

In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**SEVENTH AFFIDAVIT OF ROGER A. PETERSON**  
**(Special Deputy Commissioner for the Rehabilitation**  
**of the Segregated Account of Ambac Assurance Corporation)**  
**IN SUPPORT OF REHABILITATOR’S MOTIONS FOR**  
**APPROVAL TO COMMENCE MAKING INTERIM CASH PAYMENTS**  
**AND TO APPROVE PURCHASE OF SURPLUS NOTES**

STATE OF NEW YORK            )  
  ) ss.  
COUNTY OF NEW YORK        )

Roger A. Peterson, being first duly sworn on oath, deposes and states as follows:

1. I am the Special Deputy Commissioner (“SDC”) for the rehabilitation of the Segregated Account of Ambac Assurance Corporation (“Segregated Account”). As the SDC, I work for, and report to, the Wisconsin Commissioner of Insurance as the Rehabilitator (“the Rehabilitator”) of the Segregated Account. Prior to being appointed to my present position, I worked at the Wisconsin Office of the Commissioner of Insurance (“OCI”) for more than 20 years. During that time, I had extensive, increasing regulatory responsibilities in regard to Ambac Assurance Corporation (“Ambac” or the “General Account”). I am the person designated by OCI and the Rehabilitator to have primary responsibility for this rehabilitation proceeding. The statements in this affidavit are based on personal knowledge and information.

2. The background facts relating to Ambac, the financial deterioration of certain aspects of its business, OCI’s increasingly extensive oversight of Ambac, the decision to create

and allocate impaired policies to the Segregated Account, and the rehabilitation of the Segregated Account are set forth in my prior six affidavits in this matter and in the Findings of Fact in this Court's May 27, 2010 decision and this Court's January 24, 2011 Order Confirming the Plan of Rehabilitation, all of which are incorporated here by reference.

3. My statements in this affidavit are offered in support of two motions by the Rehabilitator. The first motion requests approval for the Segregated Account to commence making interim cash payments on permitted policy claims (the "Interim Payment Motion"). The second motion requests approval for Ambac to purchase approximately \$939 million in principal amount of surplus notes (the "Surplus Note Motion").

4. The Rehabilitator has not yet put the Plan of Rehabilitation ("Plan") into effect because the Rehabilitator is not satisfied that it is appropriate to do so and that the conditions precedent for effectiveness of the Plan have all been met. Among other things, (1) the order confirming the Plan remains subject to appellate challenges pending in the Wisconsin Court of Appeals; (2) the status of the litigation against the Internal Revenue Service pending in the United States Bankruptcy Court for the Southern District of New York and in the United States Court of Appeals for the Seventh Circuit remains uncertain while the United States pursues the multi-step process for evaluating the negotiated settlement offer submitted to it on February 24, 2012; and (3) the Rehabilitator continues to work to mitigate potential adverse tax consequences confronting the rehabilitation in order to achieve greater tax certainty and better outcomes for policyholders. Although the Rehabilitator and I believe that these issues will be successfully resolved over time, the timing of their resolution remains largely beyond the Rehabilitator's control. As a result, the Rehabilitator is presently unable to specify a firm timetable regarding the date on which the Plan will be put into effect.

5. The adverse effects of the delay in commencing payments pursuant to the Plan fall hardest upon policyholders with claims that have accrued during the moratorium, many of whom have gone without any payment on their claims since the rehabilitation commenced on March 24, 2010. The Rehabilitator and I believe that the length of this delay is contrary to the spirit of the Plan, which was intended to provide policy claimants with prompt interim payments over time as the rehabilitation process advances. Although the payment moratorium has served (and continues to serve) many necessary purposes—such as stemming the immediate outflow of claims-paying resources, enabling the Rehabilitator to comprehensively analyze and address Ambac’s financial issues, and permitting resolution of a number of long-term legal, tax and other threats to its claims-paying resources—the duration of the moratorium is a burden to policyholders who have claims that have accrued during the moratorium or who will be making claims in the near future.

6. Moreover, in certain limited instances the moratorium is causing an increase in future claim amounts and interfering with Ambac’s ability to receive funds that should be used for the benefit of all policyholders. One instance involves policies insuring certain “under-collateralized” residential mortgage-backed securities (“RMBS”) transactions. “Under-collateralized” transactions are those in which the principal amount of the bonds is not written down to equal the stated principal balances of the underlying mortgages. The Segregated Account’s non-payment of claims for under-collateralized RMBS transactions can generate increased losses in two ways. First, the underlying mortgages may not generate sufficient interest to cover the interest payments due on the higher balance of outstanding bonds, which would result in larger claims for interest shortfalls. Second, certain transactions may cover those interest shortfalls with amounts that would otherwise be used to reduce the bonds’ principal

amounts, resulting in further principal shortfalls which, if not paid by the Segregated Account, will lead to further under-collateralization. Allowing interim claims payments would reduce such increased losses on under-collateralized transactions.

