of AAC's policies out of a rehabilitation proceeding, any solution would necessarily involve subjecting some policies to regulatory action but not others. Accordingly, OCI determined that any regulatory solution must treat policies that *are* subject to a rehabilitation proceeding equitably.

These objectives led OCI to decide that policies with material projected losses would need to be subject to any rehabilitation proceeding. If such policies were not subject to the claims moratorium and partial cash claims payments deemed necessary by OCI to avoid exhausting

AAC's claims-paying resources, such policies with shorter term maturities or expected claims payments could unfairly drain claims-paying resources at cash payments of 100 cents on the dollar while longer-dated claims would be subject to uncertainty. Furthermore OCI decided that policies subject to the Proceeding should have access to AAC's full claims-paying resources, subject only to necessary limitations to preserve the ability of AAC to continue to operate.

e. Preserving Flexibility to Address Unknown Contingencies

Finally, OCI determined that given the many contingencies surrounding AAC's claims liabilities and claims-paying resources and the many uncertainties in the economy generally, which has affected, and will continue to affect, the performance of AAC's insured portfolio, it needed to preserve flexibility in its regulatory solution to adjust for outcomes better or worse than projected. Thus, OCI has preserved for itself the right to take additional regulatory action in the event that the economy worsens and OCI's advisors begin to project significant additional losses. On the other hand, in the event that general economic conditions improve and actual claims experience is significantly less than projected, OCI has preserved its ability to increase the percentage of cash claim payments, , to all policyholders, and ultimately to permit Ambac to engage in the business of insuring public-finance bonds, most likely through its subsidiary, Everspan Financial Guaranty Corp. ("Everspan"). Note, however, that OCI does not currently contemplate a scenario in which it would permit the capitalization and resumed business of Everspan in the near term.

2. Rehabilitating a Segregated Account

In considering the above objectives, OCI determined that the best option was to request AAC to form the Segregated Account, allocate to the Segregated Account only those policies, categories of policies or parts of its business for which a rehabilitation proceeding was necessary, and then limit the rehabilitation proceeding to the Segregated Account. The reasons that OCI determined the segregated account option to be the best option, among others, are as follows:

- It provided an effective mechanism for slowing claims payments through the claims moratorium initially and ultimately through the payment of claims with a combination of Cash and Surplus Notes as set forth in the Plan.

- It addressed the need for rehabilitation of certain troubled policies and segments of AAC's business, while minimizing the risk of a regulatory proceeding with respect to the entire company, which could have caused an increase in losses and a reduction in claims-paying resources.

- By providing continuing, durable coverage for certain exposures held by members of the Bank Group which were not settled in connection with the Bank Group Settlement, it facilitated the favorable settlement of AAC's exposure to ABS CDOs to the benefit of all Segregated Account policyholders.

- It avoided undermining the durable coverage provided by the majority of AAC's financial guarantees.

3. Rejecting the Complete Rehabilitation Option

OCI evaluated the possibility of a rehabilitation of AAC as a whole under these objectives, and ultimately concluded that a full rehabilitation of AAC had substantial drawbacks that would have hindered OCI's efforts to minimize the broader effects of the distress on AAC, its policyholders, and the public. The reasons that OCI rejected the full rehabilitation approach, among others, are as follows:

- It failed to preserve the durable coverage provided by AAC's financial guarantees and, in particular, risked detrimental effects on the broader economy stemming, primarily, from rehabilitation of the General Account.
- Counterparties may have attempted to exercise certain transactional control rights otherwise reserved solely to AAC that could have resulted in increased losses or reduced claims-paying resources.
- It could have caused an undue hardship on certain issuers whose obligations are insured by AAC in the form of accelerated payments, interest rate increases or termination of the financing facility.
- While OCI may have been able to forestall some of the increased losses in a full rehabilitation scenario through the use of a court ordered injunction, subjecting all of Ambac's business to a rehabilitation proceeding (at least an additional $300 billion in net par outstanding) would have unnecessarily exposed policyholders to materially greater risk.
- A full rehabilitation of AAC would also have been grounds for termination of the forbearance and standstill agreements entered into with the Bank Group, which would have permitted the fourteen members of the Bank Group to assert "mark-to-market" damage claims against AAC of approximately $12.9 billion per the analysis by a neutral appraiser. Members of the Bank Group had divergent interests and exposures with respect to Ambac, but their desire to avoid the collateral damage of a full rehabilitation influenced the parties to continue negotiations. By triggering the very collateral damage the parties wished to avoid, a full rehabilitation would have reduced incentives for members of the Bank Group to compromise their claims in a settlement. Not being able to consummate the Bank Group Settlement, which eliminated the $12.9 billion mark-to-market exposure for $4.6 billion in total payments, would have resulted in possible additional losses of as much as $8.3 billion, which would have directly diluted the recovery of all other claimants in a full rehabilitation.

4. Rejecting the Liquidation Option

OCI determined that a liquidation of either Ambac as a whole, or of only the Segregated Account, would have had severe drawbacks for policyholders as a whole and was, therefore, inconsistent with Wis. Stat. § 645.01(4), which states that the purpose of the Act is to protect the interests of insureds, creditors and the public generally. The liquidation options were rejected for a variety of reasons.

First, pursuant to Wis. Stat. § 645.43, a liquidation proceeding would result in the termination of all policies in force fifteen days after the issuance of the liquidation order, at the latest, with no clear provision for the payment of future expected losses, thereby leaving many AAC policyholders with uncertainty about future coverage and the resultant priority of their claims under Wis. Stat. § 645.68. Even those policies with unpaid losses incurred through fifteen days after the liquidation order that would be entitled to payment as Class (3) policy claims under the distribution scheme of Wis. Stat. § 645.68, would, at best, recover from a much smaller pool of claims-paying resources and over a longer time frame. In the event of a liquidation, AAC would be required to return unearned premiums of approximately $2.4 billion and would no longer have the right to receive approximately $1.9 billion in future installment premiums (net of reinsurance and discounted at 5.1%) as of December 31, 2009. An additional disadvantage of placing just the Segregated Account into liquidation rather than rehabilitation is that it would require under Wis. Stat. § 611.24(3)(e) that the General Account then be placed into rehabilitation. Placing the General Account into Rehabilitation would trigger the adverse consequences discussed above in Section II.C.3, including increased losses from failure to consummate the Bank Group Settlement of as much as $8.3 billion.

D. Establishment of the Segregated Account and Filing of Petition for Rehabilitation

On March 24, 2010, AAC's board of directors voted to: (a) create the Segregated Account; (b) allocate certain policies, rights, equity ownership interests and liabilities to the Segregated Account; (c) provide a secured note and reinsurance contract from AAC in favor of the Segregated Account to pay claims as they arise; and (d) consent to the placement of the Segregated Account into rehabilitation. The Segregated Account was 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 in accordance with a court-approved plan. The Commissioner approved the establishment of the Segregated Account and subsequently petitioned the Court to commence formal rehabilitation of the Segregated Account (the "Petition").

On March 24, 2010, the Court entered the Rehabilitation Order, by which the Commissioner's Petition was granted. With entry of the order, the Segregated Account was placed into rehabilitation pursuant to Wis. Stat. § 645.32, and the Court was named the rehabilitation court for all matters relating to the Segregated Account.

The Court appointed the Commissioner as Rehabilitator of the Segregated Account, with full powers and authority granted pursuant to Wis. Stat. §§ 645.33 to 645.35 and all other applicable laws as are reasonable and necessary to fulfill his duties and responsibilities. Further, the Court appointed Kimberly A. Shaul as Special Deputy Commissioner pursuant to Wis. Stat. § 645.33 for the purposes of carrying out the rehabilitation of the Segregated Account, with all of the powers of the Rehabilitator. Pursuant to Wis. Stat. § 645.08(1), the Rehabilitator and Special Deputy Commissioner are serving without bond.

Upon entry of the Rehabilitation Order, the Rehabilitator took control of the Segregated Account and began the rehabilitation in accordance with the Plan of Operation.

III. THE SEGREGATED ACCOUNT

The key agreements establishing and governing the Segregated Account are summarized below. These summaries are qualified in their entirety by reference to the provisions of the agreements themselves.

A. The Plan of Operation

The Segregated Account is guided principally by the Plan of Operation, a copy of which, together with all exhibits, is posted on the Website. The Plan of Operation establishes the allocation of liabilities to, the claims-paying resources available to, and the other rules for, the Segregated Account. It further memorializes the appointment of AAC as the "Management Services Provider" for the Segregated Account, and provides for cooperation between the General Account and the Segregated Account on certain matters related to decision-making, information sharing, tax compliance and allocation of expenses, all as set forth in a separate Cooperation Agreement described in more detail in Section III.C of this Disclosure Statement.

1. Allocations to the Segregated Account

OCI worked closely for weeks with outside advisors and AAC to identify those policies or categories of policies which met OCI's criteria for allocation to the Segregated Account. Assessing the pros and cons of these choices was difficult and time consuming, given the depth and breadth of AAC's insured book, which included nearly 15,000 policies across many distinct exposure categories. Ultimately, fewer than 1,000 policies (representing approximately $67 billion in net par outstanding, including more than $20 billion in "assumed" or reinsurance exposures) were allocated to the Segregated Account (the "Policies"), while approximately 14,000 policies (representing over $300 billion in net par outstanding) were left in the General Account.[1] That allocation outcome was consistent with OCI's objectives to narrowly tailor the Proceeding to preserve the financial stability provided by AAC to its policyholders.

Policies allocated to the Segregated Account as of the date of this Disclosure Statement generally fall into four discrete categories:

- policies insuring the obligations of ACP under certain CDS which contain provisions permitting the enforcement or collection of claims against ACP arising due to the occurrence of the Events, as defined in the Order for Temporary Injunctive Relief (the "Injunction"), or the financial condition of the Segregated Account, the Allocated Subsidiaries, AAC or the General Account and where no agreement to forbear on the exercise of such provisions is in-force between Ambac and the relevant counterparty;

- policies insuring RMBS;

[1] As of June 30, 2010, after giving effect to the student loan assessment process, the General Account insured approximately 13,000 policies aggregating $267 billion in net par outstanding.

- certain other identified policies, pursuant to which either AAC is expected to, or which had the potential for AAC to, suffer material losses, such as policies on the bonds relating to the Las Vegas Monorail ("LVM") (discussed below) and the Weinstein Policy (discussed below and in further detail in Section IV.D of this Disclosure Statement);

- certain other identified policies or books of business, which had the potential to cause AAC to suffer material losses arising due to the occurrence of the Events or the financial condition of the Segregated Account, AAC, the Allocated Subsidiaries or the General Account; and

- certain student loan policies, some of which were allocated to the Segregated Account on March 24, 2010 (or shortly thereafter), and some of which were allocated to the Segregated Account on October 8, 2010, after undergoing an assessment process contemplated by the Plan of Operation, and described below in this Section III.A.

As of the date of this Disclosure Statement, none of the policies in the General Account is subject to an assessment or will be allocated on an *ad hoc* or rolling basis to the Segregated Account. Clerical errors and oversights regarding allocations may continue to be corrected with the consent of the Rehabilitator and filed with or approved by the Court as required.

The original allocations to the Segregated Account also included the following:

- All remediation claims, defenses, offsets, and/or credits, if any, in respect of Policies allocated to the Segregated Account, whether now or hereafter arising, except for recoveries arising from remediation efforts or other reimbursement or collection rights;

- AAC's disputed, contingent liability, if any, under the long-term lease with One State Street, LLC ("One State Street"), effective January 1, 1992, and amended as of August 1, 1997 (the "One State Street Lease"), and its contingent liability (as guarantor), if any, under the Ambac Assurance UK Limited ("Ambac UK") lease with British Land (which lease has since been terminated);

- AAC's limited liability interests in the Allocated Subsidiaries; and

- All liabilities assumed by AAC as reinsurer under the reinsurance agreements identified in Exhibit F to the Plan of Operation, which is available on the Website.

Policies insuring RMBS were a clear-cut choice for allocation and rehabilitation because the actual and projected claims payments on RMBS are substantial and relatively short-term. Had the Petition not been filed, AAC estimates that it would have paid approximately $655 million in claims from the Petition Date to June 30, 2010. To continue to pay RMBS claims in full as they accrued would have treated certain policyholders inequitably by disproportionately reducing the amount of AAC's claims-paying resources in favor of certain RMBS policyholders with short-dated claims while possibly leaving insufficient resources to pay in full the many policyholders with longer-dated claims.

The Policies on the LVM bonds also fit OCI's criteria for allocation. LVM is in serious financial distress and filed a chapter 11 bankruptcy petition in Nevada in January 2010, where it is proposing minimal recoveries for insured bondholders. The LVM exposure represents one of the highest projected individual deal losses in the Segregated Account.

As further described in Section IV.D of this Disclosure Statement, the Policy insuring the Weinstein film securitization facility was also expected to suffer material losses and, therefore, met OCI's criteria for allocation.

The majority of student loan Policies also fit OCI's criteria for allocation, as AAC is either expected to, or has the potential to suffer material losses under such Policies, as described below.

a. Assessment Process for Student Loans

OCI determined that it was reasonably possible that certain AAC policies and debt service surety policies which guarantee indebtedness or other obligations which are either directly or indirectly collateralized by student loan receivables could suffer material losses. Among other reasons, such losses could stem from insufficient collateralization in the trust that owns such student loan receivables, significant increases in interest rates arising from failures in the auction rate and variable rate demand obligation markets, and the deterioration in the performance of student loans which are not federally guaranteed under the Federal Family Education Loan Program.

Given the foregoing, OCI (together with its advisers) developed an assessment process to allow for a more detailed review of these exposures. Pursuant to Section IV of the Plan of Operation and paragraph 13 of the Petition, approximately 131 student loan policies, aggregating approximately $11.2 billion of net par outstanding (as of September 20, 2010), were subject to an assessment process for a period of 180 days following the entry of the Order for Rehabilitation. AAC and OCI developed several criteria to determine which deals were likely to experience losses in the absence of restructuring, commutation, refinancing or other similar remediation transaction. The criteria took into account (i) debt structure, (ii) total collateralization level, and (iii) collateral type-factors that are considered to be reasonable indicators of prospective loss development. The Rehabilitator carefully monitored the development of such criteria and used these criteria to form the basis for its assessment process.

The assessment process was completed by September 20, 2010. On October 8, 2010, the Rehabilitator filed a notice with the Court by which 123 of the policies subject to the assessment process, aggregating approximately $11.0 billion of net par outstanding (as of September 20, 2010), were allocated to the Segregated Account. Eight policies, aggregating $155.5 million of net par outstanding (as of September 20, 2010), remain in the General Account.

In addition to the 123 policies allocated to the Segregated Account in connection with the assessment process, certain other student loan policies, aggregating $656.6 million of net par outstanding (as of the September 20, 2010), were allocated to the Segregated Account effective March 24, 2010, or shortly thereafter. Each of these transactions was re-evaluated under the assessment criteria discussed above, and each met at least one of the assessment criteria. Accordingly, had such policies not been allocated to the Segregated Account, such policies would have been allocated to the Segregated Account following the assessment process.

b. The One State Street Lease

In 1992, AAC entered into a lease with South Ferry Building Company, the predecessor-in-interest of One State Street, for premises located at One State Street Plaza, New York, New York. Since then, AAC, and later AFGI, has used the One State Street premises as its world headquarters. In 2002, AAC assigned the One State Street lease to its parent company, AFGI. AFGI continues to occupy the leased property and has continued to make all lease payments during the course of the Proceeding.

In 2002, One State Street and AFGI amended the One State Street lease to materially lengthen its term, expand the amount of office space it covers, and increase the total rent. AAC was not a party to the lease amendment and believes it has no liability to One State Street in connection with the One State Street lease.

In consultation with the Commissioner, AAC allocated its disputed, contingent liability, if any, under the One State Street lease to the Segregated Account to protect AAC's policyholders, creditors, and the public from the possibility that One State Street would attempt to hold AAC liable for AFGI's obligations on the One State Street lease and accelerate the collection of future rent (alleged to be up to $94 million of future lease payments). AAC and the Rehabilitator dispute One State Street's Claims, and the Plan specifically identifies any liability of the Segregated Account to One State Street as a General Claim.

2. <u>Provision for Capital and Surplus</u>

The Plan of Operation provides that the liabilities of the Segregated Account be supported by the Secured Note and the Reinsurance Agreement. The Secured Note together with the Reinsurance Agreement effectively render all of the claims-paying resources of the General Account available to pay liabilities of the Segregated Account (including any payments with respect to the Surplus Notes and the Junior Surplus Notes), subject to the maintenance of the Minimum Surplus Amount, as described below. Such liabilities, discussed in further detail below, are supported by a security interest in certain assets of the General Account.

All assets within the Segregated Account, if any, will be available exclusively for satisfying liabilities attributable to the Segregated Account, and AAC will ensure that any such assets, including any income earned thereon, will remain identifiable within the Segregated Account. Pursuant to Wis. Stat. § 611.24(3)(b), any income, gains and losses, whether or not realized, from such assets will be credited to or charged against the Segregated Account without regard to other income, gains, or losses of the General Account.

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).

a. The Secured Note

The Secured Note is a promissory note from AAC to the Segregated Account in the principal amount of $2 billion, maturing on March 24, 2050. Interest on the Secured Note accrues at 4.5% per annum, compounded quarterly.

Under the terms of the Secured Note, the Segregated Account may demand payment of note principal to satisfy liabilities of the Segregated Account due and payable in respect of cash claim payments, payments on other liabilities allocated to the Segregated Account, administrative and operating expenses, loss settlements, commutation payments, payments under surplus notes or contribution notes, if any, issued by the Segregated Account, and any other amounts directed or ordered to be paid by the Court in connection with the Proceeding.

The demand amount is reduced by the amount, as calculated by the Segregated Account, of the Segregated Account's liquid assets available to pay such liabilities at any time. The General Account's liability to the Segregated Account under the Secured Note is capped so that no payments are required under the Secured Note (i) that would result in the surplus as regards policyholders of the General Account falling below the amount of $100 million (or such higher amount as determined by the Commissioner pursuant to a prescribed accounting practice) (the "Minimum Surplus Amount") and (ii) during any period when the surplus as regards policyholders of the General Account is below the Minimum Surplus Amount.

b. The Reinsurance Agreement

Under the terms of the Reinsurance Agreement, the General Account has agreed to provide aggregate excess of loss coverage equal to the liabilities of the Segregated Account due and payable in respect of cash claim payments, loss settlements, commutation payments, payments under surplus notes or contribution notes, if any, issued by the Segregated Account, and any other amounts directed or ordered to be paid by the Court in connection with the Proceeding. Coverage under the Reinsurance Agreement will attach after all principal and accrued interest under the Secured Note has been paid by the General Account. Accordingly, even after all principal and accrued interest under the Secured Note has been paid by the General Account, the assets of the General Account will continue to be available to pay liabilities of the Segregated Account under the Reinsurance Agreement, subject to the maintenance of the Minimum Surplus Amount.

The amount of the reinsurance recoverable is reduced by the amount, as calculated by the Segregated Account, of the Segregated Account's liquid assets available to pay such liabilities at such time. The General Account's liability to the Segregated Account under the Reinsurance Agreement is capped so that no payments are required under the Reinsurance Agreement (i) that would result in the surplus as regards policyholders of the General Account falling below the Minimum Surplus Amount and (ii) during any period when such surplus is below the Minimum Surplus Amount.

In contrast to the Secured Note, the Reinsurance Agreement does not, by its terms, cover the administrative and operating expenses of the Segregated Account. Accordingly, in the event that all principal and accrued interest under the Secured Note has been paid by the General Account, the administrative and operating expenses of the Segregated Account will be covered pursuant to the Cooperation Agreement, as discussed more fully in Section III.C. of this Disclosure Statement.

c. Collateral Security

As security for the obligations of the General Account to the Segregated Account, the General Account granted a security interest to the Segregated Account in certain assets of the General

Account, including: (i) installment premiums received on Policies allocated to the Segregated Account; (ii) reinsurance premiums received in respect of assumed reinsurance agreements with respect to which the liabilities of AAC have been allocated to the Segregated Account; (iii) recoveries under third party reinsurance agreements covering losses on Policies allocated to the Segregated Account; (iv) any recoveries arising from remediation efforts or reimbursement or collection rights with respect to Policies allocated to the Segregated Account, (v) all assets evidencing any rights relating to any of the foregoing, whether in the form of instruments, general intangibles, investment property or otherwise, and (vi) all identifiable products and proceeds of any of the property described above in any form.

Further, both the Secured Note and the Reinsurance Agreement include covenants that restrict the General Account's ability to, (i) without the consent of the Segregated Account, amend investment policies if such amendment would have a material adverse effect on AAC's ability to perform its obligations under the Secured Note or the Reinsurance Agreement, (ii) without the approval of the Rehabilitator and OCI, directly or indirectly make shareholder distributions or redeem any of its securities and, (iii) without the consent of the Segregated Account, enter into any transaction other than pursuant to the reasonable requirements of AAC's business and which AAC reasonably believes are fair and reasonable terms and provisions.

3. Other Rules of the Segregated Account

Assets and investments of either the Segregated Account or the General Account will not be charged with any costs, expenses, charges, or liabilities arising out of any business of the other, except as specifically provided in the Secured Note, the Reinsurance Agreement or the Cooperation Agreement. Expenses of the General Account not covered under the Management Services Agreement (described below) will be divided between the General Account and the Segregated Account on such reasonable basis as the Rehabilitator and AAC shall mutually agree. The Segregated Account may offset and recoup any balance or amount due from AAC to the Segregated Account.

Unless otherwise previously dissolved or merged into the General Account, AAC will merge the Segregated Account into the General Account upon the final resolution of all liabilities attributable to the business allocated to the Segregated Account, or upon order from the Rehabilitator.

B. The Management Services Agreement

The Management Services Agreement, dated March 24, 2010 (the "Management Services Agreement"), provides for the engagement of AAC as Management Services Provider for the Segregated Account (the "Management Services Provider") in order to perform the administrative and management services described therein. These services include information technology services, such as the provision, support and development of hardware, software and information systems, credit exposure management, treasury services, including cash management, accounting, finance and regulatory services, performance assessments, taxation, risk management, loss management, internal audit services and business continuity services. The services to be provided under the Management Services Agreement have been refined consistent with the decision-making guidelines and clarifications shared by the Rehabilitator with the Court on June 4 and August 19, 2010.

AAC, as Management Services Provider, is entitled to compensation for such services, in amounts agreeable to the Rehabilitator and the Segregated Account. AAC's out-of-pocket expenses are also reimbursed. The Management Services Provider is required to prepare, on a calendar year basis, in advance, a projected cost allocation to be submitted to the Segregated Account by December 15 of each year for its approval. Further terms of compensation are set forth in Exhibit A to the Management Services Agreement.

