



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Sean Dilweg, Commissioner

Wisconsin.gov

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November 7, 2010

To the Members of the
Board of Directors of Ambac Assurance Corporation
c/o Ambac Assurance Corporation
One State Street Plaza
New York, New York 10004

Ladies and Gentlemen:

As you are aware, in my role as both the Wisconsin Commissioner of Insurance and the court appointed rehabilitator of the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), I am kept apprised of issues material to both Ambac Assurance Corporation ("AAC") and the Segregated Account. In recent weeks, my attention, as well as the attention of my staff and advisors, has been focused on the negotiations between Ambac Financial Group, Inc. ("AFGI") and the ad hoc committee of certain AFGI debt holders (the "Ad Hoc Committee") concerning the restructuring of AFGI's debt in connection with a potential bankruptcy filing. Recently, at the request of both management and the Ad Hoc Committee, OCI and its advisors became involved in these negotiations, as several key terms in the proposed restructuring have a material impact on AAC and the Segregated Account. Based on these negotiations, we have reached an understanding with the Ad Hoc Committee which is reflected in the attached "Terms of Transaction" outline, which lists the terms and conditions of the restructuring of AFGI which require the approval of OCI, the Rehabilitator or the rehabilitation court, or otherwise have a material impact on AAC or the Segregated Account. I, together with my staff, my counsel and my financial advisors, agree that the terms and conditions reflected in the Terms of Transaction outline preserves claims-paying resources for the benefit of all policyholders and provides fair and equitable treatment of policyholders and creditors under the Wisconsin Insurers Rehabilitation and Liquidation Act.

As contemplated by the Terms of Transaction outline, there are two transactions which require action of the AAC Board of Directors (the "Board") in order to be implemented. First, action of the Board is required in order to allocate to the Segregated Account any liability that AAC may have to the Internal Revenue Service and/or the United States Department of the Treasury in regard to certain tax refunds claimed by AFGI. Such liability could be in excess of \$700 million, and in theory, could attach as a lien on the assets of AFGI or any of its subsidiaries, including AAC. Based on the advice of my staff, my counsel and my financial advisors, it is my belief that allocating this potential liability to the Segregated Account is in the best interests of AAC and the Segregated Account.



November 7, 2010
Page 2

Second, action of the Board is required in order to allocate to the Segregated Account any liability that may arise from certain claims that may be asserted against AAC by, or on behalf of, AFGI in regard to, or respecting, tax refunds and/or the Tax Sharing Agreement (or amendments thereto) to which AAC, AFGI and their affiliates are party. Such claims against AAC could be in excess of \$440 million. Based on the advice of my staff, my counsel and my financial advisors, it is my belief that allocating this potential liability to the Segregated Account is in the best interests of AAC and the Segregated Account.

Therefore, in furtherance of the foregoing, I hereby request that the Board (i) adopt Amendment No. 1 to the Plan of Operations (a copy of which is attached hereto), which amends the Plan of Operation to allocate the liabilities discussed above to the Segregated Account, and (ii) direct the officers of AAC to submit to the OCI a request to approve the same Amendment No. 1 to the Plan of Operations.

In the event that the Plan of Operation is not amended in the manner set forth above, I am prepared to take independent action seeking the full rehabilitation of AAC, as full rehabilitation will put AAC in a favorable position to subordinate the claims discussed above to policyholder claims in the event such liabilities materialize. I urge you to act in the best interest of policyholders and amend the Plan of Operation as I have requested above.

Sincerely,



Sean Dilweg, Wisconsin Commissioner of
Insurance

cc: David W. Wallis, Ambac Assurance Corporation

Terms of Transaction

This outline sets forth those terms and conditions of a possible restructuring of Ambac Financial Group, Inc. ("AFG") in a Chapter 11 proceeding (the "Bankruptcy Case") in which it is anticipated that there will be a debt for equity exchange of AFG's senior bonds, and that impact Ambac Assurance Corporation ("AAC") and the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), and are therefore relevant to the Wisconsin Office of the Commissioner of Insurance ("OCI") and the court-appointed rehabilitator of the Segregated Account (the "Rehabilitator"). The terms and conditions set forth herein have been prepared in consultation with the ad hoc committee of certain AFG debt holders (the "Ad Hoc Committee").