7. The moratorium also interferes with Ambac's ability to receive "excess spread"—that is, interest cash flows that exceed current interest owed on the bonds—in certain RMBS transactions. In certain transactions, all or a portion of such excess spread would be distributed to Ambac as a reimbursement for its payment of claims. But Ambac receives no reimbursements for claims that have accrued but remain unpaid. In those instances, the excess spread that would be distributed to Ambac in the absence of the moratorium is instead distributed to bondholders. In the majority of RMBS transactions, excess spread is being distributed to insured bondholders, which reduces claims under the applicable policy dollar-for-dollar and therefore has no material adverse effect on the total claim amount under such policies. However, in certain RMBS transactions, excess spread is currently being distributed to, or is expected to be distributed to, uninsured bondholders, to the detriment of policyholders and the Segregated Account.

8. The Rehabilitator and I believe that an interim cash payment of 25% of policyholder-level claims can be safely supported by the current claims-paying resources of the Segregated Account and Ambac. We do not foresee any reasonable circumstances that would reduce the initial cash payment under the Plan to less than 25% of the amount of each permitted policy claim at any point in the future.

9. Jefferies & Co. and Gordian Group, LLC—the professional financial advisors that OCI retained in early 2008 in regard to Ambac, and that the Rehabilitator continues to use in regard to Ambac and the Segregated Account—actively assisted me in evaluating whether the 25% cash payment remains economically viable. We devoted considerable time and effort to our

analysis. We evaluated the 25% initial cash payment in four scenarios that represent a broad range of potential financial outcomes for Segregated Account policyholders. Each of the scenarios assumes that the unpaid balance of each policy claim would be satisfied through the issuance of a surplus note or other type of deferred payment obligation. The portion of each policy claim that is not paid in cash in the initial distribution (the “Non-Cash Consideration”) was analyzed as being *pari passu* with the surplus notes consistent with the positions of OCI and the Rehabilitator.

10. The primary variables in each of the four scenarios are: 1) the amount of estimated losses for both the General Account and the Segregated Account, and 2) the amount of estimated recoveries to be received from remediation efforts for residential mortgage backed securities (“RMBS”) policies allocated to the Segregated Account. Projected losses were estimated under “base case” and “stress case” scenarios using a 5.1% discount rate. The base case losses (including accrued but unpaid claims, as applicable) for the General Account and the Segregated Account are estimated to be, respectively, \$570 million and \$7.4 billion. The stress case losses (including accrued but unpaid claims, as applicable) for the General Account and the Segregated Account are estimated to be, respectively, \$1.0 billion and \$9.0 billion. RMBS remediation recoveries are assumed to be either 100% or 50% of Ambac’s projections, which were estimated to be \$2.4 billion, using a 5.1% discount rate. All of the above estimates are based on financial data for the fiscal quarter ending September 30, 2011.

11. The Rehabilitator used four similar economic scenarios in his October 10, 2010 Disclosure Statement. At that time, the scenarios assumed that RMBS remediation recoveries would be either 100% or 0.0%. I am now much more familiar with the details of Ambac’s RMBS remediation efforts and, without going into the privileged details of our assessments of

the merits of those claims, I now believe it is more reasonable to assume that Ambac will recover at least 50% of its estimated \$2.4 billion of RMBS remediation recoveries. Ambac's total potential RMBS remediation recoveries exceed the \$2.4 billion estimate used for purposes of the current analysis. The \$2.4 billion estimate takes into account, among other things, risks and uncertainties inherent in litigation.

12. A brief description of each of the current four scenarios follows:

(a) *Scenario One:* Assumes base case losses for both the General Account and the Segregated Account, and full realization of the RMBS remediation recoveries projected by Ambac.

(b) *Scenario Two:* Assumes base case losses for both the General Account and the Segregated Account, and a 50% realization of the RMBS remediation recoveries projected by Ambac.

(c) *Scenario Three:* Assumes stress case losses for both the General Account and the Segregated Account, and full realization of the RMBS remediation recoveries projected by Ambac.