The Management Services Agreement remains in effect so long as (i) the Segregated Account retains any liability under Policies or other liabilities allocated thereto or (ii) any interest or principal remains outstanding under any surplus notes issued by the Segregated Account. Further terms and conditions specify the circumstances under which AAC may resign or be terminated as Management Services Provider.

C. The Cooperation Agreement

The Cooperation Agreement, dated as of March 24, 2010, between AAC and the Segregated Account (the "Cooperation Agreement") includes provisions for, among other things, decision-making and shared authority, information sharing, tax compliance, and allocation of expenses.

1. Decision-Making and Shared Authority

AAC and the Segregated Account have generally expressed their intent to consult with each other and cooperate in good faith on any "Material Decisions" reasonably likely to have a material effect upon the assets and/or liabilities of AAC. The parties have likewise expressed their intent to share copies of material reports, analyses and correspondence relevant to such "Material Decisions."

Most significantly, AAC is not permitted to enter into any transaction with, or use any asset or property of, any third party (other than the Segregated Account) involving consideration or other proceeds in excess of $5 million without the Segregated Account's prior written consent, which the Segregated Account may withhold or condition in its reasonable discretion. This limitation does not apply to the payment of policy claims in the ordinary course of business or any investment made in accordance with AAC's investment policy.

AAC's directors, officers and employees may serve, without compensation, as directors, officers, agents, nominees, employees or signatories for the Segregated Account and, when acting in the scope of such employment, are generally deemed to be acting solely for the Segregated Account.

2. Information Sharing

AAC and the Segregated Account are required to share accurate, timely and complete information with respect to relevant, material business activities, including transactions proposed or undertaken, and their respective assets and liabilities. Specific examples of the kind of information and documents to be shared are provided in Section 2.01 of the Cooperation Agreement. AAC is required to provide the Segregated Account with an annual budget and projection for itself and its subsidiaries, and, thereafter three times a year, comparisons of actual expenditures to projected expenses.

These sharing obligations remain in effect even if the Segregated Account terminates the Management Services Agreement or replaces AAC as the Management Services Provider. Following any such event, Section 2 of the Cooperation Agreement contains certain guidelines for performance and operation of the Segregated Account.

3. Tax Compliance

AFGI is responsible for filing a U.S. consolidated income tax return on behalf of the AAC affiliated group. All members of the group, including the Segregated Account, are liable for applicable U.S. federal income taxes. The Segregated Account will provide AAC with sufficient information to file consolidated tax returns.

4. Allocation of Expenses

If the Segregated Account is no longer able to demand payment from the General Account under the Secured Note to satisfy the administrative and operating expenses of the Segregated Account, the Segregated Account has the right to seek reimbursement for such administrative and operating expenses from the General Account pursuant to the Cooperation Agreement. Such administrative and operating expenses may include, but are not limited to, fees, costs and expenses for management services, including all fees and payments pursuant to the Management Services Agreement, fees, costs and expenses for financial advisory, consulting and legal services (and indemnification under commercially reasonable indemnification agreements with providers of such services), and amounts due under agreements executed prior to the establishment of the Segregated Account for financial, consulting or legal services provided to the Rehabilitator. AAC's expense reimbursement obligation is subject to the maintenance of the Minimum Surplus Amount, as described above.

IV. SIGNIFICANT POST-PETITION ACTIONS

A. Entry of Order for Temporary Injunctive Relief

On March 24, 2010, the Court entered the Injunction, relating to the Segregated Account, AAC in respect of the Segregated Account, the Policies, rights, and liabilities allocated to the Segregated Account, and the Allocated Subsidiaries.

The Injunction provides generally that all persons and entities are enjoined and restrained from commencing or prosecuting any actions or claims against (i) the Segregated Account, (ii) AAC or the General Account in respect of the Segregated Account or policies, rights, equity ownership interests or liabilities allocated to the Segregated Account, (iii) the Allocated Subsidiaries, or (iv) the Commissioner.

It further enjoins and restrains, generally and without limitation:

- any efforts to impose civil liability on the Commissioner arising out of any alleged act, error, or omission in the performance of his duties;
- termination of, collection on, or claims against Policies or contracts allocated to the Segregated Account, or contracts with Allocated Subsidiaries, on the basis of the Events or the financial condition of the Segregated Account, the Allocated

Subsidiaries, or the General Account, notwithstanding any language in such Policies or contracts to the contrary;

- the assertion of market quotation, "mark-to-market" loss or "closeout amount" claims under or in relation to Policies or contracts allocated to the Segregated Account or contracts with an Allocated Subsidiary;

- action to exercise any approval, consent, direction, voting, veto, or other rights that the Segregated Account, AAC or the Allocated Subsidiaries may have (or would have but for the occurrence of the Events or the financial condition of the Segregated Account, the Allocated Subsidiaries or the General Account) under any agreements relating to Policies, contracts allocated to the Segregated Account, or contracts with Allocated Subsidiaries, or willfully failing to take any action directed to be taken under any such documents pursuant to the exercise by the Rehabilitator of such rights that the Segregated Account, AAC or the Allocated Subsidiaries may have;

- withholding or failing to pay or setting off premiums or other payments owed (or that would have been owed but for the occurrence of the Events or the financial condition of the Segregated Account, any Allocated Subsidiary or the General Account) to the Segregated Account, any Allocated Subsidiary or the General Account under or in connection with Policies or contracts allocated to the Segregated Account, or contracts with an Allocated Subsidiary or any documents associated therewith or related thereto; and

- other than pursuant to the Plan, paying claims or obligations of the Segregated Account or an Allocated Subsidiary without the consent of the Rehabilitator or its representatives.

Additional terms and conditions of the Injunction, including more detailed restrictions on transactions such as CDS, RMBS and other structured finance transactions, are set forth in the Injunction, which is available on the Website.

Persons or entities violating the Injunction may be subject to sanctions, including civil forfeiture and criminal penalties. Willful violation of the Injunction may also constitute good cause for the Rehabilitator to void or limit any policy or other contract obligations otherwise owed by the Segregated Account or an Allocated Subsidiary to the party violating the Injunction. Policyholders in violation of the Injunction may not be entitled to claims payments under the Plan, and are subject to partial or full disallowance of Claims.

Following entry of the Injunction and the Order for Rehabilitation of the Segregated Account, several parties-in-interest filed motions challenging the legal basis for the establishment of the Segregated Account and/or the scope and provisions of the Injunction. First, on April 5, 2010, Wells Fargo Bank, N.A. (acting as trustee for certain holders of LVM bonds) challenged the establishment of the Segregated Account on statutory, common law, and constitutional grounds and moved to remove the LVM policies from the Segregated Account. Wells Fargo Bank, N.A. later withdrew its motion and joined a narrower motion filed by some of its trust beneficiaries, which challenged the LVM policy allocation to the Segregated Account solely on equal protection and statutory grounds. The Court heard these motions on July 9, 2010, and denied

them by written decision on July 16, 2010. That decision is on appeal, and the parties to the appeal have stipulated to consolidate resolution of that appeal with the resolution of the other pending appeals described herein. The parties' Motion to Consolidate is pending before the Wisconsin Court of Appeals. Under the revised schedule contemplated by the Motion to Consolidate, briefing on the appeals will be complete by the end of 2010.

Second, on April 30, 2010, a group of owners or managers of funds that own certain RMBS, consisting of Aurelius Capital Management, LP, Fir Tree, Inc., King Street Capital Master Fund, Ltd., Monarch Alternative Capital LP, and Stonehill Capital Management LLC (collectively, the "RMBS Movants") filed a motion challenging, among other things, the establishment of the Segregated Account on statutory, common law, and constitutional grounds. OCI and AAC filed briefs and numerous affidavits in opposition to the RMBS Movants' motion. The Court heard the RMBS Movants' challenges on May 25, 2010, and denied them by written Findings of Fact and Conclusions of Law on May 27, 2010. The RMBS Movants have appealed that order, and their appeal is among those included in the pending Motion to Consolidate.

Finally, on June 22, 2010, 12 trustees, policy beneficiaries, issuers, administrators, or other interested entities filed motions challenging the establishment of the Segregated Account and/or provisions of the Injunction on several grounds, some specific to the policies or liabilities in which the movant claimed an interest and others based on law or facts equally applicable to all holders or beneficiaries of Segregated Account Policies or liabilities. The Court received numerous briefs and affidavits and, per its scheduling order, heard the latter group of general challenges on September 9, 2010, and the former group of policy-specific challenges on September 13, 2010. The Court has taken the motions under advisement and its decision is pending.

B. Formation of Ambac Rehabilitation Advisor Council

On June 28, 2010, the Rehabilitator announced the formation of, and appointment of members to, the AAC Rehabilitation Advisor Council (the "Advisor Council"). The Rehabilitator expects to call on and benefit from the advice of the Advisor Council while formulating and confirming the Plan. The current members of the Advisor Council are: (1) the Rehabilitator, Advisor Council Chair; (2) Kimberly Shaul, Special Deputy Rehabilitator; (3) Jeff Post, President and CEO, Cuna Mutual Group; (4) Steve Callahan, Senior Consultant and Practice Development Director, Robert E. Nolan Company; (5) David Walsh, Foley & Lardner LLP, Counsel to the Rehabilitator; (6) Kenneth Gibbs, President of Municipal Securities, Jefferies Group, Inc.; (7) Karl Case, Professor of Economics, Wellesley College; (8) Patricia Hopkins, Senior Exec. V.P. and CFO, Independent Community Bankers of America; (9) Chris Evangel, Managing Director, Securities Valuation Office/NAIC; and (10) Thomas E. Jones, Distinguished Professor of Accounting, Lubin School of Business, Pace University.

C. The Bank Group Settlement

1. Background

In the fall of 2009, AAC became aware that several large financial institutions that were parties to CDS with ACP in respect of ABS CDOs and collateralized loan obligations ("CLOs") and other CDOs were forming a group to negotiate with AAC regarding a global commutation of those exposures (the "Bank Group"). The Bank Group eventually consisted of 14 financial

institutions that, together with their direct affiliates, are among the largest financial institutions in the world.[2] Ambac had previously engaged in negotiations for bilateral "one-off" commutations with some of those institutions, and it renewed those talks with an eye toward global settlement of its ABS CDOs. As the negotiations continued into late 2009 and early 2010, OCI took an active role in overseeing, evaluating, and facilitating discussions between Ambac and the Bank Group.

Although the 14 financial institutions in the Bank Group accounted for fewer than 120 named beneficiary policies and less than $40 billion of net par outstanding (approximately 30 of which were ABS CDO policies with approximately $16.7 billion of net par outstanding), those policies represented the greatest concentration of projected losses to AAC as well as the largest potential source of collateral damage through the possibility of major "market value" damages (also referred to as "mark-to-market" damages).

In the absence of a negotiated settlement (through commutation of the Bank Group policies), in 2009 OCI projected that the ABS CDO exposures would experience the greatest losses of all AAC exposures—materially greater than even the troubled RMBS book. Various loss exposure estimates available to OCI during the negotiations with the Bank Group showed dramatic increases in the estimated amounts of loss projections. Of further concern, the ABS CDO structures are particularly sensitive to increases in interest rates, such that even a one percent increase in such rates could have significantly added to losses. The existence of contractual triggers that might have allowed policy beneficiaries to terminate the CDS contracts and seek "mark-to-market" damages upon certain AAC-related conditions or events added uncertainty to the size and timing of such losses.

2. The BlackRock Appraisals

When Ambac and the Bank Group commenced the process of settlement negotiations in the fall of 2009, a threshold challenge to structuring any consensual resolution was the uncertainty and disagreement between Ambac (and its professional advisors) and among the Bank Group participants (and their professional advisors) as to an agreed range of projected economic and market value losses for the ABS CDO book of policies. To resolve that problem, Ambac and the Bank Group sought to identify a highly qualified, mutually agreeable third-party professional organization with recognized expertise concerning the complex ABS CDO category of transactions to independently appraise Ambac's ABS CDO book of business on a detailed deal-by-deal basis.

After vetting the alternatives, Ambac and the Bank Group selected BlackRock Solutions ("BlackRock"). BlackRock was selected because of its expertise in valuing the securities

[2] The Bank Group is comprised of Banco Bilbao Vizcaya Argentaria, S.A., Banco Santander, S.A., Barclays Bank PLC, BNP Paribas, Canadian Imperial Bank of Commerce, Citibank, N.A., Citigroup Global Markets Limited, Commerzbank AG London Branch, Credit Agricole Corporate and Investment Bank, Deutsche Bank AG London Branch, Deutsche Bank AG New York Branch, Natixis, Natixis Financial Products, Inc., Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. "Rabobank International," The Royal Bank of Scotland, PLC, Société Générale, and UBS AG, London Branch. Because certain of the institutions listed above are affiliated with one another, OCI and AAC generally refer to the Bank Group as having 14 members.

comprising ABS CDOs and its previous experience in performing neutral appraisals in situations where other monoline financial guarantors like AAC sought to commute their troubled ABS CDO policies. OCI was comfortable with the choice of BlackRock as an independent appraiser.

BlackRock delivered its independent appraisal assignment, with a valuation date as of October 31, 2009, in early January 2010. That appraisal contained an analysis of each of the ABS CDO transactions in detail, on a deal-by-deal and asset-by-asset basis, and included valuations of the Bank Group's potential claims under three different scenarios: "base case," "stress case," and "mark-to-market" or "market value" case. The "base case" valuation relied on certain economic assumptions, including a forecasted housing price bottom in the second quarter of 2010. The "stress case" valuation reflected a more pessimistic decline in housing prices (1.5x default rates) than the "base case". The "mark-to-market" case estimated the mid-market fair value of each analyzed ABS CDO tranche, using a market adjusted discount rate to discount the projected deal-by-deal cash flows determined in the "base case" scenario. This "mark-to-market" case is indicative of the market-value based termination payment which could have arisen if certain conditions occurred and the Bank Group members successfully exercised their termination rights. In determining the valuations for the base and stress case scenarios, BlackRock discounted the base and stress case cash flows, respectively and on a deal-by-deal basis, using a discount rate equivalent to the interest rate on the related debt obligation issued by the ABS CDO and specified in the relevant CDS contract.

BlackRock's aggregate valuations of the loss estimates for the approximately 30 policies at issue, taking into account Ambac's exposure, were as follows: base case -- $8.7 billion; stress case -- $10.4 billion; and market value case -- $12.9 billion. Applying a 5.1% discount rate (which equals the discount rate applied by Ambac in the preparation of its annual statutory financial statements for the year ending December 31, 2009) to the base and stress case cash flows, rather than the obligation-specific discount rates employed by BlackRock, the base case valuation was $7.7 billion and the stress case valuation was $9.2 billion.

Based on their extensive evaluation of these exposures over time, OCI and its financial advisors believed (and continue to believe) that the BlackRock appraisals were fair and reasonable estimates for purposes of making informed regulatory decisions. These independent appraisals were not out of line with the loss expectations OCI developed based upon its own concurrent and ongoing assessment of Ambac's ABS CDO book.

3. The Settlement

On June 7, 2010, AAC, AFGI, ACP and the Bank Group entered into a settlement agreement which effected the commutation of all of ACP's outstanding CDS in respect of ABS CDOs with respect to the Bank Group, and all of AAC's related financial guaranty exposure (the "Bank Group Settlement"). In exchange for AAC and ACP commuting $16.7 billion of net par exposure, with an appraised present value ranging from $8.7 to $12.9 billion of projected losses ($7.7 to $12.9 billion using a 5.1% discount rate), AAC transferred to the Bank Group, in the aggregate, $2.6 billion in cash and $2 billion of surplus notes newly issued by AAC (the "Bank Settlement Notes"). The Bank Settlement Notes are *pari passu* with the Surplus Notes and the Weinstein Notes, described in further detail below. In addition to the commutation of the ABS CDO obligations with the members of the Bank Group, AAC also paid $96.5 million to the Bank Group to commute certain other obligations, including certain non-ABS CDO obligations, with par amounting to $1.4 billion, in full satisfaction, but partial payment, of such obligations. In

addition, subject to certain conditions, certain other non-ABS CDO exposures with par amounting to a maximum of $1.5 billion are expected to be commuted within twelve months of the settlement date for an amount up to approximately $115 million of cash plus up to $60 million of surplus notes issued by AAC (which, if issued, will constitute Bank Settlement Notes), which payment would result in full satisfaction, but partial payment, of such obligations.

Averaging the BlackRock valuations under its base, stress, and mark-to-market case scenarios, the Bank Group Settlement ultimately paid the Bank Group 43.3% of the present value of expected losses, with 24.5% in cash and 18.8% in notes.

Notably, the total consideration paid to the Bank Group in the settlement, as a percentage of the projected claims, is substantially less than the consideration that will be paid to policyholders in the Segregated Account pursuant to the Plan. If the Bank Group Settlement had not been achieved, the total value of claims to be administered under the Plan would have been several billion dollars higher, thus substantially diminishing the amount of consideration payable to policyholders. In the worst case, the Bank Group might have been entitled to market value termination payments (per BlackRock appraisals) of $12.9 billion had the Bank Group's claims been allowed in full after litigation. Compared to the Bank Group's capped settlement consideration of $4.6 billion, such market value termination payments would have increased total claims liabilities by almost $8.3 billion.

In accordance with applicable law, OCI issued a letter non-disapproving the terms of the Bank Group Settlement on June 4, 2010. OCI determined that the Bank Group Settlement was fair and equitable to *all* policyholders in both the General Account and the Segregated Account. Settling the growing, volatile ABS CDO exposures at a major discount inured to the benefit of all policyholders, including those policyholders in the Segregated Account. Accordingly, the Bank Group Settlement was (and is) an integral part of OCI's objective to develop and implement an effective solution for all policyholders.

4. Objections by RMBS and LVM Movants

On March 24, 2010, OCI, AAC and all members of the Bank Group entered into a forbearance agreement pending the final documentation and closing of the Bank Group Settlement. In connection with the execution of the forbearance agreement, the key terms of the proposed settlement were publicly disclosed. On April 30, 2010, the RMBS Movants filed an "Emergency Motion to Modify Order for Temporary Injunctive Relief Filed by Certain RMBS Policyholders and Motion Seeking Expedited Relief." With their motion, the RMBS Movants sought to enjoin consummation of the Bank Group Settlement.

Several days later, on May 5, 2010, a group of owners or managers of funds and accounts that hold LVM bonds, consisting of Eaton Vance Management, Nuveen Asset Management, Restoration Capital Management LLC, and Stone Lion Capital Partners L.P. (collectively, the "LVM Movants"), filed a similar motion, entitled "Emergency Motion to Enjoin Consummation of the Proposed Settlement Between AAC and Certain CDS Counterparties" (together with the RMBS Movants' motion, the "RMBS/LVM Motions"). The LVM Movants also sought to enjoin consummation of the Bank Group Settlement. Thereafter, several parties-in-interest joined the RMBS/LVM Motions, including the Federal Home Loan Mortgage Corporation ("Freddie Mac").

The RMBS/LVM Motions were heard by the Court on May 25, 2010, and denied by order dated May 27, 2010. The Court concluded, among other things, that the RMBS and LVM Movants failed to satisfy their burden of demonstrating irreparable harm and a likelihood of success on the merits.

As noted above, the Bank Group Settlement was consummated on June 7, 2010. The RMBS Movants, the LVM Movants, and Freddie Mac each appealed the Court's denial of the motions to enjoin the Bank Group Settlement. Those appeals are pending, and are among those encompassed by the Motion to Consolidate described in Section IV.A of this Disclosure Statement.

D. The Weinstein Settlement

On July 29, 2010, AAC, as Management Services Provider for the Segregated Account, commuted the Segregated Account's exposure under a financial guaranty insurance policy (the "Weinstein Policy") relating to a December 23, 2005, film securitization facility (the "Facility") between The Weinstein Company LLC ("TWC"), HSBC Bank USA, National Association, as agent for the lender, The Weinstein Portfolio Funding Company LLC ("WPFC"), a special purpose subsidiary of TWC, and AAC. The Facility provided $500 million of funding for WPFC, and had an outstanding principal balance of approximately $450 million. Under the Weinstein Policy, AAC had guaranteed the timely payment of interest and ultimate repayment of principal.

TWC is an independent motion picture company founded in 2005. TWC's primary business is to develop, produce and distribute motion pictures in the United States and abroad. The proceeds of funding under the Facility were used to acquire a library of films from TWC and to fund the production and distribution of additional TWC films. Based on information available to the Rehabilitator, it appeared that the sole lender under the Facility was, and the entire outstanding principal amount of debt of WPFC was held by, Morrigan TRR Funding LLC, a wholly-owned subsidiary of Goldman Sachs ("Morrigan"). It also appeared that Assured Guaranty, Ltd. ("Assured") had indirectly guaranteed repayment to Morrigan of, or provided credit protection to Morrigan in respect of, a portion of the unpaid principal and interest.

The films TWC transferred to WPFC failed to generate the level of revenues or profits that TWC had projected. As a result, TWC had exhausted its liquidity, which in turn impaired its ability to fund the production and distribution of motion pictures. The first event of default under the Facility occurred as early as August 2006, and numerous events of default occurred in the years following, leading to 25 amendment and waiver agreements between AAC and TWC, and multiple attempts to restructure the Facility.

When the restructuring negotiations failed, AAC commenced commutation negotiations with Morrigan and Assured. The result was a proposed settlement, by which AAC would be fully and completely released from the Weinstein Policy in exchange for a cash payment of $65 million from the Segregated Account and delivery of $50 million in principal amount of surplus notes (the "Weinstein Notes"), which are *pari passu* with the Surplus Notes and the Bank Settlement Notes), to be issued from the Segregated Account (the "Weinstein Settlement"). To assist it in these negotiations, AAC retained legal advisors who in turn retained Centerview Partners LLC ("Centerview"), a global financial advisory firm with expertise in the analysis and valuation of assets such as WPFC's film library.

On June 11, 2010, the Rehabilitator filed a motion with the Court seeking approval of the Weinstein Settlement. Among other reasons, the Rehabilitator supported the Weinstein Settlement as being in the best interests of policyholders and the Segregated Account because it capped AAC's liability under the Weinstein Policy at a favorable amount compared to the projected claims on the Weinstein Policy that Morrigan would have, discounted to present value. Based on Centerview's analysis, the Rehabilitator determined that prospective losses ranged from $264 million to $300 million, meaning that the Segregated Account paid to Morrigan and Assured between 21.7% and 24.6% of their prospective losses in cash, and between 38.3% and 43.5% in total consideration (cash and Weinstein Notes).

The Court approved the Weinstein Settlement by order dated June 23, 2010, finding that claims under the Weinstein Policy were likely to far exceed the amount of the commutation and that the commutation was fair and equitable to policyholders and other creditors of the Segregated Account. As noted above, the Weinstein Settlement was closed on July 29, 2010.

