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August 4, 2011

VIA FACSIMILE AND FIRST-CLASS MAIL

Honorable William D. Johnston
Lafayette County Circuit Court
Lafayette County Courthouse
626 Main Street
Post Office Box 40
Darlington, Wisconsin 53530-0040

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

Motions of Assured Reinsurers for Emergency Relief and Partial Stay Pending Appeal

Dear Judge Johnston:

Please note that the Rehabilitator and OCI oppose the motions filed and served late yesterday by the Assured Reinsurers for emergency relief and relief pending their appeal of your order dated June 14, 2011. We would be happy to explicate the grounds for our objection to the Assured motions beyond what is stated below if the Court wishes to hold a hearing on the issue.

There should not have been a need for Assured to proceed with its motions on an "emergency" basis given that the Rehabilitator generously granted Assured four separate extensions of the Court-ordered deadline for Assured to comply with its contracts and this Court's injunction order. We have been clear throughout our several weeks of discussions with Assured that the Rehabilitator expects any consensual arrangement for relief pending appeal (in the form of Assured paying the amounts required by its contracts and this Court's order into escrow rather than to Ambac) to include a reasonable rate of interest so the rehabilitation is not prejudiced by the arrangement. We provided proof to Assured (*see* attached) that Ambac would earn over 6% on the funds if Assured honored its contracts and this Court's order regarding payment rather than paying it into an escrow. As Assured and the Court are aware, Wisconsin money judgments normally earn 12% interest (*see* Wis. Stat. § 815.05(8)) and 5% is the minimum legal rate for forbearance on amounts due by contract (*see* Wis. Stat. § 138.04).

In an effort to avoid the need to bother the Court with this type of last-minute motion practice by Assured, the Rehabilitator offered to accept interest at only 5.1% (*see* attached), rather than the higher actual rates of return it would earn on the money if Assured honored its contracts and this Court's order, but Assured has refused to pay <u>any</u> interest itself, leaving the rehabilitation to be prejudiced by the arrangement because it would receive only the 0.01% to 0.1% which the escrow bank might pay on the escrow (*see* Affidavit of Assured's lawyer, Josephine Benkers, at ¶ 7). The Rehabilitator also suggested the 5.1% as a reasonable compromise because, as the Court is aware from the confirmation process, 5.1% is the OCI-mandated discount rate used in the company's statutory accounting financial statements (*see also* the attached page from the AAC financial statement), and is also the interest rate specified in the surplus notes which have been issued to commuting policyholders with this Court's approval and are specified in the Court-approved confirmation plan. There is no basis for Assured's assertion that paying 5.1% interest on the escrow would be a "windfall" to the rehabilitation (Assured motion brief at p. 25) when the undisputed evidence shows that the rehabilitation would earn over 6% if Assured complied with your order.

It would be inequitable and imprudent to allow Assured the benefit of the extraordinary remedy of relief pending appeal on its obligations to comply with its contracts and this Court's order in a way which would cause a negative interest-rate spread between (i) the amount the rehabilitation is accruing on claims and earns on its investment portfolio-versus-(ii) the amount the rehabilitation will receive from the escrow when your order is affirmed on appeal. Assured points to no authority which would entitle it to pay no interest whatsoever under these circumstances while it gets the benefit of avoiding its court-ordered contact obligations.

Assured admits in its brief that the questions of whether and on what terms to grant any relief pending appeal is totally within this Court's discretion (*see* Assured motion brief at pp. 24-25). We urge that the Assured motions should be denied unless it accepts the Rehabilitator's reasonable proposal on interest. We would be happy to address these issues in greater detail at any hearing the Court deems appropriate.

Very truly yours,

FOLEY & LARDNER LLP

Michael B. Van Sicklen

Enclosures
cc: Josephine Benkers (with enclosures, via email)
Counsel of Record (with enclosures, via email)
Jody Baux, Dane County Circuit Court Clerk

From: Van Sicklen, Michael B.
Sent: Monday, July 18, 2011 2:41 PM
To: josephine.benkers@quarles.com
Cc: 'Ricardo, Henry'
Subject: FW: Assured Escrow

Josie--per our call this afternoon, we expect not to be in a negative interest carry position on the escrow-v- policyholder notes and believe 5.1% is reasonable given that the company's regulated portfolio earns more.
See the attached.

It is a page from AAC's 2010 Annual Statutory Statement indicating AAC's return on the admitted assets in its investment portfolio.

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NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Practices

a. Accounting Practices

The accompanying financial statements of Ambac Assurance Corporation (the "Company" or "Ambac Assurance") have been prepared on the basis of accounting practices prescribed or permitted by the State of Wisconsin Office of the Commissioner of Insurance ("Wisconsin Insurance Commissioner" or "OCI").

The Wisconsin Insurance Commissioner recognizes only statutory accounting practices prescribed or permitted by the State of Wisconsin for determining and reporting the financial condition and results of operations of an insurance company for determining its solvency under Wisconsin Insurance Law. The National Association of Insurance Commissioners ("NAIC") Accounting Practices and Procedures manual ("NAIC SAP") has been adopted as a component of prescribed practices by the State of Wisconsin.