(d) *Scenario Four:* Assumes stress case losses for both the General Account and the Segregated Account, and 50% realization of the RMBS remediation recoveries projected by Ambac.

13. In all four scenarios, the Non-Cash Consideration component of the policyholder recoveries is assumed to earn interest at the rate of 5.1% -- the rate that surplus notes would earn under the Plan and the rate which the Rehabilitator believes is appropriate to balance the interests of holders of short-term and long-term claims. Use of current low market interest rates, or no rate at all, would have resulted in higher projected recoveries.

14. Our analysis showed that in each of the four scenarios the claims-paying resources available to the Segregated Account remain well in excess of the amounts necessary to support the 25% initial cash payment. For example, our analysis showed that under Scenario Four (a reasonable worst case scenario) the annual balances for Ambac’s highly liquid investment securities (which are all available to pay Segregated Account claims) are projected to be as follows through 2016:

	2012	2013	2014	2015	2016
<b>End of Period Balance (in millions)</b>	\$ 765	\$ 967	\$ 907	\$ 945	\$ 1,039

15. As discussed during my testimony at the Plan confirmation hearing, the Rehabilitator and I continue to believe it is prudent to begin with a conservative initial cash payment given the long-term nature of certain policies allocated to the Segregated Account. Setting the initial cash payment at 25% at this time ensures that there will be adequate resources available to pay claims when the Segregated Account’s long-tail claims are likely to materialize. The Rehabilitator and his advisors will continue to actively monitor changes in projected claims and Ambac’s claims-paying resources, and will recommend cash payments in excess of 25% at such time as there is less uncertainty regarding litigation and tax issues and we feel comfortable that larger payments can be made without undue risk to holders of potential long-tail claims.

16. With respect to the Surplus Note Motion, the Rehabilitator and I have concluded that Ambac should be permitted to purchase approximately \$939 million in principal amount of surplus notes that are due June 7, 2020 (the “Surplus Notes”). The Surplus Notes were issued by Ambac on June 7, 2010 in connection with a settlement agreement (the “Bank Group

Settlement”) entered into by Ambac on June 7, 2010 with certain bank counterparties to outstanding credit default swaps with Ambac Credit Products, LLC that were guaranteed by Ambac. Ambac negotiated and entered into irrevocable option agreements with three of the bank counterparties pursuant to which Ambac secured the right to repurchase the Surplus Notes originally issued to those banks (each, a “Call Option”). On behalf of the Rehabilitator, I have been directly involved with, and overseen, the regulatory analysis of Ambac’s proposed purchase of the Surplus Notes pursuant to the three Call Options.

17. Attached as **Exhibits A, B, and C** are true and correct copies of the letter agreements with each bank counterparty setting forth the terms of each Call Option, which were delivered to OCI and the Rehabilitator at their request. To comply with confidentiality provisions of the Bank Group Settlement, the Rehabilitator has agreed not to disclose the names of the respective bank counterparties and those names have been redacted from each exhibit. I will refer to the banks as Bank A, Bank B, and Bank C.

18. Ambac’s agreement with Bank A grants Ambac the right to purchase \$500 million in principal amount of Surplus Notes issued to Bank A. The total cash price for the Surplus Notes issued to Bank A is equal to \$.20 per dollar of principal amount, resulting in a total price of \$100 million. Ambac will remain obligated to pay the interest that has accrued on those Surplus Notes prior to the exercise date, with the interest being payable when interest is paid on other surplus notes.

19. Ambac’s agreement with Bank B grants Ambac the right to purchase \$150 million in principal amount of Surplus Notes issued to Bank B. The total cash price is determined by the following formula: \$.30 per dollar of principal amount of the Surplus Notes, plus an amount



equal to the accrued unpaid interest on them. The total cash price that Ambac would pay for the Surplus Notes issued to Bank B is approximately \$60.7 million.

20. Ambac's agreement with Bank C grants Ambac the right to purchase approximately \$289 million in principal amount of Surplus Notes issued to Bank C. On its face, Ambac's agreement with Bank C specifies a total cash price equal to \$.20 per dollar of principal amount of the Surplus Notes, plus an amount equal to the accrued unpaid interest on them. However, the agreement with Bank C also contains a "most favored nation" provision that requires the rate-per-dollar to be adjusted upward to equal the most favorable rate-per-dollar paid pursuant to any other call option with another party to the Bank Group Settlement. As a result, the total cash price for the Surplus Notes issued to Bank C – like the Surplus Notes issued to Bank B – is \$.30 per dollar of principal amount of Surplus Notes, plus an amount equal to the accrued unpaid interest on them. That formula results in a total cash price of approximately \$117 million. Ambac will be entitled to receive interest that has accrued on those Surplus Note initially issued to Bank B and Bank C prior to purchase, with the interest being payable when interest is paid on other surplus notes.