E. Commutation of AUK Reinsurance Agreement

On September 28, 2010, AAC entered into a Commutation and Release Agreement (the "AUK Commutation Agreement") with Ambac UK and the Special Deputy Commissioner, pursuant to which (i) the Amended and Restated 1997 Reinsurance Agreement, dated as of November 17, 2009, by and between Ambac UK and AAC (the "AUK Reinsurance Agreement") was commuted and (ii) the Net Worth Maintenance Agreement, dated as of January 1, 1997, by and between Ambac UK and AAC (the "NWMA") was terminated.

Ambac UK is a wholly-owned subsidiary of AAC which formerly wrote financial guaranty insurance business in the United Kingdom and in other member states of the European Union. Ambac UK's activities are now restricted to run-off of its insured portfolio of financial guaranty insurance business. Pursuant to the AUK Reinsurance Agreement, AAC reinsured, (a) on a quota share basis, 90% of Ambac UK's liability under all financial guaranty insurance policies, surety bonds and commitments and binders written by Ambac UK and, (b) on an excess of loss basis, all incurred losses in excess of £500,000 in any calendar year in respect of such policies, bonds and commitments and binders. Pursuant to the NWMA, AAC agreed, among other things, to contribute capital to Ambac UK to ensure that Ambac UK maintains "free assets" of £10.5 million or such higher amount as may be required by United Kingdom law or United Kingdom regulatory authorities.

Ambac UK purported to terminate the AUK Reinsurance Agreement on March 22, 2010, and then again on March 24, 2010, after commencement of the Proceeding. On March 24, 2010, AAC's liabilities under the AUK Reinsurance Agreement were allocated to the Segregated Account.

Pursuant to the AUK Commutation Agreement, the Segregated Account's obligations to Ambac UK under the AUK Reinsurance Agreement were commuted and AAC's obligations under the NWMA were terminated in exchange for, among other things, certain mutual releases, including, without limitation, any right of AAC or the Segregated Account to reinsurance premiums received by Ambac UK. AAC paid a nominal termination amount of $1 to Ambac UK in connection with the commutation.

F. Other Commutations and Settlements

The Segregated Account has commuted 31 policies, aggregating $3.2 billion of net par outstanding, without any payments by Ambac, and settled or otherwise resolved its liabilities under certain additional policies allocated to the Segregated Account since the commencement of the Proceeding. Each such resolution was concluded with the consent of the Rehabilitator or Special Deputy Commissioner, as authorized by Wis. Stat. § 645.33(2), the Order for Rehabilitation, and the Injunction.

V. DETAILED SUMMARY OF THE PLAN

The detailed summary of the Plan set forth below is qualified in its entirety by reference to the provisions of the Plan. Capitalized terms not defined in this section have the meanings ascribed to them in the Plan.

A. Implementation of the Plan

1. Continuation of the Segregated Account

The Segregated Account will continue to exist after the Effective Date, with all powers available under applicable law and without prejudice to any right to terminate such existence under applicable law after the Effective Date, for the purpose of conducting an orderly run-off and/or settlement of the Policies and other liabilities allocated thereto in accordance with the Plan. The Segregated Account Operational Documents will remain in full force and effect according to their respective terms after the Effective Date.

The Commissioner will remain the appointed Rehabilitator of the Segregated Account and the Special Deputy Commissioner will retain her role. Any successors to these positions will automatically assume their respective appointments, with all the powers and duties described in the Plan, Wisconsin law, the Rehabilitation Order and the Segregated Account Operational Documents. Without limiting the generality of the foregoing, the Rehabilitator will continue to have the full powers and authority granted pursuant to Wis. Stat. §§ 645.33 to 645.35 and all other applicable laws as are reasonable and necessary to fulfill his duties and responsibilities under the Rehabilitation Order and the Plan, including, but not limited to, the power and authority to interpret the terms and conditions of the Plan in order to carry out its purposes and effects. In furtherance thereof, the Rehabilitator has the authority to issue to all interested Persons guidelines or further directions as may be necessary or appropriate from time to time in his sole and absolute discretion in order to carry out the purposes and effects of the Plan.

All parties to the Segregated Account Operational Documents will retain their positions and appointments made thereby, unless and until terminated in accordance with the terms and conditions of such documents.

2. Administration of the Plan

After the Effective Date, the Management Services Provider will perform those responsibilities, duties, and obligations set forth in the Plan on behalf of the Segregated Account. To the extent that the manner of performance is not specified in the Plan, the Management Services Agreement, the Cooperation Agreement, or any guidelines issued by the Rehabilitator or Special Deputy Commissioner under any of the foregoing, the Management Services Provider will have the discretion to carry out and perform all other obligations or duties imposed on it by the Plan or

by law in any manner it so chooses, as long as such performance is consistent with the purposes and effects of the Plan, as determined by the Rehabilitator in his sole and absolute discretion.

B. Treatment of Claims

In the Plan, Claims against the Segregated Account are categorized into three groups: Administrative Claims, Policy Claims, and General Claims.

1. Administrative Claims

Each Holder of a Permitted Administrative Claim will receive, in complete satisfaction of such Permitted Administrative Claim, Cash equal to the dollar amount of such Permitted Claim in accordance with the claims administration and distribution procedures described below.

2. Policy Claims

Each Holder of a Permitted Policy Claim will receive, in full satisfaction of such Permitted Claim, (i) Cash equal to the amount of such Permitted Claim multiplied by the Cash Percentage (initially 25%) and (ii) a Surplus Note (or beneficial interest therein), the principal amount of which is equal to the amount of such Permitted Policy Claim multiplied by the Surplus Note Percentage (initially 75%), in accordance with the claims administration and distribution procedures described below. Nothing in the Plan will cause to inure to the benefit of any Holder of a Policy Claim any greater right than that which would have existed were the Segregated Account not in rehabilitation.

3. General Claims

Each Holder of a Permitted General Claim will receive, in full satisfaction of such Permitted Claim, a Junior Surplus Note, the principal amount of which is equal to the amount of such Permitted General Claim, in accordance with the claims administration and distribution procedures described below.

C. Claims Administration

1. Claims Administration Responsibility

The Management Services Provider will retain responsibility for administering, disputing, objecting to, compromising or otherwise resolving all Claims in accordance with the Plan, subject to the provisions of the Plan and the Segregated Account Operational Documents, together with any guidelines issued by the Rehabilitator or the Special Deputy Commissioner under any of the foregoing, and the specific direction of the Rehabilitator or the Special Deputy Commissioner.

2. Submission of Administrative Claims

The Holder of an Administrative Claim must submit its Administrative Claim to the Management Services Provider or, if directed by the Rehabilitator, to the Rehabilitator, in the same manner as such Holder would submit such Administrative Claim in the ordinary course of business, and in accordance with, and including such information as is required by, the provisions of the underlying instrument(s), contract(s) or arrangement(s) giving rise to such

Administrative Claim, if any. Each such Administrative Claim submitted in accordance with the Plan will be referred to as a Pending Administrative Claim. The administration of Pending Claims is discussed below.

3. Submission of Policy Claims

The Holder of a Policy Claim, including any Policy Claim arising prior to the Effective Date, must submit to the Management Services Provider (i) such Policy Claim, in the same manner as such Holder would submit such Policy Claim in the ordinary course of business, and in accordance with, and including such information as is required by, the provisions of the applicable Policy and any other underlying instrument(s) or contract(s) giving rise to or governing the submission of such Policy Claim and (ii) a completed and executed Proof of Policy Claim Form relating to such Policy Claim. The Proof of Policy Claim Form is attached to the Plan as Exhibit C, and is available on the Website.

Other than in the case of excusable neglect, Holders of Policy Claims that arose during the time between the entry of the Rehabilitation Order and the Effective Date of the Plan must submit such Policy Claims within 120 days of the Effective Date, or else such Policy Claim will be considered a Late Claim and will be denied pursuant to the terms of the Plan.

Other than in the case of excusable neglect, Holders of Policy Claims that arise after the Effective Date of the Plan must submit such Policy Claims within 120 days of the earliest date on which such Policy Claim, if it had been submitted, would have satisfied all of the requirements to be considered a Permitted Claim, or else such Policy Claim will be considered a Late Claim and will be denied pursuant to the terms of the Plan. However, Holders of Policy Claims are not permitted to submit such Policy Claims any earlier than permitted under the relevant Policy or other underlying instrument(s) or contract(s) giving rise to or governing the submission of such Policy Claims.

Each such Policy Claim submitted in accordance with the Plan will be referred to as a Pending Policy Claim. The administration of Pending Claims is discussed below.

4. Submission of General Claims

The Holder of a General Claim must submit its General Claim to the Management Services Provider or, if directed, to the Rehabilitator in the same manner as such Holder would submit such General Claim in the ordinary course of business, and in accordance with, and including such information as is required by, the provisions of the underlying instrument(s) or contract(s) giving rise to or governing the submission of such General Claim, if any. Holders of General Claims are not permitted to submit such General Claims any earlier than permitted under the relevant instrument(s) or contract(s) giving rise to or governing the submission of such General Claims. Each such General Claim submitted in accordance with the Plan will be referred to as a Pending General Claim. The administration of Pending Claims is discussed below.

5. Evaluation of Pending Claims

The Management Services Provider, or in his sole discretion, the Rehabilitator, will evaluate each Pending Claim to determine whether such Pending Claim is a Permitted Claim or whether an Objection should be raised as to such Claim in accordance with the Plan. The Rehabilitator or

Management Services Provider may ask any Holder to supplement its Pending Claim with further supporting documentation in order to evaluate such Pending Claim. Upon the determination by the Management Services Provider or Rehabilitator that a Pending Claim constitutes a Permitted Claim, such Claim will be considered a Permitted Claim. The payment of Permitted Claims is discussed below.

6. Procedures for Treating and Resolving Disputed Claims

The Rehabilitator or Management Services Provider may raise an Objection to any Pending Claim in whole or in part on any ground, including, but not limited to, the ground that the Rehabilitator or the Management Services Provider lacks sufficient information to evaluate such Pending Claim, that all or a part of such Claim is a Duplicate Claim or that all or a part of such Claim is a Late Claim, by providing the Holder of the Claim or the Holder's attorney (as applicable) with written notice of the substance of the Objection.

A "Duplicate Claim" is any Claim for which the Rehabilitator has determined (in his sole and absolute discretion) that (i) the payment obligation of the Segregated Account under the provisions of the underlying instrument or contract giving rise to such Claim or (ii) the underlying risk of loss insured pursuant to the provisions of the Policy or other instrument(s) or contract(s) giving rise to such Claim has, in either case, been released, satisfied (by Distributions under the Plan or otherwise), terminated, commuted or otherwise extinguished, or is the subject of, or is, a Pending Claim, a Disputed Claim, a Late Claim, a Disallowed Claim or a Permitted Claim that has already been honored by the Segregated Account pursuant to the Plan.

A "Late Claim" is, other than in the case of excusable neglect (as determined by the Rehabilitator in his sole and absolute discretion), any Claim determined by the Rehabilitator to not have been submitted in compliance with the provisions of the Plan within 120 days of the later of the Effective Date and the earliest date on which such Claim, if it had been submitted, would have satisfied all of the requirements to be considered a Permitted Claim.

No later than the sixtieth (60th) day after the Rehabilitator or Management Services Provider provides to the Holder written notice of the Objection, the Holder, if it wishes to dispute such Objection, must send to the Management Services Provider written responses to the Objection. The responses must clearly set forth all facts and the legal basis, if any, for the opposition and the reasons why the Claim should be a Permitted Claim. If no timely response is filed by the Holder within such sixty (60) day period, the Claim will become a Disallowed Claim without order of the Court. If a response is timely submitted, the Rehabilitator will resolve such dispute in accordance with the Plan and communicate such resolution to the Holder. In the event that the Rehabilitator determines that such Disputed Claim is fully or partially a Disallowed Claim, the Holder may file a motion with the Court asserting that the Rehabilitator has disallowed such Claim in violation of the provisions of the Plan.

7. Alternative Resolutions of Claims

Generally speaking, the Plan does not limit the ability of the Rehabilitator to resolve any Claim through the arrangement, negotiation, effectuation and execution of an amendment, restructuring, refinancing, purchase, repurchase, termination, settlement, commutation, tender, synthetic commutation or tear-up, or any similar transaction that results in the extinguishment or reduction of the Segregated Account's liability, in respect of, as applicable, (i) all or part of the Policy or

Policies, (ii) all or part of the underlying obligation or obligations insured by such Policy or Policies, or (iii) the underlying instrument, contract or arrangement, if any, giving rise to such Claims (each, as applicable, an "Alternative Resolution"); *provided*, that unless otherwise provided in the Plan: (a) each Alternative Resolution must not violate the law and must be equitable to the interests of the Holders of Policy Claims generally, as determined in the sole and absolute discretion of the Rehabilitator; and (b) the Rehabilitator must obtain the approval of the Court prior to effectuating any Alternative Resolution that involves the payment of Cash by the Segregated Account in excess of $50 million.

D. Distributions

1. Cash Distributions

Cash Distributions under the Plan generally involve a two-step process: (1) periodic demands for payment from AAC under the Secured Note, the Reinsurance Agreement or the Cooperation Agreement; and (2) payments to Holders of Permitted Claims who are entitled to receive Cash under the Plan.

As for the first step, the Management Services Provider will, from time to time on behalf of the Segregated Account, demand payment from AAC pursuant to the Secured Note in the amount of the Cash to be distributed in respect of Permitted Claims. In the event that the Secured Note has been fully drawn, the Management Services Provider will, on behalf of the Segregated Account, as applicable, render the Monthly Account (as defined in the Reinsurance Agreement) to AAC pursuant to Section 1.05 of the Reinsurance Agreement or demand payment from AAC pursuant to Section 4.02 of the Cooperation Agreement, in each case in accordance with the respective terms thereof.

After the funds are received from AAC, the Management Services Provider will distribute to each Holder of a Permitted Administrative Claim, in accordance with normal business practices and in complete satisfaction of such Permitted Administrative Claim, Cash equal to the dollar amount of such Administrative Claim. However, the Management Services Provider may, in its discretion, allow Permitted Administrative Claims to be paid directly by AAC. If it does, such amounts will be deemed to have been paid by the Segregated Account.

As for Policy Claims, the Management Services Provider will, subject to Section 3.06 of the Plan, distribute to each Holder of a Permitted Policy Claim Cash equal to the dollar amount of such Permitted Policy Claim multiplied by the Cash Percentage (initially 25%). These Distributions will occur on the Payment Date that next follows the Determination Date (initially the 15th day of each month or the immediately following Business Day) on which such Policy Claim was determined to be a Permitted Policy Claim. Funds will be paid to the account of the Holder specified in the Proof of Policy Claim Form relating to such Permitted Policy Claim. Such payment of Cash and the issuance of Surplus Notes, as provided in the Plan, will constitute full and complete payment and settlement of such Permitted Policy Claim. See Sections V.E and V.F for further details.

2. Distributions of Surplus Notes

In addition to Cash, Holders of Permitted Policy Claims are entitled to receive Surplus Notes. Subject to Section 3.06 of the Plan, the Segregated Account will distribute to each Holder of a

Permitted Policy Claim Surplus Notes with a principal amount equal to the dollar amount of such Permitted Policy Claim multiplied by the Surplus Note Percentage (initially 75%). These Distributions will occur on the Payment Date that next follows the Determination Date (initially the 15th day of each month or the immediately following Business Day) on which such Claim was determined to be a Permitted Policy Claim.

On or prior to the scheduled payment date, the Management Services Provider will, on behalf of the Segregated Account, execute and deposit with the Fiscal Agent (The Bank of New York Mellon, see Section VI. of this Disclosure Statement, below) a global Surplus Note in the name of The Depository Trust Corporation (or nominee thereof) in principal amount equal to the aggregate dollar amount of Surplus Notes to be issued on such date. A Holder of a Permitted Policy Claim may request in the relevant Proof of Policy Claim Form to receive a certificated Surplus Note in lieu of a beneficial interest in a global Surplus Note, and the principal amount of such global Surplus Note will be reduced by an amount equal to the principal amount of any certificated Surplus Note delivered in response to such request; *provided*, that the Management Services Provider may, in his sole and absolute discretion, decline to issue such Surplus Notes in certificated form.

Beneficial interests in the Surplus Notes held in global form will be transferred to the Holders of Permitted Policy Claims in accordance with the rules and procedures of the Fiscal Agent and The Depository Trust Corporation, including any arrangements agreed to with the Segregated Account from time to time, and to the extent received by a Holder acting in its capacity as trustee, shall be transferred by such Holder to the beneficial holders for whom it is acting as trustee. Each Holder of a Permitted Policy Claim, including a Holder acting in its capacity as trustee, and each party to any instrument(s) or contract(s) (i) pursuant to which a Policy was issued, (ii) which governs the payment of claims under a Policy or (iii) which governs or specifies the subsequent allocation, distribution or disbursement of cash, funds, moneys or other amounts received pursuant to a Policy, including, but not limited to, any note, indenture, certificate, servicing agreement or other similar instrument or agreement, will be required to accept any Surplus Notes (or any beneficial interest therein) issued to such Holder or beneficiary in accordance with the Plan, in lieu of any cash payments required to be made to such Holder or beneficiary in full and complete satisfaction of such cash payment obligation of the Segregated Account in respect of such Permitted Policy Claim, regardless of the existence of any provision in such Policy or any other underlying instrument(s) or contract(s) that would require, or that contemplates, the discharge of the obligations of the Segregated Account through the payment of Cash. Notwithstanding the generality of the foregoing, the Segregated Account or any such Holder or beneficiary acting as a trustee may allocate, distribute or disburse Surplus Notes issued in accordance with the Plan by allocating, distributing or disbursing such Surplus Notes (or any beneficial interest therein) to the beneficial holders of such underlying financial instrument(s) through the relevant custodians holding the positions on behalf of the beneficial holders, and such custodians will be required to accept and distribute such Surplus Notes to the beneficial holders in accordance with procedures acceptable to the Rehabilitator.

The terms of the Surplus Notes are described in Section VI. of this Disclosure Statement.

3. Distributions of Junior Surplus Notes

From time to time, the Management Services Provider will, on behalf of the Segregated Account, execute and deliver to each Holder of a Permitted General Claim a Junior Surplus Note in a principal amount equal to the dollar amount of such Permitted General Claim.

4. Subsequent Adjustments

If the Rehabilitator or the Management Services Provider determines that the amount of the Cash received by, and/or the principal amount of the Surplus Note credited to, the Holder of a Permitted Policy Claim as a Distribution in any given Distribution was incorrect, the Rehabilitator or Management Services Provider will adjust the amount of the Cash received and/or the principal amount of the Surplus Note credited in respect of such Policy in one or more subsequent Distributions as necessary to account for such error.

5. Amendments to Cash Percentage and Surplus Note Percentage

In conjunction with the submission of the annual reports described in Section V.G. of this Disclosure Statement, the Rehabilitator may petition the Court to amend the Plan in accordance with Section 10.04 thereof to simultaneously increase the Cash Percentage and decrease the Surplus Note Percentage by corresponding amounts, if, based on the Rehabilitator's analysis of the estimated liabilities and available claims-paying resources of the Segregated Account, the Rehabilitator has determined, in his sole and absolute discretion, that such an amendment is equitable to the interests of the Holders of Policy Claims generally. In determining whether such an amendment is equitable to the interests of the Holders of Policy Claims generally, the Rehabilitator will consider whether, in conjunction with any such amendment, all outstanding Surplus Notes should be partially redeemed or pre-paid or called.

6. Interest on Claims

With the exception of the Surplus Notes and the Junior Surplus Notes, which provide for payments of interest, and unless otherwise specifically provided for in the Plan, no interest will accrue or be paid on Permitted Claims, and no Holder of any Permitted Claim will be entitled to interest.

7. Setoffs

The Rehabilitator may set off in whole or in part against any Permitted Claim or any Distribution of Cash, Surplus Notes or Junior Surplus Notes to be made under the Plan on account of such Permitted Claim, all claims, rights, and causes of action of any nature that the Rehabilitator, AAC or the Segregated Account may have against the Holder of such Permitted Claim that are not otherwise waived, released, or compromised in accordance with the Plan; *provided*, *however*, that neither the failure to effect such a setoff nor the determination that any Claim is permitted under the Plan will constitute a waiver or release by the Rehabilitator, AAC or the Segregated Account of any such claims, rights, and causes of action, notwithstanding any compulsory counterclaim rules or requirements to the contrary.

8. Withholding and Reporting Requirements

In connection with the Plan and all Distributions thereunder, the Fiscal Agent will comply with all applicable tax withholding and reporting requirements imposed by any federal, state,

provincial, local or foreign taxing authority, and all Distributions will be subject to any such withholding and reporting requirements. The Fiscal Agent will be authorized to take any and all actions that may be necessary or appropriate to comply with such withholding and reporting requirements.

E. Recoveries and Reimbursements on Policy Claims

Notwithstanding the Proceeding or any provisions of the Plan, including, but not limited to, the satisfaction of Permitted Policy Claims with Surplus Notes in lieu of Cash, AAC will be entitled to recover the full amount of all recoveries, reimbursements and other payments and to receive any assets it is owed in its capacity as insurer, surety, credit support provider, credit enhancer, CDS counterparty or similar capacities, or as assignee or subrogee, under the applicable Policy and any related underlying instrument(s) or contract(s) governing the priority or distribution of cash recoveries or delivery of assets, unless otherwise waived by AAC and the Management Services Provider or the Rehabilitator or approved by AAC and the Management Services Provider or the Rehabilitator.

F. Assignment of Rights

Without prejudice to (i) the terms and provisions of the applicable Policy and any related underlying instrument(s) or contract(s) and (ii) any assignment previously executed, whether pursuant to a Proof of Policy Claim Form or otherwise, when a Holder of a Permitted Policy Claim receives a payment with respect to a Permitted Policy Claim, each such Holder will be deemed to have assigned its rights relating to payment under the underlying instrument(s) or contract(s) to AAC.

This assignment of rights, together with Ambac's right to recover the full Cash amount of all recoveries, reimbursements and other payments and to receive any assets it is owed in its capacity as insurer, surety, credit support provider, credit enhancer or CDS counterparty or similar capacities, or as assignee or subrogee, entitles AAC to recover from the primary obligor on the relevant Ambac-insured instrument or contract 100% of the cash amount such obligor was contractually obligated to pay but failed to pay, even if the Holder of a Permitted Policy Claim receives less than (or is anticipated to receive less than) 100% in Cash on account of such Permitted Policy Claim under the Plan.

G. Annual Reports to Court

No later than June 1 of each year, the Rehabilitator will file a report with the Court advising the Court on the status of the rehabilitation of the Segregated Account. The report will provide an updated financial analysis showing the estimated liabilities and available claims-paying resources of the Segregated Account, update the Court on the status of the run-off and/or settlement of the liabilities allocated to the Segregated Account, indicate whether the next scheduled interest payment in respect of the Surplus Notes will be approved by OCI, and provide such other information as is required by law, requested by the Court or deemed appropriate by the Rehabilitator.