This term sheet has been prepared for discussion and settlement purposes only and is non-binding, but shall serve as the basis for further negotiations. The terms and conditions set forth herein are subject to negotiation and execution and, where applicable, delivery of definitive documents satisfactory in form and substance to all parties.

1. AFG retains ownership of AAC.
2. OCI shall not petition for the full rehabilitation of AAC unless warranted by new material developments, as determined by OCI in its sole and absolute discretion.
3. AAC allocates the following liabilities to the Segregated Account:
 - a. Any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to its shareholder, AFG, or any successor to AFG, in regard to, or respecting, tax refunds and/or the July 18, 1991 Tax Sharing Agreement, as amended (the "TSA"). This allocation includes, but is not limited to, any preference claim or fraudulent conveyance claim pertaining to the above-referenced subjects brought by, or on behalf of, AFG in any bankruptcy proceeding involving AFG by AFG as debtor-in-possession, or a trustee or committee appointed by a bankruptcy court to pursue any such claim in regard to AFG, or any similar state court action or claim pursued by, or on behalf of any receiver or creditor of AFG. Notwithstanding the foregoing, such allocation shall not include any liability to AFG pertaining to any possible misallocation of up to \$38,485,850 of tax refunds received by AAC in September 2009 and February 2010 (the "Misallocation Claim").
 - b. Any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or in respect of, taxes imposed under the Internal Revenue Code of 1986, as amended ("Federal Taxes"), for taxable periods ending on or prior to December 31, 2009.
 - c. To the extent not described in b. above, any and all liabilities (including contingent liabilities) AAC has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or respect of, any Federal Tax refunds that were received prior to November 5, 2010 by AAC, AFG or their affiliates.

CONFIDENTIAL MATERIALS PROVIDED SUBJECT TO CONFIDENTIALITY AGREEMENTS AND TO
FRE 408 FOR SETTLEMENT PURPOSES; NON-BINDING INDICATION OF TERMS; SUBJECT TO
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4. Until December 31, 2010, the Rehabilitator shall not seek an injunction from the rehabilitation court enjoining AFG action in respect of the NOLs, and AFG shall not seek to take any action with regard to the allocation of the NOLs as between AFG and AAC.
5. Until December 31, 2010, the Ad Hoc Committee shall agree not to pursue, or support the pursuit of, any preference claim or fraudulent conveyance claim on behalf of AFG pertaining to refunds of Federal Taxes received by AAC in September 2009 and February 2010.
6. AAC agrees to negotiate a cost sharing agreement with AFG pursuant to which AAC and AFG will share the fees and expenses incurred by AFG in relation to any litigation in regard to the return of any Federal Tax refunds, on the basis of 80% to AAC and 20% to AFG. Upon being briefed on the litigation strategy, OCI may, in its sole discretion, increase AAC's share of costs to 85% (or such higher amount as determined by OCI). Such agreement will include rights for AAC to exercise certain controls over the litigation, such terms to be negotiated among OCI, AAC, AFG and counsel engaged to handle such litigation. In addition, the cost sharing agreement (or a second cost-sharing agreement) shall be on terms consistent with typical shared services agreements involving insurance companies and their affiliates, and shall address AAC's obligation to reimburse AFG for an agreed-upon percentage of compensation expenses of AFG employees properly allocable to AAC; provided that the allocation of all non-salary compensation (e.g., bonus, retention, and severance payments) shall be subject to prior approval of OCI. AAC's reimbursement obligation shall extend for a negotiated period of time. The cost allocation agreement(s) shall be subject to approval as contemplated by Section 8 below to the extent the Agreement(s) involve(s) the Segregated Account.
7. AAC and the Segregated Account agree to negotiate with AFG in good faith the modification of the TSA to address certain issues including, but not limited to, the following:
 - a. The amount of NOLs available for use by AAC, which shall be no greater than \$3.5 billion.
 - b. The amount paid by AAC to AFG for the use of the NOLs.
 - c. It is understood that AFG shall be able to utilize NOLs equal to (a) \$2.5bn plus (b) COD income incurred in exchange with reorganization, (c) any amounts related to interest deduction recapture, and (d) any amounts remaining after the AAC NOL allocation set forth above.
8. AAC shall agree in good faith with AFG on the amount of the Misallocation Claim, and AAC shall pay such amount to AFG. As contemplated by Section 8 below, the payment of such amount shall be subject to the approval of the rehabilitation court. In the event the parties are unable to reach agreement on such amount by December 31, 2010, the dispute shall be submitted to binding arbitration under the following terms:

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- a. Arbitration shall be governed by the procedures of the Federal Arbitration Act, except as modified by agreement of the parties.
 - b. A single arbitrator shall be chosen by the parties. In the event the parties are unable to agree upon an arbitrator, one shall be appointed by the bankruptcy court overseeing the Bankruptcy Case.
 - c. Arbitration shall be held at a neutral location.
9. The consummation of all agreements contemplated hereby shall be subject to the approval of the rehabilitation court and the bankruptcy court overseeing the Bankruptcy Case. Upon the determination of the amount of the Misallocation Claim (whether agreed-upon by the parties or settled through binding arbitration) and the agreement by the parties of the modification of the TSA as contemplated by Section 6, the Rehabilitator shall support such petition for approval of the rehabilitation court, and AFG and the Ad Hoc Committee shall support such application for bankruptcy court approval.
10. OCI commits to allow AAC to repurchase surplus notes (whether issued by AAC or the Segregated Account) and preferred stock subject to OCI's determination in its sole and absolute discretion that such repurchases do not violate the law, are reasonable and fair to the interests of AAC and the Segregated Account, and protect and are equitable to the interests of AAC and Segregated Account policyholders generally.
11. Transactions structured, to the extent practicable, to comply with the Bank Settlement Agreement and AAC Plan of Rehabilitation.
12. Any bankruptcy plan and confirmation order shall include third party releases consistent with those contemplated by the Memorandum of Understanding, dated as of October __, 2010, among (i) AFG, (ii) certain individual defendants named in In re Ambac Financial Group, Inc. Securities Litigation, No. 08-cv-411-NRB (S.D.N.Y.) (consolidated) and Tolin v. Ambac Financial Group, Inc., et al., No. 08-cv-11241-CM (S.D.N.Y.) (collectively, the "Securities Actions"), (iii) certain of AFG's directors and officers liability insurance carriers, and (iv) certain plaintiffs in the Securities Actions.

**AMENDMENT NO. 1 TO PLAN OF OPERATION FOR THE SEGREGATED
ACCOUNT OF AMBAC ASSURANCE CORPORATION**

The Plan of Operation for the Segregated Account of Ambac Assurance Corporation, effective March 24, 2010 (the "Plan of Operation"), is hereby amended by this Amendment No. 1 to Plan of Operation for the Segregated Account of Ambac Assurance Corporation as follows:

Effective as of November 7, 2010, the following paragraphs are added to Section IV of the Plan of Operation, "Allocations to Segregated Account":

Liabilities to Ambac Financial Group, Inc. ("AFGI"). The Company is allocating to the Segregated Account any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to its shareholder, AFGI, or any successor to AFGI, in regard to, or respecting, tax refunds and/or the July 18, 1991 Tax Sharing Agreement, as amended, provided, that such allocation shall not include any liability to AFGI pertaining to any possible misallocation of up to \$38,485,850 of tax refunds received by AAC in September 2009 and February 2010. Any such liabilities are disputed. This allocation includes, but is not limited to, any preference claim or fraudulent conveyance claim pertaining to the above-referenced subjects brought by, or on behalf of, AFGI in any bankruptcy proceeding involving AFGI by AFGI as debtor-in-possession, or a trustee or committee appointed by a bankruptcy court to pursue any such claim in regard to AFGI, or any similar state court action or claim pursued by, or on behalf of any receiver or creditor of AFGI.

Liabilities to the Internal Revenue Service ("IRS") and/or the United States Department of the Treasury ("U.S. Treasury"). The Company is allocating to the Segregated Account: (i) any and all liabilities (including contingent liabilities) it has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or in respect of, taxes imposed under the Internal Revenue Code of 1986, as amended ("Federal Taxes"), for taxable periods ending on or prior to December 31, 2009; and (ii) to the extent not described in clause (i), any and all liabilities (including contingent liabilities) the Company has or may have, now or in the future, to the IRS and/or the U.S. Treasury in regard to, or respect of, any Federal Tax refunds that were received prior to November 7, 2010 by the Company, AFGI or their affiliates. Any such liabilities are disputed.

In all other respects, the Plan of Operation effective March 24, 2010, shall continue to govern the operation of the Segregated Account of Ambac Assurance Corporation.

Terms of Transaction

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