21. The Call Options with Bank A and Bank B must be exercised no later than June 7, 2012. In the case of Bank A, the June 7, 2012 deadline is expressly stated in the agreement. In the case of Bank B, the agreement sets a default deadline of November 30, 2012, but the agreement requires that the deadline be adjusted to end on the date of the earliest Call Option deadline that Ambac negotiates with another bank, which is the June 7, 2012 deadline with Bank A. With respect to Bank C, the deadline for exercising the call options is November 30, 2012.

22. For all three transactions, Ambac's right to exercise the Call Options and purchase the Surplus Notes is binding upon the banks' transferees, assigns, successors, and their

subsequent transferees, assigns and successors. A significant portion of the Surplus Notes are now held by parties other than the banks. Ambac believes that it knows the identity of those parties and is prepared to notify them of its decision to exercise the Call Options should the Court grant this Motion.

23. Jefferies & Co. and Gordian Group, LLC actively assisted me in evaluating Ambac’s purchase of the Surplus Notes. We analyzed the Surplus Note purchase under the same four economic scenarios described in paragraphs 9 through 13 above. In each scenario we evaluated the financial effect of purchasing the Surplus Notes as compared with the financial effect of not purchasing the Surplus Notes. Our analysis showed that under each of the four scenarios, the ratio of the present value of claims-paying resources to the present value of total expected policy claims is greater with the proposed purchase of the Surplus Notes than without that purchase. As a result, under each of the four scenarios, purchasing the Surplus Notes results in a significant increase in the projected total claim recoveries for Segregated Account policyholders. The chart below sets forth the present value of, and percentage increases to, total claim recoveries under each scenario. In all cases, cash amounts have been discounted using a discount rate of 5.1%.

	<b>Scenario One</b>	<b>Scenario Two</b>	<b>Scenario Three</b>	<b>Scenario Four</b>	<b>Four Scenario Average</b>
Present Value of Increase in Total Claim Recoveries (in millions)	\$496	\$369	\$348	\$197	\$353
Increase in Percentage of Total Claim Recoveries	5.7%	4.3%	3.4%	1.9%	3.9%

24. The total cost of purchasing all of the Surplus Notes as of June 7, 2012 will be approximately \$278 million. The total principal amount of the Surplus Notes and accrued interest payable to third parties that will be reduced as a result of the purchase will be approximately \$985 million. Thus, the total purchase price represents approximately \$0.28 per dollar. The dollar amounts set forth in this paragraph and paragraphs 19 and 20 above assume that the Surplus Notes are purchased on June 7, 2012. However, if Ambac is authorized to exercise the Call Options prior to that deadline, but actually closes the purchase of the Surplus Notes several days later, the purchase price of the Surplus Notes initially issued to Banks B and C will increase slightly because the purchase price set in the Call Options with respect to those Surplus Notes is determined with reference to the amount of accrued but unpaid interest incurred through the date of purchase.

25. The proposed purchase of the Surplus Notes will result in a reduction in the statutory surplus of Ambac's General Account equal to the amount paid to purchase the Surplus Notes. I anticipate that the reduction in Ambac's statutory surplus due to the purchase of the Surplus Notes, together with an increase in reserves on both Segregated Account and General Account obligations will, as of the second quarter of 2012, cause the General Account to report statutory surplus of exactly \$100 million, and cause the Segregated Account to report negative statutory surplus. The mechanism which causes the statutory surplus of the General Account to become fixed at \$100 million is discussed below.

26. The anticipated negative statutory surplus in the Segregated Account has no bearing on my conclusion that the proposed purchase of the Surplus Notes pursuant to the Call Options is in the best interest of the Segregated Account. Statutory surplus does not provide an appropriate measure for evaluating the effect of various transactions and developments on

Segregated Account policyholders, because it is calculated with respect to Ambac's (i) statutory reserves, which do not reflect a complete picture of Ambac's total liabilities, and (ii) admitted assets, which do not reflect a complete picture of Ambac's claims-paying resources over time. In particular, although Ambac is contractually liable to pay principal and interest on the Surplus Notes, statutory accounting principles direct Ambac not to include this liability in its statutory reserves. Yet statutory accounting principles also dictate that the purchase price of the Surplus Notes be deducted from Ambac's admitted assets. Thus, no matter how much the purchase of Surplus Notes may increase the ultimate cash recovery of Segregated Account policyholders, the purchase will always reduce Ambac's statutory surplus, because Ambac's admitted assets will be reduced by the purchase price without a corresponding reduction in its statutory reserves.