On or prior to June 1, 2020, the Rehabilitator, if he determines it necessary, will include in the annual report an update on amendments to the Plan for which he will seek Court approval to address Distributions on Permitted Policy Claims expected to be made after June 1, 2020.

The Rehabilitator will make the annual reports available on the Website.

H. Matters Relating to Plan Confirmation

1. Conditions to Effectiveness of Plan

Notwithstanding any other provision of the Plan or the order of the Court confirming the Plan under Wis. Stat. § 645.33(5) (the "Confirmation Order"), the Effective Date of the Plan will not occur, and the Plan will not be binding on any party, unless and until each of the following conditions has been satisfied:

- the Court shall have entered the Confirmation Order, which Confirmation Order shall approve, among other things, the procedural and substantive fairness of the terms and conditions of the issuance of the Surplus Notes under Section 4.04(d) of the Plan, in form and substance reasonably satisfactory to the Rehabilitator and consistent with the representations in the No-action Letter Request, all as determined by the Rehabilitator in the Rehabilitator's sole and absolute discretion;

- the Rehabilitator must be in receipt of (i) a No-action Letter in form and substance reasonably satisfactory to the Rehabilitator and, (ii) where possible, and in the Rehabilitator's sole and absolute discretion, no-action letters or written confirmations of the availability of securities registration exemptions from the securities law administrator of the Jurisdictions.

- the Segregated Account and the Fiscal Agent shall have executed the Fiscal Agency Agreement;

- OCI shall have issued a letter approving the issuance of the Surplus Notes and the Junior Surplus Notes for the purposes set forth in the Plan (which letter shall be made available on the Website); and

- all other actions, documents and agreements necessary to implement the Plan as of the Effective Date shall have been delivered and all conditions precedent thereto shall have been satisfied or waived, in each case, as determined in the sole and absolute discretion of the Rehabilitator.

Upon satisfaction of all of the conditions described above, the Rehabilitator will post a notice on the Website advising of the Effective Date of the Plan.

2. Amendment and Modification of the Plan

The Rehabilitator may in his sole and absolute discretion alter, amend, or modify the Plan, the Segregated Account Operational Documents or the Disclosure Statement at any time prior to the Confirmation Hearing Date. Following the Confirmation Date, the Rehabilitator may seek the approval of the Court to alter, amend or modify the Plan or the Fiscal Agency Agreement, Form of Surplus Note, Form of Junior Surplus Note and Proof of Policy Claim Form, as the same may be amended or modified as set forth in the Plan and in accordance with the Act, (the "Plan Documents"), with such notice and hearing as the Court prescribes pursuant to Wis. Stat. § 645.33(5).

3. Revocation of the Plan

The Rehabilitator reserves the right to revoke or withdraw the Plan prior to the date on which the Confirmation Order is entered on the docket of the Court (the "Confirmation Date"). If the Rehabilitator so revokes or withdraws the Plan, then the Plan will be null and void and, in such event, nothing contained therein will be deemed to constitute a waiver or release of any Claims by or against the Segregated Account or any other Person, or to prejudice in any manner the rights of the Segregated Account or any Person in any further proceedings involving the Segregated Account.

I. Effect of Plan Confirmation

1. Discharge of Claims; Permanent Injunction

Except as may otherwise be provided in the Plan, the Distributions in respect of a Permitted Claim under the Plan will be in complete exchange for, and in full and unconditional settlement, satisfaction, discharge and release of such Claim, and shall effect a full and complete release, discharge, and termination of any Liens, or other claims, interests, or encumbrances upon the Segregated Account and AAC with respect to such Claim. In addition, upon final determination in accordance with the Plan that a Claim is a Disallowed Claim, such determination will effect a full and complete release, discharge and termination of any Liens, other claims, interests, or encumbrances upon the Segregated Account and AAC with respect to such Claim. All Holders of Claims are precluded from asserting against the Segregated Account, the General Account or AAC, or their respective successors or property or any of their respective current or former members, shareholders, affiliates, officers, directors, employees or agents, any Claims, obligations, rights, causes of action or liabilities, based upon any act, omission, transaction, or other activity of any kind or nature, other than as expressly provided for in the Plan.

Except as otherwise provided in the Plan, and except as otherwise agreed by the Rehabilitator or the Management Services Provider, all Holders of Claims will be permanently barred and enjoined from asserting against the Segregated Account, the General Account or AAC, or their respective successors or property or any of their respective current or former members, shareholders, affiliates, officers, directors, employees or agents, any of the following actions on account of such Claim: (i) commencing or continuing in any manner any action or other proceeding on account of such Claim, or the property to be distributed under the terms of the Plan, other than to enforce any right to Distribution to such Holders under the Plan; (ii) enforcing, attaching, collecting, or recovering in any manner any judgment, award, decree, or order against the Segregated Account, the General Account or AAC or any of the property to be distributed under the terms of the Plan, other than as permitted under sub-paragraph (i) above; (iii) creating, perfecting, or enforcing any Lien or encumbrance against property of the Segregated Account, the General Account or AAC, or any property to be distributed under the terms of the Plan; (iv) asserting any right of setoff, subrogation, or recoupment of any kind, directly or indirectly, against any obligation due to the Segregated Account, the General Account or AAC or any property of the Segregated Account, the General Account or AAC, or any direct or indirect transferee of any property of, or successor in interest to, the Segregated Account, the General Account or AAC as prohibited by Wis. Stat. § 645.56; and (v) acting or proceeding in any manner, in any place whatsoever, that does not conform to, or comply with, the provisions of the Plan.

2. Retention of Court Jurisdiction

Following the Effective Date, the Court will retain exclusive jurisdiction over the Proceeding in accordance with the Act to ensure that the purposes and intent of the Plan are carried out. Without limiting the generality of the foregoing, the Court will also expressly retain exclusive jurisdiction: (i) to hear and determine all Objections to Disputed Claims; (ii) to hear, determine and enforce all causes of action that may exist against the Segregated Account or against the General Account or AAC or the Management Services Provider in regards to the Segregated Account; and (iii) for all purposes pertaining to the treatment or classification of Claims. The Court will further retain exclusive jurisdiction for the following additional purposes:

- to modify the Plan after the Confirmation Date;
- to enter such orders and injunctions as are necessary to enforce the respective title, rights, and powers of the Segregated Account, the terms of the Plan, and to impose such limitations, restrictions, terms, and conditions on such title, rights, and powers as the Court may deem necessary;
- to enter an order closing the Proceeding;
- to correct any defect, cure any omission, or reconcile any inconsistency in the Plan or in any order of the Court as may be necessary to implement the purposes and intent of the Plan;
- to determine any and all motions, applications, and other contested matters that may be pending on the Effective Date;
- to consider any amendment or modification of the Plan or any Plan Document;
- to determine all controversies, suits, and disputes that may arise in connection with the interpretation, enforcement, or consummation of the Plan;
- to consider and act on the compromise and settlement of any Claim against or cause of action by or against the Segregated Account or in relation to Policies and other liabilities allocated to the Segregated Account arising under or in connection with the Plan;
- to determine such other matters or proceedings as may be provided for under the Act, the Plan, or in any order or orders of the Court, including, but not limited to, the Confirmation Order or any order that may arise in connection with the Plan, the Proceeding, or the Confirmation Order; and
- to interpret and enforce, and determine all questions and disputes regarding, the injunctions, releases, exculpations, and indemnifications provided for or set forth in the Plan or the Confirmation Order.

3. Releases; Indemnification

Each of OCI, the Rehabilitator, the Special Deputy Commissioner, the Segregated Account, AAC and the General Account, and the Management Services Provider, and each of their respective current and former members, shareholders, affiliates, officers, directors, employees and agents (including any attorneys, financial advisors, investment bankers, consultants and other professionals retained by such Persons, and any other advisors or experts with whom OCI, the Rehabilitator or the Special Deputy Commissioner consults, as contemplated by section 645.33(3) of the Act) (collectively, the "Indemnified Persons") will have official immunity and will be immune from suit and liability, both personally and in their official capacities, for any act or omission made in connection with, or arising out of the Segregated Account, AAC or the General Account with respect to the Segregated Account, the Proceeding, the Plan (and the Confirmation Order related thereto), consummation of the Plan, or the administration of the Plan or the property to be distributed under the Plan, whether prior to or following the commencement of the Proceeding, with the sole exception of acts or omissions resulting from intentional fraud or willful misconduct as determined by a Final Order and, in all respects, such Indemnified Persons will be entitled to rely upon the advice of counsel with respect to their duties and responsibilities, if any, under the Plan.

If any legal action is commenced against any Indemnified Person, whether against that Indemnified Person personally or in an official capacity, alleging property damage, property loss, personal injury or other civil liability caused by or resulting from any act or omission made in connection with, or arising out of the Segregated Account, AAC or the General Account with respect to the Segregated Account, the Proceeding, the Plan (and the Confirmation Order related thereto), consummation of the Plan, or the administration of the Plan or the property to be distributed under the Plan, that Indemnified Person will be indemnified by the Segregated Account for all expenses, attorneys' fees, judgments, settlements, decrees or amounts due and owing or paid in satisfaction of or incurred in the defense of such legal action, unless it is determined by a Final Order that the alleged act or omission was caused by intentional fraud or willful misconduct.

Any indemnification for expense payments, judgments, settlements, decrees, attorneys' fees, surety bond premiums or other amounts paid or to be paid by the Segregated Account pursuant to this part of the Plan will be considered a Permitted Administrative Claim. Nothing contained in or implied by this part of the Plan will operate, or be construed or applied to deprive any Indemnified Person of any immunity, indemnity, benefits of law, rights or any defense otherwise available.

4. Preservation of Certain Causes of Action

Following confirmation of the Plan the Segregated Account will retain and may (but is not required to) enforce all causes of action allocated to it. Subject to the Rehabilitator's approval, the Segregated Account will determine, in its sole discretion, whether to bring, settle, release, compromise, or enforce any rights (or decline to do any of the foregoing) with respect to such causes of action. The failure of the Segregated Account to specifically list any cause of action in this Disclosure Statement or the Plan does not, and will not be deemed to, constitute a waiver or release by the Segregated Account of such cause of action, and the Segregated Account will retain the right to pursue such causes of action and, therefore, no preclusion doctrine, collateral

estoppel, issue preclusion, claim preclusion, estoppel (judicial, equitable or otherwise) or laches will apply to such cause of action after confirmation of the Plan.

a. Remediation Claims Relating to RMBS

The causes of action preserved by the Plan include, but are not limited to, the cases styled as *Ambac Assurance Corp. v. EMC Mortgage Corp.*, No. 08-CIV-9464 (S.D.N.Y.), *Ambac Assurance Corp. and the Segregated Account of Ambac Assurance Corp. v. DLJ Mortgage Capital, Inc. and Credit Suisse Securities* (*USA*) *LLP*, No. 10-600070 (Sup. Ct. N.Y.) and Ambac *Assurance Corporation and The Segregated Account of Ambac Assurance Corporation v. Countrywide Home Loans, Inc., Countrywide Securities Corp*., *Countrywide Financial Corp* (*n.k.a. Bank of America Home Loans*) *and Bank of America Corp*. No. 651612-10 (Sup. Ct. N.Y.). In these cases, and potentially others like them, which are discussed in more detail in Sections VIII. and IX. of this Disclosure Statement, AAC and the Segregated Account have asserted various claims in connection with insurance issued for RMBS, including claims for breach of loan-level representations and warranties, fraudulent inducement, breach of contract, and other claims, as applicable. AAC and the Segregated Account may bring additional suits against other parties asserting similar or other claims. Claims for breach of loan-level representations and warranties are hereinafter referred to as "R&W Remediation."

J. Prior Orders and Agreements

Unless modified by the Plan, the prior orders of the Court will remain in full force and effect following confirmation of the Plan and throughout the period of administration of the Plan. These orders include, without limitation, the Rehabilitation Order and the Injunction, which is discussed in further detail in Section IV.A of this Disclosure Statement. Nothing in the Plan alters prior agreements or arrangements approved by the Rehabilitator with respect to the Segregated Account or any liability in respect of any Policy or other liability allocated to the Segregated Account.

K. Applicability of Federal and Other Securities Laws

Holders of Permitted Policy Claims will receive Surplus Notes under the Plan. Holders of Permitted General Claims will receive Junior Surplus Notes. The Rehabilitator intends to rely on a No-action Letter from the SEC to exempt from registration under the Securities Act the issuance of Surplus Notes.

1. Issuance of Surplus Notes Under the Plan

Generally, Section 3(a)(10) of the Securities Act exempts from the registration requirements of Section 5 of the Securities Act the issuance of securities that meet certain criteria: (i) the securities for which exemption is sought must be issued in exchange for securities, claims or property interests, and cannot be issued for cash; (ii) a court or authorized governmental entity must approve the fairness of the terms and conditions of the exchange; (iii) before approving the exchange, the court must find that the terms and conditions of the exchange are fair to those to whom securities will be issued; (iv) the issuer must advise the court or authorized governmental entity before the court hearing that the court's or authorized governmental entity's approval of the exchange will form the basis of the issuer's reliance on the Section 3(a)(l0) exemption; (v) before approving the exchange, the court or authorized governmental entity must hold a hearing

on the fairness of the terms and conditions of the transaction; (vi) a governmental entity must be expressly authorized by law to hold the hearing; (vii) the fairness hearing must be open to everyone to whom securities would be issued in the proposed exchange; (viii) adequate notice must be given to all those persons of their right to attend the hearing, as well as adequate information necessary to assert that right; and (ix) there cannot be any improper impediments to the appearance of those persons at the hearing. The Rehabilitator believes that the issuance of Surplus Notes meets these requirements under the circumstances, and will therefore seek, and as a condition of Plan effectiveness will obtain, a No-action Letter from the SEC's Division of Corporation Finance confirming that it will not recommend any enforcement action to the SEC when the Surplus Notes are issued without registration.

The Rehabilitator's position is supported by, among other things, the SEC's No-action positions with respect to securities issued under similar plans of rehabilitation approved by other courts, including, but not limited to, The Fidelity Mutual Life Insurance Company (Nov. 27, 1998), Aetna Life Insurance and Annuity Company (July 21, 1994), Unionmutual Stock Life Insurance Co. of New York (Aug. 4, 1980), and Underwriters National Assurance Co. (May 9, 1977).

While the Rehabilitator believes that there may be exemptions from the securities registration provisions under the state securities laws of the Jurisdictions for the issuance of the Surplus Notes, the Rehabilitator intends, where possible and in his sole and absolute discretion, to rely on written confirmations for the availability of such exemptions or no-action letters from the securities law administrator of each of the Jurisdictions.

2. Transfers of Surplus Notes

The Rehabilitator anticipates that the Surplus Notes will be freely transferable, subject to applicable securities laws.

L. Termination of Rehabilitation

The Rehabilitator may at any time petition the Court for an order terminating the rehabilitation of the Segregated Account if the rehabilitation has been accomplished and the grounds for rehabilitation no longer exist.

VI. THE SURPLUS NOTES

The following is a summary of certain provisions of the Surplus Notes and the Fiscal Agency Agreement. The Fiscal Agency Agreement provides the mechanism for issuing the Surplus Notes and sets forth certain duties of the Fiscal Agent in connection therewith. The following summary does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all the provisions of the Surplus Notes and the Fiscal Agency Agreement, including the definitions therein of certain terms.

A. Maturity and Interest; No Sinking Fund

Subject to the restrictions on payment and the optional redemption provisions described below, the principal amount of the Surplus Notes is scheduled to be paid on June 7, 2020. The Surplus Notes will bear interest at the rate of 5.1% per annum from their date of issuance or, subsequently, from the most recent scheduled payment date to which interest has been paid or

provided for. Interest on the Surplus Notes will be calculated on the basis of a 360-day year consisting of 12 months of 30 days each. Subject to the restrictions on payment described below, interest is scheduled to be paid annually in arrears on June 7 of each year, in each case to the persons in whose name the Surplus Notes are registered at the close of business on the preceding May 20.

If the scheduled payment date or scheduled maturity date of any amount in respect of interest on, principal of, or redemption payment with respect to, any Surplus Note is not a Business Day at the place in which it is presented for payment, the holder thereof shall not be entitled to payment of such amount until the next succeeding Business Day at such place and shall not be entitled to any further interest or other payment in respect of any such delay. "Business Day", as used in this section, means any day which is not a day on which banking institutions are not carrying out transactions in U.S. dollars or are authorized or obligated by law or executive order to close.

The Surplus Notes are not entitled to any sinking fund.

B. Optional Redemption

The Surplus Notes will be redeemable, in whole or in part, at the option of the Segregated Account and, subject to the payment restrictions set forth in the Surplus Notes, including the prior approval by the Commissioner, at any time or from time to time, with no less than 30 and no more than 60 days prior notice to the holder, at a redemption price equal to 100% of the aggregate principal amount of the Surplus Notes to be redeemed (the "redemption price"), plus accrued and unpaid interest (including interest on interest) payments on the Surplus Notes to be redeemed to the redemption date. The Surplus Notes may not be redeemed at the option of any noteholder.

If fewer than all of the Surplus Notes are to be redeemed, the Surplus Notes shall be redeemed *pro rata*; *provided*, that if at the time of redemption such Surplus Notes are registered as a global note, the depositary for such global note shall determine, in accordance with its procedures, the principal amount of such Surplus Notes to be redeemed that are held by each holder of a beneficial interest in such global note.

C. Restrictions on Payment

Each payment of interest on, principal of, and any redemption or other payment with respect to, the Surplus Notes is subject to the prior approval of the Commissioner. The Commissioner will have absolute discretion in determining whether to allow payments to be made on the Surplus Notes.

The Segregated Account may only make a payment of interest on, principal of, or any redemption or other payment with respect to, the Surplus Notes to the extent that the Commissioner has approved such payment. If these conditions to payment are not met, the applicable scheduled payment date or scheduled maturity date will be extended until such time, if any, at which such conditions are met. Any payment with respect to which the scheduled payment date or scheduled maturity date is so extended shall be made by the Segregated Account on the Business Day following the Business Day on which the Segregated Account shall have the approval of the Commissioner to make such payment. Interest will continue to accrue on any unpaid principal amount of the Surplus Notes. In addition, interest will accrue on interest with

respect to which the scheduled payment dates have been extended, during the period of such extension. Any payment on any Surplus Note so rescheduled will forthwith cease to be payable to the person in whose name the Surplus Note was registered on the relevant record date, and such amount will instead be payable to the person in whose name such Surplus Note is registered on the special record date or other specified date determined as provided in the Surplus Notes.

If the Commissioner approves a payment of interest on, principal of, or any redemption payment with respect to, the Surplus Notes, in an amount which is less than the full amount of interest on, principal of, or any redemption or other payment with respect to, the Surplus Notes then scheduled or determined to be paid, payment of such partial amount shall be made *pro rata* among holders of the Surplus Notes as their interests may appear.

The Surplus Notes provide that so long as any amount remains unpaid on the Surplus Notes, (i) while the Segregated Account is subject to rehabilitation, the Rehabilitator will seek to and, (ii) while the Segregated Account is not subject to the rehabilitation, the Segregated Account will use its best efforts (*provided*, that such best efforts do not require the Segregated Account to raise additional capital or indebtedness) to obtain the approval of the Commissioner for the payment by the Segregated Account of interest on and principal of the Surplus Notes on the scheduled payment date or scheduled maturity date thereof and, in the event any such approval has not been obtained for any such payment at or prior to the scheduled payment date or scheduled maturity date thereof, as the case may be, the Segregated Account will continue to use its best efforts (*provided*, that such best efforts do not require the Segregated Account to raise additional capital or indebtedness) to obtain such approval promptly thereafter.

Not less than 45 days prior to the scheduled payment date or scheduled maturity date thereof (excluding any such scheduled maturity date which arises as a result of the obtaining of an order or the granting of approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account), the Segregated Account will seek the approval of the Commissioner to make each payment of interest on, principal of, and any redemption payment with respect to, the Surplus Notes. The Segregated Account shall notify in writing or cause to be notified in writing each holder and the Fiscal Agent no later than five Business Days prior to the scheduled payment date or the scheduled maturity date, as the case may be (excluding any scheduled maturity date which arises as a result of the obtaining of an order or the granting of approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account), in the event that the Commissioner has not then approved the making of any such payment on such scheduled payment date or such scheduled maturity date and thereafter if such payment has been approved by the Commissioner shall promptly notify in writing or cause to be notified in writing each holder and the Fiscal Agent of such approval and the fact that, notwithstanding such approval, the Segregated Account shall have failed to make any such payment on such scheduled payment date or scheduled maturity date.

D. Subordination

The Surplus Notes will rank *pari passu* with any other similarly subordinated obligations of the Segregated Account, including the Weinstein Surplus Notes. Any surplus or contribution notes or similar obligations of AAC (including the Bank Settlement Notes) will rank *pari passu* with the Surplus Notes unless the terms thereof expressly state that such notes are subordinated to the Surplus Notes. The payment of the principal of and interest on the Surplus Notes will be expressly subordinate in right of payment to the prior payment in full of all Indebtedness, Policy

Claims and Prior Claims (each as defined below) of the Segregated Account, including all insurance policies and existing or future indebtedness issued, incurred or guaranteed by the Segregated Account, other than any future surplus notes or future similarly subordinated obligations, or any indebtedness that is expressly subordinate to, or ranks *pari passu* with, the Surplus Notes. Pursuant to section 645.68 of the Wisconsin Statutes, upon any distribution to creditors of claims in any rehabilitation, liquidation, conservation, dissolution or similar proceeding relating to the Segregated Account or its property, the holders of Indebtedness, the Holders of Policy Claims and the holders of Prior Claims, including, without limitation, general creditors of the Segregated Account, will first be entitled to receive payment in full of all amounts due or to become due with respect thereto before the holders of the Surplus Notes will be entitled to receive any payment in respect of the principal of or interest on, or redemption payment with respect to, the Surplus Notes.

"Indebtedness" means (i) all existing or future indebtedness of the Segregated Account for borrowed money; (ii) all existing or future indebtedness for borrowed money of other persons, the payment of which is guaranteed by the Segregated Account; (iii) all existing or future obligations of the Segregated Account under any agreement obligating the Segregated Account to cause another person to maintain a minimum level of net worth, or otherwise to ensure the solvency of such person; and (iv) all other claims or amounts owed, to the extent that the payment of principal of, interest on or any redemption payment with respect to, the Surplus Notes would be required by law to be subordinated to the prior payment of any such claim or amount in the event of a distribution of claims pursuant to section 645.68 of the Wisconsin Statutes. Any indebtedness of the Segregated Account, which, by its express terms or other contract, is subordinated in right of payment to, or ranks equally with, the Surplus Notes shall not constitute Indebtedness. Any other surplus or contribution notes or similar obligations of the Segregated Account (including the Weinstein Notes) shall not constitute Indebtedness and will rank *pari passu* with the Surplus Notes.