The Wisconsin Insurance Commissioner has prescribed an accounting practice that differs from NAIC SAP. Paragraph 7 of Statement of Statutory Accounting Principles No. 60 "Financial Guaranty Insurance" ("SSAP 60") allows for a deduction from loss reserves for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the financial guaranty insurer as of the date of the computation of the reserve. The discount rate shall be adjusted at the end of each calendar year. Additionally, in accordance with paragraph 7 of Statutory Accounting Principles No. 5 "Liabilities, Contingencies and Impairments of Assets", Ambac Assurance records probable losses on its subsidiaries credit derivative contracts, using a discount rate equal to the average rate of return on its admitted assets. The Company's average rates of return on its admitted assets at December 31, 2010 and December 31, 2009 were 7.06% and 6.74%, respectively. The Wisconsin Insurance Commissioner has directed the Company to utilize a prescribed discount rate of 5.10% for the purpose of discounting both its loss reserves and its estimated impairment losses on subsidiary guarantees. Statutory surplus at December 31, 2010 and December 31, 2009 was lower by $35,233,482 and $1,515,691,199, respectively, than if the Company had reported such amounts in accordance with NAIC SAP. Net income for the years ended December 31, 2010 and 2009 was higher by $1,480,457,717 and lower by $1,515,691,199, respectively, than if the Company had reported such amounts in accordance with NAIC SAP.

The Wisconsin Insurance Commissioner has prescribed an additional accounting practice that differs from NAIC SAP. Paragraph 4 of Statement of Statutory Accounting Principles No. 41 "Surplus Notes" ("SSAP 41") states that proceeds received by the issuer of surplus notes must be in the form of cash or other admitted assets having readily determinable values and liquidity satisfactory to the commissioner of the state of domicile. Under the statutory accounting principles as generally applied, surplus notes issued in conjunction with commutations or the settlement of claims would be valued at zero upon issuance pursuant to paragraph 4, SSAP 41. The Wisconsin Insurance Commissioner has directed the Company to record surplus notes issued in connection with commutations or the settlement of claims at full par value upon issuance as in these instances the surplus notes do not represent a contribution of capital, but rather a distribution of value from the common and preferred shareholders of the Company. The surplus notes issued in connection with commutations or settlement of claims has a claim against surplus senior to the preferred and common shareholders. Statutory surplus is not impacted as a result of the prescribed practice as it is a reclassification from unassigned funds to surplus notes. Net income for the year ended December 31, 2010 is lower by $2,000,000,000 than if the Company had recorded the issuance of surplus notes in accordance with NAIC SAP.

The Wisconsin Insurance Commissioner has extended the preceding prescribed practice related to surplus notes to the evaluation of other-than-temporary impairments for Ambac Assurance guaranteed securities held in the investment portfolio. Paragraph 35 of Statement of Statutory Accounting Principles No. 43R '"Loan-backed and Structured Securities" states that when an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized as a realized loss shall equal the difference between the investment's amortized cost basis and the present value of cash flows expected to be collected, discounted at the loan-backed or structured security's effective interest rate. Under NAIC SAP, the present value of cash flows expected to be collected should include the fair value of surplus notes received from Ambac Assurance, as required under the Segregated Account Rehabilitation Plan (as defined below). The Wisconsin Insurance Commissioner has prescribed an accounting practice that differs from NAIC and has directed the Company to utilize par value rather than fair value of these surplus notes in this computation. Statutory surplus at December 31, 2010 is greater by $76,709,311 and net income for the year ended December 31, 2010 is greater by $137,092,347 than if the present value of the cash flows expected to be collected included the surplus notes at fair value in accordance with NAIC SAP.

Wisconsin accounting practices for changes to contingency reserves differ from NAIC SAP. Under NAIC SAP, contributions to and releases from the contingency reserve are recorded via a direct charge or credit to surplus. Under section 3.08(7)(b) of the Wisconsin Administrative Code, contributions to and releases from the contingency reserve are to be recorded through underwriting income. The Company received permission of the Wisconsin Insurance Commissioner to record contributions to and releases from the contingency reserve and the related tax and loss bond impact, in accordance with NAIC SAP. Statutory surplus is the same using each of these accounting practices. Net income for the years ended December 31, 2010 and December 31, 2009 is higher by $159,270,677 and lower by $1,578,541,184, respectively than if the Company had reported the contributions to the contingency reserve in accordance with the Wisconsin Administrative Code.

A reconciliation of the Company's net income and statutory surplus between practices prescribed and permitted by the Wisconsin Insurance Commissioner and NAIC SAP is shown below:

	2010	2009
Net Loss, Per Annual Statement	$ (1,471,903,054)	$ (2,479,611,710)
Effect of Wisconsin Permitted Practice	(159,270,677)	1,578,541,184
Net Loss, Wisconsin Basis	(1,631,173,731)	(901,070,526)
Effect of Wisconsin Prescribed Practices	382,908,282	1,515,691,199
Effect of Wisconsin Permitted Practice	159,270,677	(1,578,541,184)
Net Loss, NAIC SAP	$ (1,088,994,772)	$ (963,920,511)
Statutory Surplus, Wisconsin Basis	$ 1,026,920,181	$ 801,868,685
Effect of Wisconsin Prescribed Practices	(41,017,484)	1,515,691,199
Effect of Wisconsin Permitted Practice	-	-
Statutory Surplus, NAIC SAP	$ 985,902,697	$ 2,317,559,884

b. Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements in conformity with statutory accounting practices prescribed or permitted by the State of Wisconsin requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the statutory financial statements, and the reported revenues and expenses during the reporting period. Such estimates are used in connection with certain fair value measurements, the evaluation of other than temporary impairments on investments and case basis loss reserves. Current market conditions increase the risk and complexity of the judgments in estimates. Actual results could differ