27. The more appropriate measure for evaluating the benefits of this transaction involves comparing the present value of total claims-paying resources with the present value of total expected policy-level claims with the proposed transaction, and without the proposed transaction. Using such a measure, our financial analysis projects that in each scenario, the ratio of the present value of claims paying resources to the present value of total expected policy-level claims is greater with the proposed purchase of the Surplus Notes than without such purchase. As set forth above, it is projected that the purchase of the Surplus Notes will result in Segregated Account policyholders recovering 1.9 to 5.7 percentage points more on their claims than would be the case if the options are not exercised.

28. The anticipated statutory surplus of exactly \$100 million in the General Account will not affect the ability of the Segregated Account to pay policy claims, and the assets of the General Account will continue to be available to pay Segregated Account policy claims through the Secured Note and Aggregate Excess of Loss Reinsurance Agreement (the "Reinsurance

Agreement”). There are provisions in both the Secured Note (Section 1(c)) and Reinsurance Agreement (Section 1.04) which state that the General Account will not have any liability to make any payment to the Segregated Account under the Secured Note or Reinsurance Agreement, as applicable, to the extent that such payment would cause the statutory surplus of the General Account to fall below \$100 million (or such higher amount as determined by OCI pursuant to a prescribed accounting practice).

29. Those provisions are implemented by reducing the liability that the Segregated Account cedes to the General Account, such that the General Account’s statutory surplus stops decreasing when it reaches \$100 million and any further decreases in statutory surplus (*e.g.*, due to an increase in reserves or a decrease in assets without a corresponding decrease in reserves) will be reflected in the statutory surplus of the Segregated Account – not the General Account. The Rehabilitator anticipates that the reduction in Ambac’s statutory surplus due to the purchase of the Surplus Notes, together with an increase in reserves on both Segregated Account and General Account obligations, will, as of the second quarter of 2012, cause the General Account to report a statutory surplus of exactly \$100 million, and cause the Segregated Account to report a negative statutory surplus.


30. I believe that the purchase of the Surplus Notes by exercising the Call Options is in the best interest of the Segregated Account because it resolves Ambac’s liability under the Surplus Notes for substantially less than Ambac would ultimately pay if it did not purchase the Surplus Notes. As a result, the purchase will make additional funds available to pay the claims of Segregated Account policyholders, and as shown above, increase the projected recovery to Segregated Account policyholders under each of the four scenarios.

31. Time is of the essence in approving the purchase of the Surplus Notes, as Ambac's right to purchase the Bank A and Bank B Surplus Notes pursuant to the respective Call Options expires on June 7, 2012. The Surplus Notes are currently held by a number of parties (including at least one located overseas), which makes the logistics of notification more time-sensitive. If the Court does not grant approval of the purchase of the Surplus Notes with sufficient time to allow Ambac to exercise its Call Options before June 7, 2012, the benefits to Segregated Account policyholders of purchasing the Bank A and Bank B Surplus Notes will be lost.

Dated this 15<sup>th</sup> day of May, 2012.

  
\_\_\_\_\_  
Roger A. Peterson

Subscribed and sworn to before me  
this 15<sup>th</sup> day of May, 2012.

  
\_\_\_\_\_  
Notary Public, State of New York.  
My Commission: 02KW6251360

**DWIGHT KWA**  
**NOTARY PUBLIC-STATE OF NEW YORK**  
**No. 02KW6251360**  
**My Commission Expires November 14, 2015**



# **EXHIBIT A**



Confidential

June 7, 2010



**Re: Letter Agreement re: Call Option**

Ladies & Gentlemen:

Reference is hereby made to the terms of the Settlement Agreement (the "Settlement Agreement") dated as of June 7, 2010 among Ambac Assurance Corporation ("AAC"), Ambac Credit Products ("ACP"), certain other affiliates of AAC and certain financial institutions. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Settlement Agreement.