"Policy Claims" means all existing or future claims of policyowners, beneficiaries and insureds arising from and within the coverage of, and not in excess of the applicable limits of, any and all existing or future policies, endorsements, riders and other contracts of insurance, annuity contracts (including, without limitation, guaranteed investment contracts and funding agreements) issued, assumed or renewed by the Segregated Account on or prior to the date hereof or hereafter created, all claims under separate account agreements to the extent such claims are not fully discharged by the assets held by the Segregated Account in the applicable separate accounts and all claims of any guaranty corporation or association of the State of Wisconsin or any other jurisdiction against the Segregated Account.

"Prior Claims" means all other claims against the Segregated Account, which, in the event of a rehabilitation, liquidation, conservation, dissolution or similar proceeding relating to the Segregated Account pursuant to section 645.68 of the Wisconsin Statutes, would have priority over claims with respect to the Surplus Notes. Under section 645.68 of the Wisconsin Statutes as currently in effect, such other claims include: (i) costs and expenses of administration during conservation, rehabilitation, liquidation or similar proceedings, including, but not limited to, actual and necessary costs of preserving or recovering the assets of the insurer, compensation for all services rendered in the liquidation, necessary filing fees, fees and mileage payable to witnesses, and reasonable attorney fees; (ii) all claims under policies for losses incurred, including third party claims and federal, state and local government claims, except the first $200 of losses otherwise payable to any claimant under this clause (ii) other than the federal

government; (iii) claims of the federal government not included under clause (ii), interest at the legal rate compounded annually on all claims in the class under this clause (iii), and on all claims of the federal government in the class under clause (ii), from the date of the petition for liquidation or the date on which the claim becomes due, whichever is later, until the date on which the dividend is declared; (iv) claims against the Segregated Account that are not under policies and that are for liability for bodily injury or for injury to or destruction of tangible property; (v) debts due to employees (with the exception of officers) for services performed, not to exceed $1,000 to each employee which have been earned within one year before the filing of the petition for liquidation, which shall be in lieu of any other similar priority authorized by law as to wages or compensation of employees, *provided*, *however*, that if there are no claims of the federal government, the claims in clause (v) have priority over all claims under clauses (ii) to (x); (vi) claims under non-assessable policies for unearned premiums and other premium refunds and the first $200 of loss excepted by the deductible provision under clause (ii); (vii) all other claims, including claims of any state or local government, not falling within other clauses and claims, including those of any state or local governmental body, for a penalty or forfeiture, but only to the extent of the pecuniary loss sustained from the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby; (viii) claims based solely on judgments; (ix) interest at the legal rate compounded annually on all claims in the classes under clauses (i) to (viii), except for claims of the federal government in the classes under clauses (ii) and (iii), from the date of the petition for liquidation or the date on which the claim becomes due, whichever is later, until the date on which the dividend is declared; and (x) pursuant to subdivision (8) of section 645.68 of the Wisconsin Statutes, the remaining claims or portions of claims not already paid, with interest calculated in accordance with clause (ix).

The Surplus Notes do not prohibit or limit the incurrence of additional Indebtedness, Policy Claims or Prior Claims. The Surplus Notes are unsecured obligations and are expressly subordinate in right of payment to all existing and future Indebtedness, Policy Claims and Prior Claims.

E. No Restrictive Covenants

Neither the Fiscal Agency Agreement nor the Surplus Notes contains any restrictive covenants. For example, the Segregated Account is not restricted from incurring, assuming or becoming liable with respect to any indebtedness, liens or any other obligations, whether secured or unsecured.

In addition, there are also no financial ratios or specified levels of net worth, surplus or liquidity to which the Segregated Account must adhere. In addition, the Segregated Account is not required to repurchase, redeem or modify the terms of any of the Surplus Notes upon a change in control or other event involving the Segregated Account that may adversely affect the creditworthiness of the Surplus Notes.

F. Affirmative Covenants

The Fiscal Agency Agreement provides, subject to certain exceptions, that the Segregated Account will do or cause to be done all things necessary to preserve and keep in full force and effect its corporate existence, material rights (charter and statutory), if any, and material franchises pursuant to the provisions of the Act; *provided, however*, that the Segregated Account shall not be required to preserve any such right or franchise if the Rehabilitator or the Board of

Directors of AAC shall determine that the preservation thereof is no longer desirable in the conduct of the business of the Segregated Account and that the Segregated Account has used its reasonable best efforts not to disadvantage in any material respect the holders of the Surplus Notes.

For any amounts due and payable under the Surplus Notes that are approved by the Commissioner and which are due and payable under the Secured Note or the Reinsurance Agreement, as the case may be, the Segregated Account will undertake to demand payment under the Secured Note or the Reinsurance Agreement, as the case may be, against AAC.

G. Remedies

In the event that any state or federal agency obtains an order or grants approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account (other than any Excluded Order), the Surplus Notes will, upon the obtaining of such an order or granting of such approval, immediately mature in full without any action on the part of the Fiscal Agent or any holder of the Surplus Notes, with payment thereon being subject to the satisfaction of the conditions to payment described herein and to any restrictions imposed as a consequence of, or pursuant to, such proceedings. "Excluded Order" means any order or approval under which any state or federal agency obtains an order or grants approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account which is entered or granted prior to the date hereof or any such order or approval entered or granted on or after the date hereof in the Proceeding, except to the extent that any such order or approval by its express terms provides for the acceleration of the maturity of the Surplus Notes or otherwise designates the scheduled maturity date or other maturity date or date for the payment of principal of the Surplus Notes.

In the event that the Commissioner approves in whole or in part a payment of any interest on, principal of, or any redemption payment with respect to, the Surplus Notes and the Segregated Account fails to pay the full amount of such approved payment on the date such amount is scheduled to be paid, such approved amount will be immediately payable on such date without any action on the part of the Fiscal Agent or any holder of Surplus Notes.

In no event shall the Fiscal Agent or any holder of Surplus Notes be entitled to declare the Surplus Notes to be immediately due or otherwise to be immediately payable, except for payments approved by the Commissioner. Other than as set forth in this section, there is no right of acceleration of the principal of or interest on, or any redemption payment with respect to, the Surplus Notes upon a failure to pay the principal of or interest on, or any redemption payment with respect to, or in the performance of any agreement applicable to, the Surplus Notes or in the Fiscal Agency Agreement.

H. Meetings; Certain Rights of the Holders

The Fiscal Agency Agreement contains provisions for convening meetings of noteholders to consider matters affecting their interests. The Fiscal Agency Agreement provides that the Fiscal Agent thereunder acts solely as the agent of the Segregated Account and does not assume any obligation or relationship of agency or trust for or with the holders of the Surplus Notes, except with respect to the payment to such holders of funds held by the Fiscal Agent for the payment of principal of, or interest on, or any redemption payment with respect to, the Surplus Notes. In the event of any breach by the Segregated Account of its obligations under the Surplus Notes, each

holder of Surplus Notes shall be entitled to institute action for any remedy under the Surplus Notes, subject to the limits on remedies described above under "Remedies," and to the limitations of section 611.33(2)(d) of the Wisconsin Statutes, without the consent of the Fiscal Agent or any other holder of Surplus Notes.

The Segregated Account, the Fiscal Agent and their respective agents may treat the person in whose name a Surplus Note is registered as the absolute owner and holder of such Surplus Note.

I. Modification of the Fiscal Agency Agreement and Waiver

Any amendment or modification of the Fiscal Agency Agreement or the terms of the Surplus Notes requires the consent of the Commissioner.

Without the Vote or Consent of the Noteholders. The Segregated Account and the Fiscal Agent may, with the prior approval of the Commissioner, amend or modify the Fiscal Agency Agreement or the terms of the Surplus Notes without the vote or consent of the holders of any of the Surplus Notes for the purpose of (i) adding to the covenants of the Segregated Account for the benefit of the holders of Surplus Notes, (ii) surrendering any right or power conferred upon the Segregated Account, (iii) securing the Surplus Notes, (iv) evidencing the succession of another entity to the Segregated Account and the assumption by such successor of the covenants and obligations of the Segregated Account contained in the Fiscal Agency Agreement and in the Surplus Notes as permitted by the Fiscal Agency Agreement and the Surplus Notes, (v) modifying the restrictions on, and procedures for, resale and other transfers of the Surplus Notes to the extent required by any change in applicable law or regulation, or the interpretation thereof, or in practices relating to the resale or transfer of restricted securities generally, (vi) accommodating the issuance, if any, of Surplus Notes in book-entry or certificated form and matters related thereto which do not adversely affect the interest of any holders of Surplus Notes in any material respect, (vii) curing any ambiguity or correcting or supplementing any defective provision contained in the Fiscal Agency Agreement or in the Surplus Notes in a manner which does not adversely affect the interest of any holders of Surplus Notes in any material respect, or (viii) effecting any amendment which the Segregated Account and the Fiscal Agent may determine is necessary or desirable and which shall not adversely affect the interest of any holders of Surplus Notes.

With the Consent of the Noteholders. The Fiscal Agency Agreement also contains provisions permitting the Segregated Account and the Fiscal Agent, with the prior consent of the holders of a majority in aggregate principal amount of the Surplus Notes then outstanding and with the prior approval of the Commissioner, to modify, amend or supplement the terms of the Fiscal Agency Agreement or the Surplus Notes; *provided, however*, that no such modification, amendment or supplement may, without the consent of the holder of each Surplus Note affected thereby and the Commissioner, (i) change the scheduled payment date or scheduled maturity date of the principal of, or any installment of interest on, any Surplus Note, (ii) reduce the principal amount of or interest rate on any Surplus Note or the premium payable, if any, with respect to a redemption thereof, (iii) change the place or currency of payment of principal of or interest on or redemption payment with respect to any Surplus Note, (iv) impair any right of a holder of a Surplus Note to institute suit for the enforcement of any payment, if such payment has been approved by the Commissioner pursuant to section 611.33(2)(d) of the Wisconsin Statutes, on or with respect to any Surplus Note, (v) modify the provisions of Section 10 of the Surplus Notes (which address subordination) in a manner adverse to the holders of the Surplus Notes, (vii)

reduce the percentage of the principal amount of outstanding Surplus Notes the vote or consent of the holders which is necessary to modify, amend or supplement the Surplus Notes or the Fiscal Agency Agreement or to make, take or give any request, demand, authorization, direction, notice, consent, waiver (including waiver of any future compliance or past failure to perform) or other action provided thereby to be made, taken or given, (viii) reduce the percentage of aggregate principal amount of outstanding Surplus Notes necessary to constitute a quorum at any meeting of holders of Surplus Notes at which a resolution is adopted, or (ix) change the restrictions on payment of principal of or interest on or redemption payment with respect to the Surplus Notes provided therein in a manner adverse to the holders of the Surplus Notes.

J. Merger, Consolidation or Sale by the Segregated Account

The Surplus Notes provide that the Segregated Account may merge or consolidate with or into any other corporation or sell, convey, transfer or otherwise dispose of all or substantially all of its assets to any person, firm or corporation, if, (i) (a) in the case of a merger or consolidation, the Segregated Account is the surviving corporation or (b) in the case of a merger or consolidation in which the Segregated Account is not the surviving corporation and in case of any such sale, conveyance, transfer or other disposition, the successor corporation to the Segregated Account, if applicable, is either AAC (or its successor) or a corporation organized and existing under the laws of the United States of America or a state thereof and such corporation expressly assumes by supplemental fiscal agency agreement all the obligations of the Segregated Account under the Fiscal Agency Agreement and the Surplus Notes, (ii) at the time of any such merger or consolidation, or such sale, conveyance, transfer or other disposition, the Segregated Account shall not have failed to make payment of interest on, principal of, or the redemption payment with respect to, the Surplus Notes after having received the Commissioner's prior approval to make such payment and (iii) the Segregated Account has delivered to the Fiscal Agent an officer's certificate stating that such merger, consolidation, sale, conveyance, transfer or other disposition complies with the relevant provisions of the Surplus Notes and that all conditions precedent in the Surplus Notes with respect to the permissibility of such transaction have been complied with. In the event a successor corporation assumes the obligations of the Segregated Account as provided in (i)(b) above, such successor corporation shall succeed to and be substituted for the Segregated Account under the Fiscal Agency Agreement and the Surplus Notes and all obligations of the Segregated Account thereunder shall terminate.

K. Book-Entry, Delivery and Form

The Surplus Notes will be issued in fully registered form, without coupons. The Surplus Notes shall be issuable in minimum denominations of $1 and integral multiples of $1 in excess thereof.

L. Payments and Paying Agents

The Segregated Account has appointed The Bank of New York Mellon ("BNYM"), the Fiscal Agent, to act as registrar, principal paying agent and transfer agent with respect to the Surplus Notes. In these capacities, BNYM will be responsible for, among other things:

- maintaining a record of the aggregate holdings of Surplus Notes represented by the global note, and accepting Surplus Notes for exchange and registration of transfer;

- ensuring that payments of principal of and interest on the Surplus Notes received by the Fiscal Agent from the Segregated Account are duly paid to DTC or its nominee and any other holders of any Surplus Notes; and

- transmitting to the Segregated Account any notices from noteholders.

The Segregated Account will cause the registrar and transfer agent to keep at its offices a register in which to provide for the registration of the Surplus Notes and registration of transfers of the Surplus Notes. The Segregated Account may vary or terminate the appointment of the transfer agent or any paying agent or appoint additional or other transfer agents or paying agents or approve any change in the office through which any transfer agent or paying agent acts; *provided*, that there shall at all times be a transfer agent in the Borough of Manhattan, The City of New York (which paying agent and transfer agent may be the Fiscal Agent). The Segregated Account will cause notice of any resignation, termination or appointment of the Fiscal Agent, or any paying agent or transfer agent, and of any change in the office through which any such agent will act, to be provided to holders of the Surplus Notes.

The Fiscal Agency Agreement provides that any money paid by the Segregated Account to the Fiscal Agent, for any payment with respect to the Surplus Notes that is permitted under the payment restrictions in the Fiscal Agency Agreement and the Surplus Notes, which remains unclaimed for two years will be repaid to the Segregated Account and all liability of the Fiscal Agent and any paying agents will thereupon cease. Thereafter, the holder will look only to the Segregated Account for payments thereof as an unsecured creditor and the Segregated Account will not be liable to pay any taxes or other duties in connection with such payments.

M. Governing Law

The Fiscal Agency Agreement and the Surplus Notes will be governed by and construed in accordance with the laws of the State of Wisconsin. The Commissioner's exercise of regulatory authority, including approval of payments on the Surplus Notes, shall be governed by, and construed in accordance with, the laws of the State of Wisconsin (or, if the Commissioner is no longer the primary regulator of the financial condition of the Segregated Account, the law of such jurisdiction of the primary regulator of the financial condition of the Segregated Account), and the parties to the Fiscal Agency Agreement and holders of Surplus Notes shall submit any disputes related to the exercise of such regulatory authority to the exclusive jurisdiction of the Court, or, so long as any proceeding is pending in Wisconsin as to the Segregated Account under chapter 645 of the Wisconsin Statutes, then to that case and court.

N. Fiscal Agent

BNYM will be the fiscal agent (the "Fiscal Agent") under the Fiscal Agency Agreement, and will perform its functions through its office located at 101 Barclay Street, Floor 8W, New York, New York 10286. BNYM has from time to time engaged in, and will continue to engage in, banking and other commercial dealings in the ordinary course of business with the Segregated Account and its subsidiaries and affiliates. BNYM has received, and will continue to receive, customary remunerations from these transactions.

The Fiscal Agent may resign at any time upon 60 days' prior written notice or may be removed by the Segregated Account at any time. If the Fiscal Agent resigns, is removed or if a vacancy

occurs in the office of the Fiscal Agent for any reason, a successor Fiscal Agent shall be appointed in accordance with the provisions of the Fiscal Agency Agreement. Any resignation or removal of the Fiscal Agent will only take effect upon the appointment by the Segregated Account of a successor Fiscal Agent. If a successor Fiscal Agent does not take office within 60 days after the retiring Fiscal Agent provides written notice of its intent to resign or is removed, the retiring Fiscal Agent, at the expense of the Segregated Account, the Segregated Account or the holders of at least 10% in aggregate principal amount of the Surplus Notes then outstanding may petition any court of competent jurisdiction for the appointment of a successor Fiscal Agent.

O. Risks Relating to the Surplus Notes

The assumptions and estimates underlying the Rehabilitator's Financial Projections set forth in Section VIII of this Disclosure Statement and Exhibits C-G hereto are inherently uncertain and, though considered reasonable by the Rehabilitator as of the date hereof, are subject to a wide variety of significant business, economic, competitive and political risks and uncertainties. The Rehabilitator's Financial Projections are not necessarily indicative of the future financial position or results of operations of the Segregated Account, which may vary significantly from those set forth in the Rehabilitator's Financial Projections. Consequently, the Rehabilitator's Financial Projections contained herein should not be regarded as a representation by the Rehabilitator or the Segregated Account, or their advisors, or any other person that the projected financial position or results of operations can or will be achieved. The Rehabilitator's Financial Projections are also "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. There are many factors that could cause actual results to differ materially from those set forth in the Rehabilitator's Financial Projections.

VII. THE JUNIOR SURPLUS NOTES

The following is a summary of certain provisions of the Junior Surplus Notes. The following summary does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all the provisions of the Junior Surplus Notes, including the definitions therein of certain terms.

A. Maturity and Interest; No Sinking Fund

Subject to the restrictions on payment and the optional redemption provisions described below, the principal amount of the Junior Surplus Notes is scheduled to be paid on June 7, 2020. The Junior Surplus Notes will bear interest at the rate of 5.1% per annum from their date of issuance, or, subsequently, from the most recent scheduled payment date to which interest has been paid or provided for. Interest on the Junior Surplus Notes will be calculated on the basis of a 360-day year consisting of 12 months of 30 days each. Subject to the restrictions on payment described below, interest is scheduled to be paid annually in arrears on June 7 of each year.

If the scheduled payment date or scheduled maturity date of any amount in respect of interest on, principal of, or redemption payment with respect to, any Junior Surplus Note is not a Business Day at the place in which it is presented for payment, the holder thereof shall not be entitled to payment of such amount until the next succeeding Business Day at such place and shall not be entitled to any further interest or other payment in respect of any such delay. "Business Day", as used in this section, means any day which is not a day on which banking institutions are not

carrying out transactions in U.S. dollars or are authorized or obligated by law or executive order to close.

The Junior Surplus Notes are not entitled to any sinking fund.

B. Optional Redemption

The Junior Surplus Notes will be redeemable, in whole or in part, at the option of the Segregated Account and, subject to the payment restrictions set forth in the Junior Surplus Notes, including the prior approval by the Commissioner, at any time or from time to time, with no less than 30 and no more than 60 days' prior notice to the holder, at a redemption price equal to 100% of the aggregate principal amount of the Junior Surplus Notes to be redeemed (the "redemption price"), plus accrued and unpaid interest (including interest on interest) payments on the Junior Surplus Notes to be redeemed to the redemption date. The Junior Surplus Notes may not be redeemed at the option of any noteholder.

C. Restrictions on Payment

Each payment of interest on, principal of, and any redemption payment with respect to, the Junior Surplus Notes is subject to the prior approval of the Commissioner. The Commissioner will have absolute discretion in determining whether to allow payments to be made on the Junior Surplus Notes.

The Segregated Account may only make a payment of interest on, principal of, or any redemption payment with respect to, the Junior Surplus Notes to the extent that the Commissioner has approved such payment. If these conditions to payment are not met, the applicable scheduled payment date or scheduled maturity date will be extended until such time, if any, at which such conditions are met. Any payment with respect to which the scheduled payment date or scheduled maturity date is so extended shall be made by the Segregated Account on the Business Day following the Business Day on which the Segregated Account shall have the approval of the Commissioner to make such payment. Interest will continue to accrue on any unpaid principal amount of the Junior Surplus Notes. In addition, interest will accrue on interest with respect to which the scheduled payment dates have been extended, during the period of such extension.

D. Subordination

The Junior Surplus Notes are subordinated to the Surplus Notes, the Weinstein Notes, the Bank Settlement Notes, and similar surplus notes and obligations discussed in Section VI. above, and will rank *pari passu* with any other similarly subordinated obligations of the Segregated Account.

The payment of the principal of and interest on the Junior Surplus Notes will be expressly subordinate in right of payment to the prior payment in full of all Indebtedness, Policy Claims and Prior Claims (each as defined below), including all insurance policies and existing or future indebtedness issued, incurred or guaranteed by the Segregated Account, other than any future surplus notes or future similarly subordinated obligations, or any indebtedness that is expressly subordinate to, or ranks *pari passu* with, the Junior Surplus Notes. In addition, 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, including upon any distribution to creditors of the Segregated Account in any rehabilitation, liquidation, conservation or dissolution or similar proceeding relating to the Segregated Account or its property.

Pursuant to section 645.68 of the Wisconsin Statutes, upon any distribution to creditors of claims in any rehabilitation, liquidation, conservation, dissolution or similar proceeding relating to the Segregated Account or its property, the holders of Indebtedness, the Holders of Policy Claims and the holders of Prior Claims, including, without limitation, general creditors of the Segregated Account, will first be entitled to receive payment in full of all amounts due or to become due with respect thereto before the holders of the Junior Surplus Notes will be entitled to receive any payment in respect of the principal of or interest on, or redemption payment with respect to, the Junior Surplus Notes.

"Indebtedness" means (i) all existing or future surplus notes of the Segregated Account (including the Surplus Notes and the Weinstein Notes); (ii) all existing or future indebtedness of the Segregated Account for borrowed money; (iii) all existing or future indebtedness for borrowed money of other persons, the payment of which is guaranteed by the Segregated Account; (iv) all existing or future obligations of the Segregated Account under any agreement obligating the Segregated Account to cause another person to maintain a minimum level of net worth, or otherwise to ensure the solvency of such person; (v) all other claims or amounts owed, to the extent that the payment of principal of, interest on or any redemption payment with respect to, the Junior Surplus Notes would be required by law to be subordinated to the prior payment of any such claim or amount in the event of a distribution of claims pursuant to section 645.68 of the Wisconsin Statutes; and (vi) any surplus or contribution notes or similar obligations of AAC, unless the terms thereof expressly state that such notes are *pari passu* with or subordinated to the Junior Surplus Notes. Any indebtedness of the Segregated Account, which, by its express terms or other contract, is subordinated in right of payment to, or ranks equally with, the Junior Surplus Notes shall not constitute Indebtedness. Any other junior surplus notes or similar obligations of the Segregated Account shall not constitute Indebtedness and will rank *pari passu* with the Junior Surplus Notes.

"Policy Claims" means all existing or future claims of policyowners, beneficiaries and insureds arising from and within the coverage of, and not in excess of the applicable limits of, any and all existing or future policies, endorsements, riders and other contracts of insurance, annuity contracts (including, without limitation, guaranteed investment contracts and funding agreements) issued, assumed or renewed by the Segregated Account on or prior to the date hereof or hereafter created, all claims under separate account agreements to the extent such claims are not fully discharged by the assets held by the Segregated Account in the applicable separate accounts and all claims of any guaranty corporation or association of the State of Wisconsin or any other jurisdiction against the Segregated Account.