██████████ and ██████████ ("██████████" and, together with ██████████, "██████████") have agreed to enter into this Letter Agreement with AAC to support the restructuring of AAC. In furtherance of such restructuring, effective as of the Closing, ██████████ hereby grants to AAC or its successors or assignees an irrevocable option (the "Call Option") to purchase any or all of ██████████ right, title and interest in and to \$500 million in principal amount of AAC Surplus Notes issued to any or all of ██████████ or ██████████ (collectively, the "██████████ Surplus Notes") for a cash purchase price equal to \$.20 per dollar (the "██████████ Rate") of the principal amount of the purchased ██████████ Surplus Notes (the "Call Option Purchase Price"). The Call Option may be exercised by AAC on multiple dates, in whole or in part (provided that any exercise in part shall apply to no less than \$25 million of principal amount of the ██████████ Surplus Notes), by notice in writing to ██████████ at its address set forth below its signature line hereto, deliverable in accordance with the notice provisions set forth in the Commutation Agreement of even date herewith among ██████████, AAC and Ambac Credit Products, LLC., at any time or from time to time from the date hereof until 5:00 p.m., New York time, on June 7, 2012 (the "Call Option Term").

Any interest that accrues on any of the ██████████ Surplus Notes or any portion thereof held by a Holder prior to the exercise of the Call Option for such Notes or portion thereof shall be for the account of the Holder of such Notes or portion. Any interest that accrues on any of the ██████████ Surplus Notes or portion thereof after the exercise of the Call Option for such Notes or portion thereof shall be for the account of the Buyer thereof. To effectuate the foregoing, AAC agrees (regardless of whether AAC or its assignee is the Buyer) to pay directly to ██████████, at the time AAC makes any payment of interest on the AAC Surplus Notes, an amount equal to the unpaid interest accrued prior to the applicable date of exercise of the Call Option with respect to any ██████████ Surplus Notes that ██████████ would have been entitled to receive had the Call Option with respect to such ██████████ Surplus Notes not been exercised, and concurrently to provide ██████████ with a reasonably detailed calculation showing how the amount of interest paid was derived.

Prior to or during the Call Option Term, if AAC (or any assignee thereof, as provided below (AAC or such assignee being a "Buyer") shall exercise a call option with any other Commuting Policy Beneficiary for a cash purchase price at a rate per dollar higher than the ██████████ Rate (any such higher rate, a "Higher Call Option Rate"), the ██████████ Rate shall not be subject to any adjustment upward to equal such Higher Call Option Rate, *provided, however*, that if any Commuting Policy Beneficiary is granted a Higher Call Option Rate greater than or equal to a cash purchase price equal to or in excess of \$.40 per

dollar of the principal amount of the AAC Surplus Notes (prior to or during the Call Option Term), then the [REDACTED] Rate shall be adjusted with respect to any [REDACTED] Surplus Notes not previously purchased by a Buyer to equal such Higher Call Option Rate.

The rights of AAC under this Letter Agreement shall be assignable by AAC in whole or in part, in the sole discretion of AAC, upon written notice to [REDACTED].

[REDACTED] agrees that the rights of a Buyer to purchase up to \$500 million of [REDACTED] Surplus Notes shall be binding upon any subsequent holder of such [REDACTED] Surplus Notes ([REDACTED] or any other holder of [REDACTED] Surplus Notes subject to this Letter Agreement being a "Holder") and, accordingly, that as a condition to any transfer or other disposition of any of its interest in such [REDACTED] Surplus Notes, [REDACTED], or any subsequent Holder, as the case may be, shall require such transferee to execute and deliver to AAC an acknowledgement in form and substance reasonably satisfactory to the Buyer pursuant to which such transferee shall acknowledge that it is acquiring such Notes subject to the rights of a Buyer hereunder, that such transferee agrees to be bound by the obligations undertaken by [REDACTED] herein with respect thereto, and that such obligations shall be enforceable by a Buyer as against such transferee.

The parties agree that any transfer of [REDACTED] Surplus Notes pursuant to this Letter Agreement shall be subject to compliance with applicable requirements of the Securities Act of 1933, as amended, and the rules and regulations of the Securities and Exchange Commission thereunder.

The parties agree that, at the closing of the purchase of any [REDACTED] Surplus Notes pursuant to this Letter Agreement, the Buyer and Holder will execute and deliver a transfer agreement reasonably satisfactory to each, which transfer agreement will include customary representations and warranties, including that such Holder owns the sole legal and beneficial right, title and interest, free and clear of all liens and encumbrances, in such [REDACTED] Surplus Notes.

[REDACTED], ACP, and AAC each agrees to treat the fact and terms of this Letter Agreement as CA Confidential Information and to keep such CA Confidential Information confidential in accordance with Section 9.01 of the Commutation Agreement.