"Prior Claims" means all other claims against the Segregated Account, which, in the event of a rehabilitation, liquidation, conservation, dissolution or similar proceeding relating to the Segregated Account pursuant to section 645.68 of the Wisconsin Statutes, would have priority over claims with respect to the Surplus Notes. Under section 645.68 of the Wisconsin Statutes as currently in effect, such other claims include: (i) costs and expenses of administration during conservation, rehabilitation, liquidation or similar proceedings, including, but not limited to, actual and necessary costs of preserving or recovering the assets of the insurer, compensation for

all services rendered in the liquidation, necessary filing fees, fees and mileage payable to witnesses, and reasonable attorney fees; (ii) all claims under policies for losses incurred, including third party claims and federal, state and local government claims, except the first $200 of losses otherwise payable to any claimant under this clause (ii) other than the federal government; (iii) claims of the federal government not included under clause (ii), interest at the legal rate compounded annually on all claims in the class under this clause (iii), and on all claims of the federal government in the class under clause (ii), from the date of the petition for liquidation or the date on which the claim becomes due, whichever is later, until the date on which the dividend is declared; (iv) claims against the Segregated Account that are not under policies and that are for liability for bodily injury or for injury to or destruction of tangible property; (v) debts due to employees (with the exception of officers) for services performed, not to exceed $1,000 to each employee which have been earned within one year before the filing of the petition for liquidation, which shall be in lieu of any other similar priority authorized by law as to wages or compensation of employees, *provided*, *however*, that if there are no claims of the federal government, the claims in clause (v) have priority over all claims under clauses (ii) to (x); (vi) claims under non-assessable policies for unearned premiums and other premium refunds and the first $200 of loss excepted by the deductible provision under clause (ii); (vii) all other claims, including claims of any state or local government, not falling within other clauses and claims, including those of any state or local governmental body, for a penalty or forfeiture, but only to the extent of the pecuniary loss sustained from the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby; (viii) claims based solely on judgments; (ix) interest at the legal rate compounded annually on all claims in the classes under clauses (i) to (viii), except for claims of the federal government in the classes under clauses (ii) and (iii), from the date of the petition for liquidation or the date on which the claim becomes due, whichever is later, until the date on which the dividend is declared; and (x) pursuant to subdivision (8) of section 645.68 of the Wisconsin Statutes, the remaining claims or portions of claims not already paid, with interest calculated in accordance with clause (ix).

The Junior Surplus Notes do not prohibit or limit the incurrence of additional Indebtedness, Policy Claims or Prior Claims. The Junior Surplus Notes are unsecured obligations and are expressly subordinate in right of payment to all existing and future Indebtedness, Policy Claims and Prior Claims.

E. No Restrictive Covenants

The Junior Surplus Notes do not contain any restrictive covenants. For example, the Segregated Account is not restricted from incurring, assuming or becoming liable with respect to any indebtedness, liens or any other obligations, whether secured or unsecured.

In addition, there are also no financial ratios or specified levels of net worth, surplus or liquidity to which the Segregated Account must adhere. In addition, the Segregated Account is not required to repurchase, redeem or modify the terms of any of the Junior Surplus Notes upon a change in control or other event involving the Segregated Account that may adversely affect the creditworthiness of the Junior Surplus Notes.

F. Remedies

In the event that any state or federal agency obtains an order or grants approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account (other than any

Excluded Order), the Junior Surplus Notes will, upon the obtaining of such an order or granting of such approval, immediately mature in full without any action on the part of any holder of the Junior Surplus Notes, with payment thereon being subject to the satisfaction of the conditions to payment described herein and to any restrictions imposed as a consequence of, or pursuant to, such proceedings. "Excluded Order" means any order or approval under which any state or federal agency obtains an order or grants approval for the rehabilitation, liquidation, conservation or dissolution of the Segregated Account which is entered or granted prior to the date hereof or any such order or approval entered or granted on or after the date hereof in the Proceeding, except to the extent that any such order or approval by its express terms provides for the acceleration of the maturity of the Junior Surplus Notes or otherwise designates the scheduled maturity date or other maturity date or date for the payment of principal of the Junior Surplus Notes.

In the event that the Commissioner approves in whole or in part a payment of any interest on, principal of, or any redemption payment with respect to, the Junior Surplus Notes and the Segregated Account fails to pay the full amount of such approved payment on the date such amount is scheduled to be paid, such approved amount will be immediately payable on such date without any action on the part of any holder of Junior Surplus Notes.

In no event shall any holder of Junior Surplus Notes be entitled to declare the Junior Surplus Notes to be immediately due or otherwise to be immediately payable, except for payments approved by the Commissioner. Other than as set forth in this section, there is no right of acceleration of the principal of or interest on, or any redemption payment with respect to, the Junior Surplus Notes upon a failure to pay the principal of or interest on, or any redemption payment with respect to, or in the performance of any agreement applicable to, the Junior Surplus Notes.

G. Governing Law

The Junior Surplus Notes will be governed by and construed in accordance with the laws of the State of Wisconsin. The Commissioner's exercise of regulatory authority, including approval of payments on the Junior Surplus Notes, shall be governed by, and construed in accordance with, the laws of the State of Wisconsin (or, if the Commissioner is no longer the primary regulator of the financial condition of the Segregated Account, the law of such jurisdiction of the primary regulator of the financial condition of the Segregated Account), and the holders of Junior Surplus Notes shall submit any disputes related to the exercise of such regulatory authority to the exclusive jurisdiction of the Court, or, so long as any proceeding is pending in Wisconsin as to the Segregated Account under chapter 645 of the Wisconsin Statutes, then to that case and court.

H. Risks Relating to the Junior Surplus Notes

The assumptions and estimates underlying the Rehabilitator's Financial Projections set forth in Section VIII. of this Disclosure Statement and Exhibits C-G hereto are inherently uncertain and, though considered reasonable by the Rehabilitator as of the date hereof, are subject to a wide variety of significant business, economic, competitive and political risks and uncertainties. The Rehabilitator's Financial Projections are not necessarily indicative of the future financial position or results of operations of the Segregated Account, which may vary significantly from those set forth in the Rehabilitator's Financial Projections. Consequently, the Rehabilitator's Financial Projections contained herein should not be regarded as a representation by the Rehabilitator or

the Segregated Account, or their advisors, or any other person that the projected financial position or results of operations can or will be achieved. The Rehabilitator's Financial Projections are also "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. There are many factors that could cause actual results to differ materially from those set forth in the Rehabilitator's Financial Projections.

VIII. RECOVERY ANALYSIS

Subject to the Minimum Surplus Amount requirement, all claims-paying resources of the General Account will be available to pay Claims against the Segregated Account in accordance with the terms of the Plan. With the assistance of its financial advisors, the Rehabilitator has set forth below a detailed report on the assets and liabilities of the General Account, followed by an analysis of projected recoveries for Holders of Policy Claims under certain scenarios.

A. General Account Assets Available to Pay Segregated Account (and other) Liabilities

Total claims-paying resources were approximately $6.8 billion as of June 30, 2010 (reflecting the termination of the AUK Reinsurance Agreement), comprising approximately (i) $4.6 billion of investment portfolio assets at statutory carrying value, (ii) $1.0 billion in net present value of future installment premiums (reflecting the termination of the AUK Reinsurance Agreement), (iii) $0.8 billion of intercompany loans at statutory carrying value, (iv) $0.2 billion of investments in subsidiaries, and (v) $0.2 billion of miscellaneous assets. The foregoing estimate of claims-paying resources includes certain assumptions and judgments regarding future events that are described more fully below.

1. Investment Portfolio Holdings

As of June 30, 2010, AAC held fixed income investment securities with fair value of approximately $4.8 billion, statutory carrying value of $4.6 billion and par value of $6.1 billion. Portfolio holdings by asset class are summarized below.

AAC Investment Portfolio by Asset Class as of June 30, 2010

	Fair Value	Carrying Value	Par Value	YTM[(1)]	WAL
		(In millions)			
Municipal Obligations	$1,885	$1,814	$1,985	4.90%	11.4
RMBS	778	601	1,786	18.23%	7.4
Corporate Obligations	690	670	647	4.99%	6.6
Short-Term	492	492	491	0.17%	0.0
Military Housing	400	363	391	7.51%	17.9
U.S. Government, Agency, and GSE Obligations	355	337	332	3.65%	2.6
ABS, CDO, and Structured Insurance	249	296	428	2.16%	12.8
Total	**$4,848**	**$4,572**	**$6,059**	**6.09%**	**8.8**

(1) Does not fully reflect the impact of Surplus Notes received by AAC under the Plan as the result of its holdings of AAC-insured securities.

	Fair Value	Carrying Value	Par Value
	(Percentage of Total)		
Municipal Obligations	39%	40%	33%
RMBS	16%	13%	29%
Corporate Obligations	14%	15%	11%
Short-Term	10%	11%	8%
Military Housing	8%	8%	6%
U.S. Government, Agency, and GSE Obligations	8%	7%	6%
ABS, CDO, and Structured Insurance	5%	6%	7%
Total	**100%**	**100%**	**100%**

The investment portfolio is subject to certain internal investment guidelines, including minimum credit rating requirements and credit risk concentration limits. Changes to the investment policy are subject to covenants contained in the Secured Note and the Reinsurance Agreement that limit AAC's ability to amend its investment policy to the extent such amendment would impair AAC's ability to perform its obligations under those agreements.

AAC previously managed its investment portfolio in a manner that allowed it to minimize capital charges under applicable rating agency models. Following the downgrades that occurred in the second half of calendar 2008 (and the related implications for those financial services affiliates with obligations guaranteed by AAC), investment portfolio guidelines were broadened in an effort to increase after-tax portfolio returns while protecting claims-paying resources and satisfying liquidity needs. Accordingly, the composition and characteristics of the investment portfolio have changed significantly since 2008.

The most significant change during this period is the substantial increase in RMBS, which represents the second largest asset class by fair value and aggregate par amount in AAC's investment portfolio as of June 30, 2010. Approximately 56% of existing RMBS investments by par value were originally purchased by Ambac Investments, Inc. ("AII") and transferred to AAC in exchange for cash to satisfy AII's liquidity needs resulting from the springing collateral posting and contract termination obligations triggered in the second half of 2008 and 2009. These RMBS account for approximately 9% of portfolio fair value but 17% of aggregate portfolio par value, implying a weighted-average fair value estimate equal to 53% of the aggregate par value for such instruments.

Most other RMBS investments, as well as certain structured insurance and ABS holdings, are Ambac-insured obligations, generally acquired at discounts to par. In the aggregate, Ambac-insured instruments held in AAC's investment portfolio account for 6% of portfolio fair value and 16% of par value, implying a weighted-average fair value estimate equal to 38% of the aggregate par value for such instruments.

Commencing in mid-2008 AAC began to increase its investment in corporate securities because of its tax position. Such holdings represent 14% of aggregate portfolio fair value as of June 2010, versus 3% as of December 31, 2007.

In general, investment portfolio performance has been adversely affected by capital market developments, including (i) decreased market liquidity for certain asset classes, (ii) increased perceptions of credit risk with respect to certain asset classes (with corresponding credit spread-widening) and (iii) extended duration for certain investment assets. These trends, combined with

the changes in investment portfolio composition described above, have exposed AAC to greater portfolio risk and a corresponding increase in investment losses in recent years.

a. Market Liquidity of Investment Portfolio

AAC categorizes investment portfolio holdings by market liquidity, or salability. This categorization process is intended to assess the relative ease with which a particular security can be sold. Accordingly, each security is classified as either (i) highly liquid, (ii) medium liquid, (iii) low liquid or (iv) illiquid. The market liquidity profile of AAC's investment portfolio as of June 30, 2010 is summarized below:

AAC Investment Portfolio by Market Liquidity Classification as of June 30, 2010

	Fair Value	Carrying Value	Par Value	Fair Value	Carrying Value	Par Value
		(In millions)			(Percentage of Total)	
Highly Liquid.........	$1,650	$1,594	$1,576	34%	35%	26%
Medium Liquid.......	1,792	1,723	1,931	37%	38%	32%
Low Liquid	439	331	924	9%	7%	15%
Illiquid..................	966	924	1,628	20%	20%	27%
Total	**$4,848**	**$4,572**	**$6,059**	**100%**	**100%**	**100%**

1. **Highly Liquid:** Includes widely-held securities with tight bid/ask spreads and transparent markets. Asset classes represented in this category include money market holdings, certain municipal bonds, and U.S. agencies and treasuries.

2. **Medium Liquid:** Incorporates widely-held securities with broader bid/ask spreads in actively-traded markets. Asset classes represented in this category include certain asset-backed securities, investment-grade corporate obligations, and certain municipal bonds.

3. **Low Liquid:** Incorporates closely-held securities with wide bid/ask spreads. Price changes are primarily credit-driven. Asset classes represented in this category include certain asset-backed securities and residential mortgage-backed securities.

4. **Illiquid:** Includes distressed and/or complex securities in specialty asset classes such as CDO/CLOs, distressed RMBS, structured insurance, and certain asset-backed securities.

Approximately 29% of aggregate investment portfolio holdings at fair value were classified as either low liquid or illiquid (although many of these securities do generate periodic principal distributions). Accordingly, AAC could realize losses in a forced sale scenario. RMBS, ABS, CDO, and structured insurance investments account for more than 60% of all investments in the low liquid or illiquid classifications; more than 85% of all RMBS, ABS, CDO, and structured insurance investments fall into one of these two categories. Substantially all Ambac-insured instruments held in the investment portfolio are in either the low liquid or illiquid classifications.

2. Installment Premiums

Many insurance policies provide for premiums to be paid to AAC over the life of the exposure. As of June 30, 2010, employing a 5.1% discount rate, the present value of such future installment premiums (net of reinsurance and reflecting the termination of the AUK Reinsurance

Agreement) is estimated at $1.0 billion. Under the terms of the Plan of Operation, the General Account retained the right to receive installment premiums from all policies, although the right to receive installment premiums related to Segregated Account Policies constitutes part of the security for its obligations under the Secured Note and the Reinsurance Agreement.

The ultimate value attributable to future installment premium receipts is subject to significant uncertainty. In the ordinary course of business, factors such as early contract termination or commutation, accelerated prepayments of underlying obligations, or insufficiency of cash flows (by the premium paying entity) may lead to lower-than-projected installment premium receipts.

3. Intercompany Loans

As of June 30, 2010, AAC has approximately $1.1 billion in loans to affiliates, comprised of (i) $194 million in secured loans and $360 million in unsecured loans extended to Ambac Capital Funding Inc. ("ACFI"), and (ii) $559 million in loans extended to Ambac Financial Services, LLC ("AFS"). The ACFI and AFS loans were provided to support the orderly runoff of these businesses following the collateral posting and contract termination obligations triggered by ratings downgrades in the second half of 2008.

A portion of the AFS obligation is comprised of $130 million of loans provided in the form of marketable securities. Under SAP, the statutory carrying value of the loaned securities are included in the investment portfolio totals summarized in Section VIII.1.a above and, therefore, such $130 million is excluded from this calculation of the intercompany loan component of claims-paying resources. Ambac anticipates that (i) no impairments will be experienced with respect to the ACFI secured loan and (ii) $193 million of impairments will be experienced with respect to the unsecured intercompany loans, resulting in aggregate statutory carrying value of $790 million (as reported in AAC's June 30, 2010 statutory financial balance sheet).

a. ACFI Intercompany Loans

The guaranteed investment contract ("GIC") business, operated through ACFI, has been reduced substantially through both contractual and negotiated terminations. As of June 30, 2010, GICs aggregating less than $950 million remained outstanding, compared with approximately $2.6 billion outstanding as of December 31, 2008. Accordingly, intercompany loan balances have declined from $1.0 billion as of December 31, 2008 to current levels. In the absence of further negotiated terminations or accelerations, AAC's GIC obligations are scheduled to extend until 2031.

AAC currently expects to experience a $76 million impairment of the unsecured loan, implying a 79% recovery of principal on the unsecured obligation and an 86% recovery on the aggregate obligation. This impairment estimate is based upon various assumptions, including, but not limited to, assumptions regarding interest rates, portfolio performance, early contract terminations, and litigation recoveries. Accordingly, the ultimate impairment realized in respect of this obligation may change, perhaps materially, to the extent future performance differs from such assumptions.

b. AFS Intercompany Loans

The swap intermediation business, operated through AFS, has also been reduced since the beginning of 2009. As of June 30, 2010, AFS maintained positions with gross notional exposure of $6.4 billion, compared with gross notional exposure of $9.6 billion as of December 31, 2008. These swap obligations are primarily floating-for-fixed interest rate swaps with municipalities and financial institutions.

As a result of the rating downgrades that occurred in the second half of 2008, AFS is required to post collateral to certain financial institution counterparties in respect of its net mark-to-market exposure as well as certain independent amounts, which are additional collateral postings required by counterparties to provide additional security in the event of market declines. Collateral posting obligations are asymmetric as municipal counterparties who hold the offsetting swap do not post collateral to AFS, creating the liquidity gap that was resolved through the intercompany loan.

The intercompany loan balance varies with market movements (primarily interest rates) and contract terminations. Collateral posting requirements move inversely with U.S. interest rates, such that the mark-to-market portion of AFS' collateral posting requirement grows with declines in U.S. interest rates and shrinks with increases in U.S. interest rates. Collateral posting requirements were $203 million as of June 30, 2010 (comprising $94 million in net mark-to-market collateral and $109 million in independent amounts), compared with $201 million (comprising $82 million in net mark-to-market collateral and $119 million in independent amounts) as of December 31, 2009.

AAC currently projects aggregate impairments of $116 million on the AFS loan, implying a 73% recovery of principal (excluding the $130 million securities loan). This impairment estimate is based upon various assumptions, including, but not limited to, forward interest rates, the ability of counterparties to pay when due, early contract terminations and litigation recoveries. Accordingly, the ultimate impairment realized in respect of this obligation may change, perhaps materially, to the extent future performance differs from such assumptions.

4. Investment in Subsidiaries

As of June 30, 2010, AAC's investment in subsidiaries comprised $173 million in Everspan and $338 million in Ambac UK. AAC's investment in Everspan is expected to ultimately be realized by policyholders in both the General Account and the Segregated Account, given AAC's current expectation of negligible loss development at Everspan.

Ambac UK's primary business is the run-off of its insured portfolio of financial guaranty insurance business. Following the consummation of the AUK Commutation Agreement, AAC expects to report a significant decline in the statutory carrying value of its investment in Ambac UK. Given uncertainties regarding the recoverability of AAC's investment in Ambac UK, including, but not limited to, future loss development and the impacts of regulatory control, this analysis attributes no value to AAC's investment in Ambac UK.

5. Miscellaneous

Other prospective claims-paying resources include (i) reinsurance settlements, (ii) accrued but unpaid interest, and (iii) certain tax attributes.

a. Reinsurance Settlements

Subsequent to the end of the second fiscal quarter, AAC consummated a reinsurance settlement in which it received $205 million.

b. Accrued Interest and Cash

As of June 30, 2010, AAC had $40 million in accrued and unpaid interest and $9 million in cash, neither of which is incorporated in the investment portfolio totals summarized in Section VIII.1.a above.

c. Certain Tax Attributes

As of June 30, 2010, the consolidated return group of which AAC is a part (the "Ambac Group") had net operating losses ("NOLs") of approximately $7.0 billion. The Ambac Group can utilize these tax attributes in certain circumstances to offset future U.S. taxable income and reduce the U.S. federal income tax liability of a member of the Ambac Group (including AAC). However, the ultimate benefits that may be realized by the members of the Ambac Group are subject to many uncertainties, including AAC's ability to generate taxable income that would allow for meaningful utilization of the NOLs, the potential of annual limitations on usage due to an "ownership change" as defined under Section 382 of the Internal Revenue Code, whether as the result of an AFGI reorganization, or as a result of the classification of the Surplus Notes as being an equity interest, rather than indebtedness, for federal income tax purposes, or otherwise. Readers should consult AFGI's quarterly report on form 10-Q for the period ended June 30, 2010 for further information. Based upon the foregoing, OCI has ascribed no value to the NOLs for purposes of assessing claims-paying resources.

B. Policy Liabilities of the General Account and the Segregated Account

1. Summary of Liabilities

The Segregated Account is primarily exposed to RMBS-related risk, although some public finance and non-RMBS structured finance policies have also been allocated to the Segregated Account as well. While the General Account is primarily exposed to the U.S. public finance sector on a direct basis, it retains exposure to Segregated Account Policies under the terms of the Secured Note and the Reinsurance Agreement.

The following information about General Account and Segregated Account exposures is presented as of June 30, 2010, provided that such information has been updated to reflect the results of the student loan assessment process and the termination of the AUK Reinsurance Agreement (except where explicitly noted otherwise).

2. General Account Exposures

a. Overview

As of June 30, 2010, approximately 13,000 policies representing $267 billion in net par outstanding remain in the General Account, after giving effect to the student loan assessment process referenced previously. The General Account is predominantly exposed to municipal credit risk, as U.S. public finance exposures represent 95% of total policies and 79% of

aggregate net par outstanding in the General Account. Other exposures that remain in the General Account include (i) certain structured finance exposures (such as rental car fleet securitizations and whole business securitizations), (ii) certain CLOs and other CDOs and (iii) certain international infrastructure obligations. See below for a summary of policies and net par outstanding by exposure category.

General Account Policies and Net Par Outstanding as of June 30, 2010[(1)]

	Policies		Net Par Outstanding	
	Amount	Percentage	Amount (In millions)	Percentage
U.S. Public Finance	12,267	95%	$210,113	79%
Other Structured Finance [(2)]	525	4%	28,612	11%
CLOs and other CDOs	63	0%	17,977	7%
International	76	1%	9,923	4%
Total	**12,931**	**100%**	**$266,624**	**100%**

(1) This table excludes policies that matured, terminated or were otherwise extinguished after June 30, 2010.

(2) Includes student loan information, which reflects the assessment process and uses net par outstanding as of September 20, 2010.

b. Credit Profile

AAC's periodic credit review indicates that relatively few exposures are perceived to be problematic at this time. Approximately $5.2 billion of General Account net par outstanding is adversely classified, with the majority of such policies found in the I-A and II classifications. A description of the risk classifications used by AAC in its surveillance process is found in Exhibit B. A summary of adversely classified General Account net par outstanding is found below.

Net Par Outstanding Associated with Adversely Classified General Account Policies [(1)]

	Adversely Classified NPO[(1)]	Credit Classification[(2)]			
		I-A	II	III	IV
			(In millions)		
U.S. Public Finance	$2,198	$268	$1,188	$144	$598
Other Structured Finance[(3)]	$2,419	$1,827	$592	$0	$0
CLOs and other CDOs	$364	$259	$105	$0	$0
International	$227	$0	$227	$0	$0
Total	**$5,208**	**$2,354**	**$2,112**	**$144**	**$598**

(1) Net par outstanding reflects (i) June 30, 2010 amounts for all exposures other than student loans, and (ii) September 20, 2010 amounts for student loans.

(2) Credit classifications reflect (i) August 31, 2010 amounts for all exposures other than student loans, and (ii) September 20, 2010 classifications for student loans.

(3) Includes student loans.

c. Loss Reserves

Statutory loss reserves reflect AAC management's best estimate of the present value of future loss payments (net of projected subrogation recoveries) for policies that have already defaulted, discounted at the applicable statutory rate (currently 5.1%). As of June 30, 2010, total statutory reserves associated with General Account policies were approximately $(24.4) million, comprised of $16.0 million in projected claims offset by $40.4 million in prospective recoveries.

d. Prospective Losses

In addition to the best estimate loss projections underlying statutory loss reserves, AAC generally develops several cash flow projections for both defaulted and undefaulted policies for which losses are anticipated in accordance with GAAP. Such loss projections may be prepared for GAAP financial statements or at the request of the Rehabilitator. For purposes of the analysis in this Disclosure Statement, the Rehabilitator used (i) certain information provided by AAC to develop its base case loss estimates for the General Account (the "General Account Base Case Loss Estimates") and (ii) top-down assumptions to develop its stress case loss estimates for the General Account (the "General Account Stress Case Loss Estimates"). THESE GENERAL ACCOUNT BASE CASE LOSS ESTIMATES AND GENERAL ACCOUNT STRESS CASE LOSS ESTIMATES DO NOT REFLECT THE VIEWS OF AMBAC OR ITS MANAGEMENT.

The General Account Base Case Loss Estimates employ the nominal cash flows associated with the loss cash flow projections that provided the highest estimate of future losses (on a present value basis) for each General Account policy with loss projections. If the nominal cash flows associated with the General Account Base Case Loss Estimates are discounted at 5.1%, the present value of such future policy claims, net of reinsurance, is less than $80 million as of June 30, 2010.

Given (i) the relatively low losses contemplated by the General Account Base Case Loss Estimates and (ii) the substantial amount of exposure insured by the General Account, the Rehabilitator desired to create a more severe loss scenario for the General Account that could be used to demonstrate the effect of substantially greater loss development on Holders of Policy Claims. Based on the foregoing, the General Account Stress Case Loss Estimate, which contemplates $1 billion of lifetime losses (on a present value basis) in the General Account, was developed. The cash outflows associated with the General Account Stress Case Loss Estimate are assumed to occur between 2011 and 2022.

The ultimate losses resulting from General Account policies may exceed both the General Account Base Case Loss Estimates and the General Account Stress Case Loss Estimates, perhaps materially, and such estimates do not represent a cap on prospective losses.

3. Segregated Account Exposures

a. Overview

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. Other significant concentrations of risk include student loan exposures, which represent 19% of all Segregated Account Policies and 24% of Segregated Account net par outstanding. See below for a summary of Segregated Account Policies and net par outstanding.

Segregated Account Policies and Net Par Outstanding as of June 30, 2010[5]

Segregated Account as of June 30, 2010

	Policies		**Net Par Outstanding[4] as of June 30, 2010**	
	Amount	**Percentage**	**Amount (In millions)**	**Percentage**
Direct				
RMBS	301	45%	$29,670	63%
U.S. Public Finance	171	25%	1,342	3%
Structured Finance	35	5%	649	1%
Student Loans[1]	126	19%	11,378	24%
International	21	3%	1,227	3%
ACP[2]	19	3%	2,500	5%
Subtotal	673	100%	$46,766	99%
Assumed[3]	—	N/A	459	1%
Total	**673**	**100%**	**$47,225**	**100%**

(1) Includes student loan net par outstanding as of September 20, 2010.

(2) Includes all CDS contracts in the Segregated Account.

(3) Represents liabilities assumed under reinsurance agreements.

(4) This table excludes notional amounts associated with swap surety policies.

(5) This table excludes policies that matured, terminated, or were otherwise extinguished after June 30, 2010.

b. Credit Profile

Approximately $38 billion of Segregated Account net par outstanding is adversely classified, including $35 billion designated with the more severe III and IV risk classifications. A summary of adversely classified Segregated Account net par outstanding is found below.

Net Par Outstanding Associated with Adversely Classified Segregated Account Policies

	Adversely Classified NPO[1]	**Credit Classification[2]**			
		I-A	**II**	**III**	**IV**
			(In millions)		
Direct					
RMBS	$ 25,083	$ 390	$ 474	$ 11,025	$ 13,193
U.S. Public Finance	518	0	58	0	460
Structured Finance	55	0	55	0	0
Student Loans	11,378	0	1,624	9,754	0
International	661	324	336	0	0
CDS	265	0	0	265	0
Subtotal	$ 37,960	$ 714	$ 2,548	$ 21,044	$ 13,654
Assumed	137	0	0	137	0
Total	**$ 38,097**	**$ 714**	**$ 2,548**	**$ 21,181**	**$ 13,654**

(1) Net par outstanding reflects (i) June 30, 2010 amounts for all exposures other than student loans, and (ii) September 20, 2010 amounts for student loans.

(2) Credit classifications reflect (i) August 31, 2010 amounts for all exposures other than student loans, and (ii) September 20, 2010 classifications for student loans.

c. Loss Reserves

As of June 30, 2010, total statutory loss reserves associated with defaulted Segregated Account Policies were 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. These loss reserves are maintained in the General Account in accordance with accounting principles prescribed or permitted by OCI for reporting purposes and exclude the effect of the allocation of the Policies to the Segregated Account. The allocation of the liabilities to the Segregated Account is reflected on the balance sheet of the General Account, prepared in accordance with SAP as a "Retroactive Reinsurance Asset." See below for a summary of statutory reserves associated with Segregated Account Policies by category.

Statutory Reserves Associated with Segregated Account Policies as of June 30, 2010

	Statutory Reserves	**Statutory Reserves Excluding R&W Remediation Recoveries**
	(In millions)	
Direct		
RMBS	$1,565	$3,623
U.S. Public Finance	($4)	($4)
International	($2)	($2)
Loss Adjustment Expense[1]	$200	$200
Total[2]	**$1,758**	**$3,816**

(1) Includes reserves for past or prospective commutations and other loss adjustment expenses.

(2) Reflects the AUK Commutation Agreement and the associated elimination of approximately $290 million in reserves associated with exposures previously reinsured under the AUK Reinsurance Agreement.

d. Prospective Losses

Similar to the process described above with respect to the General Account Base Case Loss Estimates, the Rehabilitator used loss cash flow projections (or, for certain Segregated Account policies, statistical loss methods) provided by AAC to develop its Segregated Account Base Case Loss Estimates and Segregated Account Stress Case Loss Estimates. Both the Segregated Account Base Case Loss Estimates and the Segregated Account Stress Case Loss Estimates exclude R&W Remediation recoveries, which are addressed separately. Where statistical loss estimates were provided, the Rehabilitator developed nominal cash flows estimates that are believed to be consistent with such statistically-based loss estimates. THESE SEGREGATED ACCOUNT BASE CASE LOSS ESTIMATES AND SEGREGATED ACCOUNT STRESS

CASE LOSS ESTIMATES DO NOT REFLECT THE VIEWS OF AAC OR ITS MANAGEMENT.

The Segregated Account Base Case Loss Estimates are based upon (i) the nominal cash flows associated with the scenario which provides the midpoint estimate of future losses (on a present value basis) for each Segregated Account Policy and (ii) the total amount of presented but unpaid claims associated with Segregated Account Policies from the Petition Date to June 30, 2010. Applying a 5.1% discount rate to the nominal cash flows associated with the Segregated Account Base Case Loss Estimates, the present value of such future Policy claims, net of reinsurance, is approximately $4.9 billion as of June 30, 2010. In addition, $655 million of claims associated with Segregated Account Policies were presented but unpaid from the Petition Date through June 30, 2010. Therefore, the Segregated Account Base Case Loss Estimates contemplate approximately $5.6 billion in losses.

Primary components of the Segregated Account Base Case Loss Estimates include (i) $2.2 billion associated with first lien RMBS Policies (including $251 million in presented but unpaid claims from the Petition Date through June 30, 2010) (ii) $2.6 billion associated with second lien RMBS Policies (including $405 million in presented but unpaid claims from the Petition Date through June 30, 2010), (iii) $298 million associated with student loan Policies, (iv) $488 million associated with other Segregated Account Policies, and (v) $41 million associated with assumed reinsurance obligations.

The Segregated Account Stress Case Loss Estimates employ (i) the nominal cash flows associated with the scenario which provides the highest estimate of future losses (on a present value basis) for each Segregated Account Policy and (ii) the total amount of presented but unpaid claims associated with Segregated Account Policies from the Petition Date to June 30, 2010. Applying a 5.1% discount rate to the nominal cash flows associated with the Segregated Account Stress Case Loss Estimates, the present value of such future Policy claims, net of reinsurance, is approximately $7.4 billion as of June 30, 2010. In addition, $655 million of claims associated with Segregated Account Policies were presented but unpaid from the Petition Date through June 30, 2010. Therefore, the Segregated Account Stress Case Loss Estimates contemplate approximately $8.0 billion in losses.

Primary components of the Segregated Account Stress Case Loss Estimates include (i) $3.2 billion associated with first lien RMBS Policies (including $251 million in presented but unpaid claims from the Petition Date through June 30, 2010) (ii) $3.1 billion associated with second lien RMBS Policies (including $405 million in presented but unpaid claims from the Petition Date through June 30, 2010), (iii) $1.1 billion associated with student loan Policies, (iv) $502 million associated with other Segregated Account Policies, and (v) $81 million associated with assumed reinsurance obligations.

The ultimate losses resulting from Segregated Account Policies may exceed both the Segregated Account Base Case Loss Estimates and the Segregated Account Stress Case Loss Estimates, perhaps materially, and such estimates do not represent a cap on prospective losses.

4. R&W Remediation Recoveries

In an effort to better understand the unprecedented levels of mortgage delinquencies, Ambac engaged consultants with significant mortgage lending experience to review the underwriting

documentation for mortgage loans underlying certain insured RMBS transactions. These transactions have exhibited signs of exceptionally poor performance including (i) increased levels of early payment defaults, (ii) the significant number of loan liquidations or charge-offs and resulting high level of losses, and (iii) the rapid elimination of credit protections inherent in the transactions' structures. Generally, the sponsor of the transaction provides representations and warranties with respect to the securitized loans including the loan characteristics, the absence of fraud or other misconduct in the origination process, including those attesting to the compliance of home loans with the prevailing underwriting policies. Per the transaction documents, the sponsor of the transaction is contractually obligated to repurchase, cure or substitute any loan that breaches the representations and warranties. Substitution is generally limited to two years from the closing of the transaction and the cure remedy is permitted only to the extent cure is possible. Subsequent to the forensic exercise of examining loan files to ascertain whether the loans conformed to the representations and warranties, Ambac submits nonconforming loans to the sponsor for repurchase. Notwithstanding the material breaches of representations and warranties, up until the establishment of the Segregated Account and associated Proceeding, Ambac had continued to pay claims submitted under the financial guarantee insurance policies related to these securitizations and will, once again, pay claims in accordance with the Plan after it has been approved. In cases where loans are repurchased by a sponsor, the effect is typically to offset current period losses and then to increase the over-collateralization of the securitization, depending on the extent of loan repurchases and the structure of the securitization. With respect to transactions for which Ambac has recorded estimated subrogation recoveries (as further described below), Ambac insures all or a portion of the senior tranches in the capital structure of the issuer, thus any sponsor cash received from loan repurchases would entirely benefit Ambac or Ambac insured note holders. Notwithstanding the reimbursement of previous monthly claim payments, to the extent there continues to be insufficient cash in the waterfall in the current month to make scheduled principal and interest payments to the note holders, Ambac is required to make additional claim payments to cover this shortfall.

Ambac's estimate of subrogation recoveries includes two components: (1) estimated dollar amounts of loans with material breaches of representations and warranties based on an extrapolation of the breach rate identified in a random sample of loans taken from the entire population of loans in a securitization ("random sample approach") and (2) dollar amount of actual loans with identified material breaches of representations and warranties discovered from samples of impaired loans in a securitization ("adverse sample approach"). Ambac does not include estimates of damages in its estimate of subrogation recoveries under either approach. The amount the sponsors believe to be their liability for these breaches is not known.

While the obligation by sponsors to repurchase loans with material breaches is clear, generally the sponsors have not yet honored those obligations. Ambac's approach to resolving these disputes has included negotiating with individual sponsors at the transaction level and in some cases at the individual loan level and has resulted in the repurchase of some loans. Ambac has utilized the results of examinations of loan files to make demands for loan repurchases from sponsors or their successors and, in certain instances, as a part of the basis for litigation filings. Ambac has initiated and will continue to initiate lawsuits seeking compliance with the repurchase obligations in the securitization documents. Ambac estimates that it will take approximately three years from the initiation of litigation with the sponsor to ultimate resolution.

Based on this estimate as a basis for projecting the future subrogation cash flows, Ambac assumes, on average, approximately three and a half years to collect recoveries.

C. Rehabilitator's Financial Projections

The Rehabilitator has prepared several sets of the Rehabilitator's Financial Projections. A summary of the Rehabilitator's Financial Projections are attached as exhibits to this Disclosure Statement. The financial projection information discussed herein includes certain statements that may be deemed to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

The Rehabilitator's Financial Projections were not prepared to comply with the guidelines for prospective financial statements published by the American Institute of Certified Public Accountants and the Rules and Regulations of the SEC. AAC's independent accountants have neither examined nor compiled the Rehabilitator's Financial Projections and, accordingly, do not express an opinion or any other form of assurance with respect to the Rehabilitator's Financial Projections, assume no responsibility for the Rehabilitator's Financial Projections and disclaim any association with the Rehabilitator's Financial Projections.

The Rehabilitator's Financial Projections are based upon estimates and assumptions developed in good faith by the Rehabilitator based upon certain materials provided by Ambac and other information that was determined to be relevant. THE REHABILITATOR'S FINANCIAL PROJECTIONS AND UNDERLYING ASSUMPTIONS DO NOT REFLECT THE VIEWS OF AMBAC OR ITS MANAGEMENT. The estimates and assumptions incorporated in the Rehabilitator's Financial Projections may not be realized and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Rehabilitator's control. No representations can be or are made as to whether the actual results will be within the range set forth in the Rehabilitator's Financial Projections. Therefore, although the Rehabilitator's Financial Projections are necessarily presented with numerical specificity, the actual results of operations achieved during the projection period will vary from projected results. These variations may be material. Some assumptions will not materialize and events and circumstances occurring subsequent to the date on which the Rehabilitator's Financial Projections were prepared may be different from those assumed or may be unanticipated, and therefore may affect financial results in a material and possibly adverse manner. Accordingly, due to the inherently unpredictable nature of such projections, no representation can be or is being made with respect to the accuracy of the Rehabilitator's Financial Projections, and the Rehabilitator's Financial Projections, therefore, may not be relied upon as a guarantee or other assurance of the actual results that will occur.

The Rehabilitator's Financial Projections, the model upon which such Rehabilitator's Financial Projections are based, and the accompanying commentary are not intended to provide legal, regulatory, tax, accounting, investment or other advice to any recipient. Recipients should consult their own advisors and develop their own conclusions. The Rehabilitator's views about the risks, uncertainties, and assumptions are subject to change without notice and none of the Rehabilitator, the Segregated Account or AAC undertakes to update or revise such information.

1. Principal Assumptions for the Rehabilitator's Financial Projections

a. General

The Rehabilitator's Financial Projections reflect numerous assumptions with respect to general business, economic, market, and financial conditions and other matters, all of which are difficult to predict and many of which are beyond the Rehabilitator's control. Examples of such assumptions include projected operating expense levels, investment portfolio reinvestment rates and prospective loss and loss expense development.

b. Methodology

The Rehabilitator's Financial Projections were developed to illustrate the prospective financial performance of AAC under various runoff scenarios for AAC and the potential resources available to all Holders of Policy Claims under such scenarios. 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 changes in the Cash Percentage or redemption of the Surplus Notes will be determined on an annual basis in accordance with the Plan. Instead, all economic resources available to AAC at the end of the runoff period are applied to the then-outstanding balance of Surplus Notes (and interest accrued thereon) to provide an estimate of the amount of such Surplus Notes (and interest accrued thereon) that may be repaid at such time.

c. Plan Consummation and Pro Forma Balance Sheet

The Rehabilitator's Financial Projections have been prepared on the assumption that the Plan will be consummated on December 31, 2010—that is, the Effective Date will have occurred before, and the first distribution of Cash and Surplus Notes under the confirmed Plan will occur promptly following, December 31, 2010 (the "Assumed Consummation Date"). The actual confirmation date of the Plan may differ. Therefore, the projected financial charts contained in Exhibits D-G reflect projected operations for the six-month period ending on December 31, 2010, assuming the payment moratorium remains in place through that date.

The estimated balance sheet for the period following the Assumed Consummation Date (the "Post-Consummation Balance Sheet") is based on an estimated balance sheet for the period prior to the Assumed Consummation Date ("Pre-Consummation Balance Sheet"), as modified by consummation adjustments. The Pre-Consummation Balance Sheet provides estimates of assets and liabilities just prior to the Assumed Consummation Date. Certain transactions associated with consummation of the Plan, principally the distribution of (i) Cash payments equal to 25% of Permitted Claims presented but unpaid during the payment moratorium, and (ii) Surplus Notes with a face value equal to 75% of the amount of Permitted Claims presented but unpaid during the payment moratorium, are assumed to occur on the Assumed Consummation Date.

d. Other Assumptions

A summary of other financial and accounting assumptions incorporated in the Rehabilitator's Financial Projections is found in Exhibit C.

2. Description of Rehabilitator's Financial Projections Scenarios

a. Overview

Four iterations, or scenarios, of the Rehabilitator's Financial Projections have been prepared to demonstrate the sensitivity of Ambac's financial performance, and thus resources available to pay Holders of Policy Claims, under various operating assumptions. These scenarios have generally been developed to highlight the effect of certain material variables, specifically loss development and R&W Remediation recoveries, on resources available to pay policyholder Claims.

b. Scenario One

Scenario One contemplates (i) the General Account Base Case Loss Estimates and the Segregated Account Base Case Loss Estimates and (ii) realization of R&W Remediation recoveries in accordance with AAC's estimates. See Exhibit D for a summary of projected financial and operating results associated with Scenario One.

c. Scenario Two

Scenario Two contemplates (i) the General Account Base Case Loss Estimates and the Segregated Account Base Case Loss Estimates and (ii) that no R&W Remediation recoveries are realized (reflected in 2011). See Exhibit E for a summary of projected financial and operating results associated with Scenario Two.

d. Scenario Three

Scenario Three contemplates (i) the General Account Stress Case Loss Estimates and the Segregated Account Stress Case Loss Estimates, and (ii) realization of R&W Remediation recoveries in accordance with AAC's estimates. See Exhibit F for a summary of projected financial and operating results associated with Scenario Three.

e. Scenario Four

Scenario Four contemplates (i) the General Account Stress Case Loss Estimates and the Segregated Account Stress Case Loss Estimates, and (ii) that no R&W Remediation recoveries are realized (reflected in 2011). See Exhibit G for a summary of projected financial and operating results associated with Scenario Four.

3. Recovery of Surplus Note Principal and Interest under the Rehabilitator's Financial Projections

Holders of Permitted Policy Claims will receive a combination of Cash and Surplus Notes in complete satisfaction of their Policy Claims under the Plan. The ultimate recovery achieved in respect of principal and interest on the Surplus Notes will vary based upon many factors, including, but not limited to, (i) lifetime losses generated by the Policies, (ii) the amount and timing of R&W Remediation recoveries received, (iii) the operating costs expended to run off all existing Policy obligations, and (iv) investment portfolio performance.

Recoveries by the Holders of Permitted Policy Claims may be affected by Alternative Resolutions of such Claims. See Section V.C.7 of this Disclosure Statement for further details. While the Rehabilitator's Financial Projections do not contemplate any Alternative Resolutions beyond those that have already been consummated, the Rehabilitator will evaluate opportunities for Alternative Resolutions as they develop.

Payments of principal and interest on the Surplus Note will also be affected by Plan provisions. The Plan provides for an annual evaluation of the Cash Percentage and prospective Surplus Note redemptions, which could affect the amount of payments of principal and interest on the Surplus Notes. Such determination will be made based on AAC's financial condition at the time, including a review of then-existing financial resources and prospective loss development.

For purposes of this analysis, the Rehabilitator has assumed that the Cash/Surplus Note split is unchanged and all Surplus Notes remain outstanding (and interest accrues) until all Policy obligations are extinguished. At that time, all residual economic resources are distributed to Surplus Note holders up to the then-existing amount of principal and accrued interest.

a. Scenario One

Statutory surplus as regard policyholders never falls below the Minimum Surplus Amount in Scenario One. As a result, there are no limitations on payments under the Secured Note or the Reinsurance Agreement. See Section III.A.2 of this Disclosure Statement for further details on the otherwise applicable payment limitations under the Secured Note and the Reinsurance Agreement.

Under Scenario One (and based upon the calculation methodology described above), holders of Surplus Notes would receive approximately 100% of the then-outstanding principal amount of Surplus Notes (and all accrued interest thereon) at the end of the projection period. Holders of Junior Surplus Notes would receive approximately 100% of the then-outstanding principal amount of Junior Surplus Notes (and all accrued interest thereon) at the end of the Projection period. .

b. Scenario Two

Statutory surplus as regard policyholders never falls below the Minimum Surplus Amount in Scenario Two. As a result, there are no limitations on payments under the Secured Note or the Reinsurance Agreement. See Section III.A.2 of this Disclosure Statement for further details on the otherwise applicable payment limitations under the Secured Note and the Reinsurance Agreement.

Under Scenario Two (and based upon the calculation methodology described above), holders of Surplus Notes would receive approximately 85% of the then-outstanding principal amount of Surplus Notes (and all accrued interest thereon) at the end of the projection period. Holders of Junior Surplus Notes would receive no recovery of the then-outstanding principal amount of Junior Surplus Notes (and all accrued interest thereon) at the end of the projection period.

c. Scenario Three

Statutory surplus as regard policyholders never falls below the Minimum Surplus Amount in Scenario Three. As a result, there are no limitations on payments under the Secured Note or the Reinsurance Agreement. See Section III.A.2 of this Disclosure Statement for further details on the otherwise applicable payment limitations under the Secured Note and the Reinsurance Agreement.