AAC shall pay in full upon demand all of [REDACTED] reasonable out-of-pocket expenses, including the reasonable fees and expenses of legal counsel (whether for restructuring, litigation, or otherwise) in connection with the Restructuring, this Letter Agreement and the matters relating hereto, in excess of [REDACTED] pro rata share of the cap (if applicable) set forth in Section 2.03(b) of the Settlement Agreement.

Notwithstanding any communication that each party (and/or its affiliates) may have had with the other party, each party represents to the other party that: (a) it is entering into this Letter Agreement and the transactions contemplated herein as principal (and not as agent or in any other capacity); (b) neither the other party nor any of its affiliates or agents are acting as a fiduciary for it; (c) it is not relying upon any representations except those expressly set forth herein, in the Commutation Agreement, or in the Settlement Agreement; (d) it has consulted with its own legal, regulatory, tax, business, investments, financial, and accounting advisors to the extent that it has deemed necessary, and it has made its own decisions in connection with this Letter Agreement based upon its own judgment and upon any advice from such advisors as it has deemed necessary and not upon any view expressed by the other party or any of its affiliates or agents; and (e) it is entering into this Letter Agreement and any transactions contemplated in it with a full understanding of the terms, conditions and risks thereof and it is capable of and willing to assume those risks.

In addition, notwithstanding any communication that each party (and/or its affiliates) may have had with the other party, each party acknowledges that: (a) neither the other party nor its affiliates provides investment, tax, accounting, legal or other advice in respect of this Letter Agreement or any transaction

contemplated herein; and (b) it has been given the opportunity to obtain information from the other party concerning the terms and conditions of this Letter Agreement necessary in order for it to evaluate the merits and risks of the Letter Agreement and any transactions contemplated therein. Notwithstanding the foregoing, it and its advisors are not relying on any communication (written or oral and including, without limitation, opinions of third party advisors) of the other party or its affiliates as (i) legal, regulatory, tax, business, investments, financial, accounting or other advice, (ii) a recommendation to enter into this Letter Agreement or (iii) an assurance or guarantee as to the expected results of the Letter Agreement; it being understood that information and explanations related to the terms and conditions of the Letter Agreement are made incidental to the other party's business and shall not be considered (A) legal, regulatory, tax, business, investments, financial, accounting or other advice, (B) a recommendation to enter into the Letter Agreement or (C) an assurance or guarantee as to the expected results of the Letter Agreement. Any such communication should not be the basis on which the recipient has entered into this Letter Agreement, and should be independently confirmed by the recipient and its advisors prior to entering into this Letter Agreement.

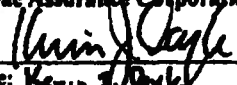
The parties hereto agree to do such further things and to execute such further documents as may be necessary so that, upon payment (or satisfaction) of the Call Option Purchase Price in respect thereof, the Buyer may obtain full legal and beneficial title to the [REDACTED] Surplus Notes being purchased.

This letter shall be in all respects governed by and construed in accordance with the law of the State of New York. This letter may be executed in counterparts (including by facsimile transmission or electronic transmission of a PDF file), each of which shall be an original and all of which together shall constitute a single letter. Notices shall be delivered to each party hereto at the address for such party as is set forth below its signature line hereto and shall be deemed effective if delivered via overnight courier, with a copy via email electronic transmission. Each of the parties hereto waives trial by jury in any litigation in any court with respect to, in connection with, or arising out of, this Letter Agreement, or the validity, protection, interpretation, collection or enforcement thereof. Each of the parties hereto irrevocably consents that any legal action or proceeding against it under, arising out of or in any manner relating to this Letter Agreement shall be subject to the exclusive jurisdiction of any court of the State of New York sitting in the County of New York or the United States District Court for the Southern District of New York.