Under Scenario Three (and based upon the calculation methodology described above), holders of Surplus Notes would receive approximately 71% of the then-outstanding principal amount of Surplus Notes (and all accrued interest thereon) at the end of the projection period. Holders of Junior Surplus Notes would receive no recovery of the then-outstanding principal amount of Junior Surplus Notes (and all accrued interest thereon) at the end of the Projection period.

d. Scenario Four

Statutory surplus as regards policyholders is equal to $100 million in 2011 and 2012 due to adjustments resulting from the application of Section 1.04 of the Reinsurance Agreement. This Section limits the maximum liability that the Segregated Account may cede to the General Account to the amount that would cause the surplus as regards policyholders of the General Account to remain at the Minimum Surplus Amount. The effect of Section 1.04 of the Reinsurance Agreement is reversed as the unadjusted surplus of the General Account recovers from 2013 through 2015, with statutory surplus exceeding the Minimum Surplus Amount in 2015 and in all following years.

Since the surplus as regards policyholders of the General Account remains at the Minimum Surplus Amount from 2011 to 2014 (and exceeds such Minimum Surplus Amount for all other years) under Scenario 4, the General Account remains obligated to satisfy the demands of the Segregated Account for payment under the Secured Note.

Under Scenario Four (and based upon the calculation methodology described above), holders of Surplus Notes would receive approximately 45% of the then-outstanding principal amount of Surplus Notes (and all accrued interest thereon) at the end of the Projection period. Holders of Junior Surplus Notes would receive no recovery of the then-outstanding principal amount of Junior Surplus Notes (and all accrued interest thereon) at the end of the Projection period.

IX. RATIONALE FOR CASH AND SURPLUS NOTE PERCENTAGES

As discussed in Section V. of this Disclosure Statement, each Holder of a Permitted Policy Claim will receive, in full satisfaction of such Permitted Claim, (i) Cash equal to the amount of such Permitted Claim multiplied by the Cash Percentage (initially 25%) and (ii) a Surplus Note (or beneficial interest therein), the principal amount of which is equal to the amount of such Permitted Policy Claim multiplied by the Surplus Note Percentage (initially 75%). For the reasons discussed in this section, among others, the Rehabilitator has determined, in the exercise of his regulatory discretion, that an initial Cash Percentage of 25% represented an appropriately conservative level that would reasonably ensure equitable treatment for all Holders of Policy Claims.

Consistent with its duty of treating all Holders of Policy Claims equitably, the Rehabilitator determined that the Cash Percentage cannot favor Holders of short-dated Policy Claims over Holders of long-dated Policy Claims. More specifically, if the Cash Percentage were set too high such that claims-paying resources were exhausted before long-dated Policy Claims matured, Holders of short-dated Policy Claims would receive more favorable treatment under the Plan than Holders of long-dated Policy Claims. The risk of such an outcome is heightened in this matter, in which substantial uncertainty exists regarding financial outcomes. Therefore, to preserve fair treatment for all Holders of Policy Claims, the Rehabilitator determined that an initial Cash Percentage of 25% appropriately balances the Rehabilitator's need to preserve

claims-paying resources for Holders of long-dated Policy Claims with the desire to distribute Cash to Holders of Permitted Policy Claims (and Holders of Permitted short-dated Policy Claims in particular) in satisfaction of their Permitted Policy Claims.

A. Loss Development

Loss development could exceed current projections. Since the beginning of the domestic housing downturn, many market participants, including Ambac, have experienced greater-than-expected losses associated with housing-related exposures and/or investments. In addition, projected losses in student loan and other sectors have, since 2008, increased due to the nature of these sectors' debt structures, including variable rate demand obligations and auction rate securities. Certain of the factors that contributed to such greater-than-expected losses, such as adverse macroeconomic and housing sector conditions and failed markets for certain debt structures, continue to exist today. If loss development were to continue to exceed expectations and the Cash Percentage were set too high, the resulting diminution of claims-paying resources could lead to inequitable treatment for Holders of long-dated Policy Claims, as claims-paying resources may be exhausted in the payment of short-dated Policy Claims before long-dated Policy Claims matured.

B. Uncertain Outcome of R&W Remediation Recoveries

The value that may ultimately be realized from R&W Remediation is subject to significant uncertainties, including, but not limited to, litigation risks, collectability concerns, costs of litigation, and timing considerations. AAC's reserves contemplate the receipt of more than $2 billion from R&W Remediation recoveries through 2013. If AAC is unable to achieve such levels of R&W Remediation recoveries, or experiences material delays in realizing such prospective benefits, and the Cash Percentage is set too high, the resulting diminution of claims-paying resources could lead to inequitable treatment for Holders of long-dated Policy Claims, as claims-paying resources may be exhausted in the payment of short-dated Policy Claims before long-dated Policy Claims matured.

C. Preservation of Claims-Paying Resources for the Benefit of all Policyholders

The difficulties posed by uncertainties of loss development and R&W Remediation recoveries are exacerbated by the nature of AAC's claims-paying resources. A significant portion of AAC's claims-paying resources can only be realized over time or may be difficult to monetize as claims payments become due. Examples of claims-paying resources that may not be immediately available to meet near-term claim demands include (i) certain investment portfolio holdings, (ii) future installment premiums, (iii) intercompany loans and (iv) investments in subsidiaries. For example, the forced liquidation of certain investment portfolio holdings to satisfy large, near-term distributions of Cash on Policy Claims could lead to less-than-optimal portfolio returns, thereby lowering the recovery received by all Holders of Policy Claims.

D. Sensitivity Analysis on Initial Cash Percentage

The following analysis illustrates the potential reduction in claims-paying resources that could result if the Cash Percentage were set too high in an adverse scenario ("Scenario Four"). As described in Section VIII.C.2.e., Scenario Four contemplates (i) the General Account Stress Case Loss Estimates and Segregated Account Stress Case Loss Estimates, and (ii) that no R&W

Remediation recoveries are realized. Two distinct initial Cash Percentages (35% and 25%, respectively) were employed in this scenario.

As illustrated below, use of a Cash Percentage of 35% under Scenario Four would result in a 21% reduction of claims-paying resources in just 30 months, compared with a 14% reduction under the 25% Cash Percentage case. Claims-paying resources would decline by 25% from June 30, 2010 to December 31, 2014 under the 35% Cash Percentage case, compared with 15% under the 25% Cash Percentage case. See below.

Projected Changes in Claims-paying Resources Assuming
(i) Scenario Four and (ii) Various Cash Percentages

	Projected Claims-Paying Resources			Cumulative Percentage Change in Projected Claims-Paying Resources from June 30, 2010	
	6/30/2010	12/31/2012	12/31/2014	12/31/2012	12/31/2014
		(In millions)			
25% Cash Percentage	$6,818	$5,880	$5,803	-14%	-15%
35% Cash Percentage	$6,818	$5,370	$5,133	-21%	-25%

The Rehabilitator believes that the rapid diminution in claims-paying resources projected under the 35% Cash Percentage case is inconsistent with his duty to preserve such resources to ensure the equitable treatment of all Holders of Policy Claims. Below that threshold, the Cash Percentage decision requires a balance between preservation of claims-paying resources and distribution of Cash to Holders of short-dated Policy Claims. While a higher Cash Percentage (such as 30%) would allow for greater distribution of Cash to Holders of short-dated Policy Claims, a lower Cash Percentage (such as 20%) would reduce the rate of diminution in claims-paying resources and better protect Holders of long-dated Policy Claims.

E. Conclusion

Ultimately, the Rehabilitator determined that the best way to reasonably ensure equitable treatment for all Holders of Policy Claims was to set the initial Cash Percentage at a conservative level at which the Rehabilitator was confident that the Segregated Account could continue paying at least the initial Cash Percentage throughout the life of the exposures allocated to the Segregated Account. If the Segregated Account became unable to continue paying the initial Cash Percentage, Holders of long-dated Policy Claims would clearly be treated inequitably in comparison with Holders of short-dated Policy Claims. Accordingly, the initial Cash Percentage had to be set low enough to withstand an outcome worse than any of the Rehabilitator's Financial Projections set forth in Section VII above. While unlikely, such a scenario could arise in the event of (i) loss development even greater than contemplated in Scenario Four, (ii) the failure to achieve projected R&W Remediation recoveries, (iii) worse-than-contemplated investment portfolio returns, and (iv) higher-than-expected operating expenses. In addition, the Plan contemplates that the Cash Percentage could be increased once the Rehabilitator has greater clarity concerning the range of potential outcomes. Therefore, in consideration of the foregoing, and in the exercise of his regulatory discretion, the Rehabilitator determined that an initial Cash Percentage of 25% represented an appropriately conservative level that would reasonably ensure equitable treatment for all Holders of Policy Claims.

X. TAX CONSEQUENCES IF THE PLAN IS CONFIRMED

The following discussion is a summary of certain material federal income tax consequences to AAC and the Segregated Account, and to U.S. Holders (as defined below) of Claims, if the Plan is confirmed. The following discussion includes a summary of the material federal income tax considerations relevant to the ownership of Surplus Notes and Junior Surplus Notes (collectively, the "Notes") by U.S. Holders whose Claims are satisfied, in whole or in part, by their receipt of Notes. This summary is based upon the Internal Revenue Code of 1986, as amended (the "Code"), Treasury regulations, rulings of the Internal Revenue Service (the "IRS"), and judicial decisions in existence on the date hereof, all of which are subject to change. Any such change could apply retroactively and could affect adversely the tax consequences described below. No assurance can be given that the IRS will agree with the views expressed in this summary, or that a court will not sustain any challenge by the IRS in the event of litigation. No advance tax ruling has been sought or obtained from the IRS regarding the tax consequences of the transactions described herein.

For purposes of this summary, a "U.S. Holder" is a beneficial owner of a Claim that is (a) an individual who is a citizen of the United States or who is resident in the United States for federal income tax purposes, (b) an entity that is classified for federal income tax purposes as a corporation and that is organized under the laws of the United States, any state thereof, or the District of Columbia, (c) an estate the income of which is subject to federal income taxation regardless of its source, or (d) a trust (i) if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and is subject to the control of one or more United States persons as described in Section 7701(a)(30) of the Code ("United States persons"), or (ii) that has a valid election in effect under applicable Treasury regulations to be treated as a United States person.

If an entity classified for federal income tax purposes as a partnership or as a "disregarded entity" owns a Claim, the tax treatment of a member of the entity will depend on the status of the members and the activities of the entity. The tax treatment of such an entity, and the tax treatment of any member of such an entity, is not addressed in this summary. Any entity that is classified for federal income tax purposes as a partnership or as a "disregarded entity" and that owns a Claim, and any members of such an entity, are urged to consult their tax advisors with respect to the federal income tax consequences if the Plan is confirmed.

This summary does not discuss all federal income tax considerations that may be relevant to U.S. Holders in light of their particular circumstances or that may be relevant to certain beneficial owners that may be subject to special treatment under federal income tax law (for example, tax-exempt organizations, insurance companies, banks and other financial institutions, dealers in securities, traders in securities that elect to use a mark-to-market method of accounting, real estate investment trusts, regulated investment companies, Subchapter S corporations, individual retirement accounts, qualified pension plans, persons who hold Notes as part of a straddle, hedging, constructive sale, conversion, or other integrated transaction, and U.S. Holders whose functional currency is not the U.S. dollar). Furthermore, this summary does not address any aspects of state, local, or foreign taxation or federal taxes other than income taxes.

This summary assumes that each U.S. Holder holds its Claims as "capital assets" (within the meaning of Section 1221 of the Code). This summary also assumes that the various obligations and other arrangements into which AAC entered prior to the creation of the Segregated Account

will be respected for federal income tax purposes in accordance with their form. The discussion below of the federal income tax consequences of the ownership of Notes does not apply to any U.S. Holder that acquires a Note from another Holder of the Note.

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, HOLDERS OF CLAIMS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS DISCLOSURE STATEMENT IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY SUCH HOLDERS OR ANY OTHER PERSONS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THEM UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION WAS WRITTEN IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) OF THE PLAN OF REHABILITATION; AND (C) HOLDERS OF CLAIMS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

A. Classification of the Notes and the Segregated Account

For federal income tax purposes, the determination of whether an instrument is classified as indebtedness, rather than as equity, requires a judgment based on an analysis of all relevant facts and circumstances, including the level of the risk of defaults in the payment of stated principal and interest under various economic conditions. There is little statutory, judicial, or administrative authority directly addressing the federal income tax treatment of an instrument similar to the Notes. AAC has informed the Rehabilitator that AAC intends to take the position that the Notes are properly classified as indebtedness for federal income tax purposes. The Rehabilitator also intends to take this position. No assurance can be given, however, that this position would be upheld in the event of a challenge by the IRS. Pursuant to Section 385(c) of the Code, the position that the Notes are properly classified as indebtedness for federal income tax purposes is binding on a beneficial owner of Notes, unless the beneficial owner discloses in the proper manner to the IRS that it is taking a different position.

The federal income tax treatment of corporations that possess separate "series" or "cells" such as the Segregated Account is uncertain. AAC has informed the Rehabilitator that AAC intends to take the position that the Segregated Account is treated for federal income tax purposes as not being an entity that is separate from AAC. The Rehabilitator also intends to take this position. No assurance can be given, however, that this position would be upheld in the event of a challenge by the IRS.

If the Notes are not classified as indebtedness for federal income tax purposes, AAC (or the Segregated Account, in the event that the Segregated Account is treated as being an entity that is separate from AAC) may be treated as experiencing an "ownership change" (within the meaning of Section 382 of the Code) as a result of the issuance of Notes if the recharacterized Notes represent 50 percent or more of the value of AAC (or the Segregated Account, in the event that the Segregated Account is treated as being an entity that is separate from AAC). In that event, Section 382 of the Code generally would impose significant restrictions on the ability of AAC (and other members of its consolidated return group) to use any NOLs arising before the "ownership change" (and certain losses that are recognized after the "ownership change" but that have economically accrued prior to the "ownership change") to offset income of AAC (or the Segregated Account, in the event that the Segregated Account is treated as being an entity that is

separate from AAC) arising after the "ownership change" and certain other adverse tax consequences may also arise in this scenario. Certain exemptions from the restrictions imposed by Section 382 of the Code may be available even in the event of an "ownership change," however. Holders should consult AFGI's quarterly report on Form 10-Q for the period ended June 30, 2010 for further information regarding the restrictions imposed under Section 382 and such other adverse consequences.

The remainder of this summary assumes that the Segregated Account will be treated for federal income tax purposes as not being an entity that is separate from AAC, and assumes that the Notes will be classified as indebtedness for federal income tax purposes. Holders of Claims are urged to consult their own tax advisors regarding the tax consequences if the Segregated Account is treated for federal income tax purposes as being an entity that is separate from AAC, or if the Notes are not classified as indebtedness for federal income tax purposes.

B. Tax Consequences to AAC and the Segregated Account

The satisfaction of a Claim in exchange for cash and the issuance of the Notes should not result in cancellation-of-indebtedness income to AAC or the Segregated Account, *provided*, that the amount of the Claim does not exceed the sum of the amount of cash and the "issue price" of the Notes. However, if the amount of the Claim exceeds the sum of the amount of cash and the "issue price" of the Notes, an exemption from cancellation-of-indebtedness income may nevertheless apply to the extent that a deduction would have been available to AAC if a cash payment in an amount equal to the principal amount of the Note had been made in place of the issuance of the Note.

The issue price of the Notes generally should equal the principal amount of the Notes, assuming that (i) the "applicable federal rate" (within the meaning of Section 1274(d) of the Code) that is in effect at the time of such issuance is not greater than the stated interest rate on the Notes (which is 5.1% in the case of the Surplus Notes and 5.1% in the case of the Junior Surplus Notes), and (ii) the Note is not treated as being part of an issue a portion of which is "traded on an established securities market" (within the meaning of Section 1273(b) of the Code). The applicable federal rate currently in effect is not greater than 3.32%.

A Note will be treated as being part of an issue a portion of which is "traded on an established securities market" if, at any time during the 60-day period ending 30 days after the issuance date of the Note, (1) the Notes are listed on a national securities exchange or interdealer quotation system, (2) the Notes are traded on an interbank market or on a board of trade designated as a contract market by the Commodities Futures Trading Commission, (3) the Notes appear in a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations or actual prices of recent sales transactions, or (4) price quotations for the Notes are readily available from dealers, brokers, or traders.

As described in X.C. below, all the interest on the Notes is likely to be treated as original issue discount ("OID"). Nevertheless, the "applicable high yield discount obligation" rules of Section 163(i) of the Code generally should not result in a deferral or disallowance of deductions for interest incurred on a Note, *provided*, that the "applicable federal rate" that is in effect at the time of the issuance of the Note is not less than the Note's yield to maturity (determined on the basis

of the Note's issue price and assuming all interest is OID that will not be paid until maturity or redemption) minus 5 percentage points.

C. Tax Consequences to U.S. Holders

1. Satisfaction of Claims

The satisfaction of a U.S. Holder's Claim through the payment of cash and the issuance of a Note generally should be treated for federal income tax purposes as a disposition of the Claim. For federal income tax purposes, the U.S. Holder generally should recognize gain or loss in an amount equal to the difference between (i) the sum of the issue price (determined as described above) of the Note and the amount of cash, and (ii) the U.S. Holder's adjusted tax basis in the Claim.

2. Accrual of Interest.

Because interest and principal payments on the Notes may be deferred (without penalty) unless and until approved by the Commissioner, it is likely that the interest on the Notes will not be deemed to be unconditionally payable (under the applicable Treasury regulations) and will not be characterized as "qualified stated interest." The regulations provide that interest is unconditionally payable only if reasonable legal remedies exist to compel timely payment, or the debt instrument provides terms that make the likelihood of late payment (other than a late payment that occurs within a reasonable grace period) or nonpayment a remote contingency.

Assuming that the interest on the Notes does not represent "qualified stated interest," all the interest on the Notes will be treated as OID and will be included in the gross income of the U.S. Holder as the interest accrues, whether or not the interest is paid. Such an inclusion in advance of receipt of the cash attributable to the income is required even if the U.S. Holder is on the cash method of accounting for federal income tax purposes. No amounts in addition to the stated interest on the Notes should be treated as OID, *provided*, that (i) the Notes are not "traded on an established securities market," and (ii) the "applicable federal rate" which is in effect at the time of issuance of any Note is not greater than the stated interest rate on the Note.

3. Disposition of Notes

In the case of a sale or other taxable disposition (including a redemption or retirement) of a Note, a U.S. Holder generally should recognize gain or loss equal to the difference, if any, between the amount received (other than any amount representing accrued but unpaid stated interest, which will be treated as ordinary income to the extent not previously included in income) and the U.S. Holder's adjusted tax basis in the Note. A U.S. Holder's adjusted tax basis in a Note generally should equal the issue price of the Note, increased by amounts includible in income as OID and reduced by any interest or principal payments made on such Note. A gain or loss recognized by a U.S. Holder on a sale or other disposition of a Note generally should constitute capital gain or loss if the Note is held as a "capital asset" within the meaning of Section 1221 of the Code. Capital gains recognized by an individual upon the sale or other disposition of a Note that is held for more than one year are generally eligible for reduced rates of federal income taxation. The deductibility of a capital loss recognized upon the sale or other disposition of a Note is subject to limitations.

4. Backup withholding and information reporting

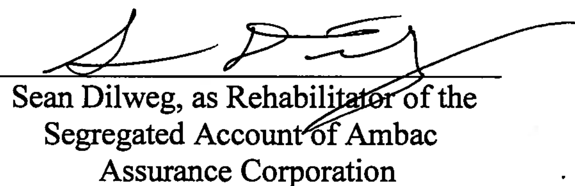
In general, information reporting requirements will apply with respect to payments of principal and interest (and annual accruals of OID) on the Notes to a U.S. Holder, and with respect to payments to a U.S. Holder of any proceeds from a disposition of the Notes. In addition, a U.S. Holder may be subject to a backup withholding tax on payments with respect to the Notes if the U.S. Holder fails to supply its correct taxpayer identification number in the manner required by applicable law, fails to certify that it is not subject to the backup withholding tax, or otherwise fails to comply with applicable backup withholding tax rules.

Any amounts withheld from a U.S. Holder under the backup withholding provisions may be credited against the federal income tax liability of the U.S. Holder, and may entitle the U.S. Holder to a refund, *provided*, that the required information is timely furnished to the IRS.

XI. CONCLUSION

The Rehabilitator believes that the Plan represents the most value to Holders of Permitted Claims against the Segregated Account. The Rehabilitator urges each Holder to support the Plan.

Dated: October 8, 2010



Sean Dilweg, as Rehabilitator of the
Segregated Account of Ambac
Assurance Corporation

INDEX OF DEFINED TERMS

AAC i
ABS CDOs 3
ACFI 55
ACP 1
Advisor Council 19
AFGI i
AFS 55
AII 53
Allocated Subsidiaries 1
Alternative Resolution 29
Ambac 1
Ambac Group 57
Ambac UK 11
Assumed Consummation Date 65
Assured 23
AUK Commutation Agreement 24
AUK Reinsurance Agreement 24
Bank Group 19
Bank Group Settlement 21
Bank Settlement Notes 21
BlackRock 20
BNYM 45
Business Day 39, 47
CDS 2
Centerview 23
Claims-paying resources 2
CLOs 19
Code 71
Commissioner 1
Confirmation Date 34
Confirmation Order 33
Cooperation Agreement 16
Court i
Disclosure Statement 1
Duplicate Claim 28
Effective Date 3
Events 10
Everspan 7
Excluded Order 43, 51
Facility 23
Fiscal Agent 46
Freddie Mac 22
GAAP ii
General Account i
General Account Base Case Loss Estimates 59
General Account Stress Case Loss Estimates 59
GIC 55
Indebtedness 41, 49
Indemnified Persons 36
Injunction 10
IRS 71
Junior Surplus Notes 3
Jurisdictions i
Late Claim 28
LVM 11
LVM Movants 22
Management Services Agreement 15
Management Services Provider 10, 15
Minimum Surplus Amount 14
Moody's 3
Morrigan 23
NOLs 57
Notes 71
NWMA 24
OCI ii
OID 73
One State Street 11
One State Street Lease 11
Petition 9
Plan 1
Plan Documents 33
Plan of Operation 1
Policies 10
Policy Claims 41, 49
Post-Consummation Balance Sheet 65
Pre-Consummation Balance Sheet 65
Prior Claims 41, 49
Proceeding i
Qualified Statutory Surplus 4
R&W Remediation 37
redemption price 39, 48
Rehabilitator 1
Rehabilitator's Financial Projections ii
RMBS 2
RMBS Movants 19
RMBS/LVM Motions 22

S&P ... 3
SAP ... ii
Scenario Four ... 69
SEC ... i
Securities Act ... i
Segregated Account ... 1
Surplus Notes ... 3
TWC ... 23
United States persons ... 71
Website ... 1
Weinstein Notes ... 23
Weinstein Policy ... 23
Weinstein Settlement ... 23
Wis. Stat. ... 1
WPFC ... 23