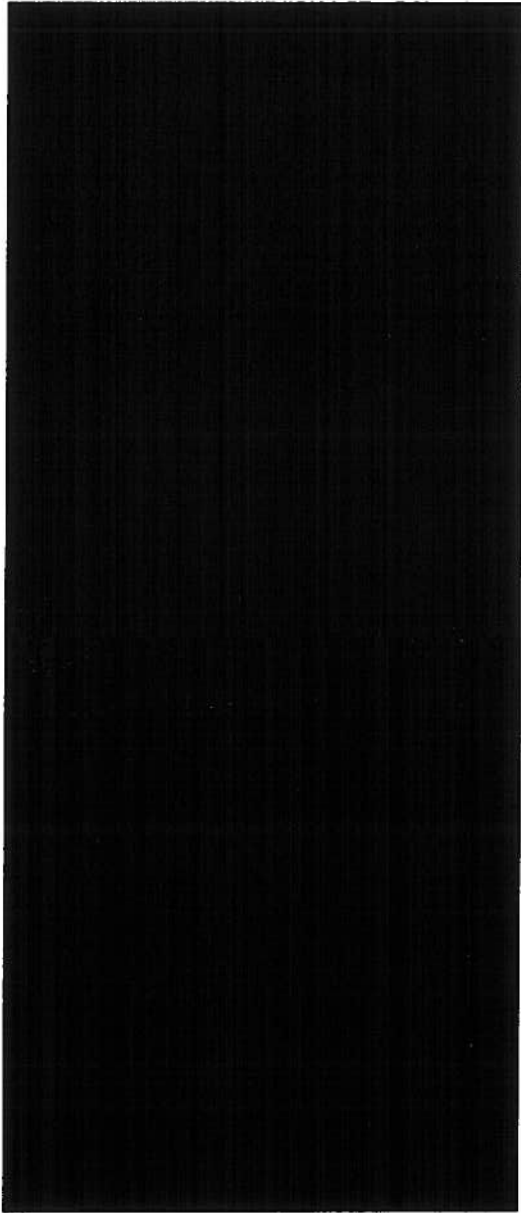
Please indicate your acceptance of the provisions hereof by signing the enclosed copy of this letter and returning it to AAC at the address specified below.

Very truly yours,

Ambac Assurance Corporation

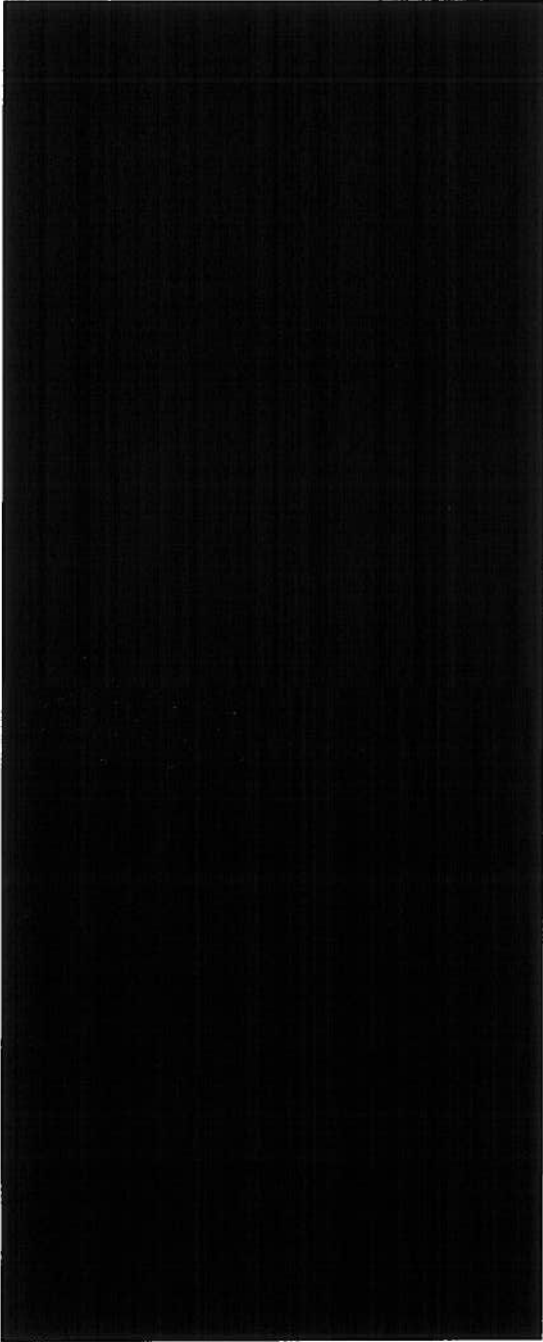
By:   
Name: Kevin J. Doyle  
Title: Senior VP  
Address:  
One State Street Plaza  
New York, New York 10004  
Attention: Kevin J. Doyle, General Counsel  
Email: kdoyle@ambac.com

**ACCEPTED AND AGREED on June 7, 2010**



**[Signature Page to Call Option Letter Agreement]**

**ACCEPTED AND AGREED on June 7, 2010**



**[Signature Page to Call Option Letter Agreement]**

# **EXHIBIT B**

*Confidential*

June 7, 2010

**Re: Letter Agreement re: Call Option**

Ladies & Gentlemen:

Reference is hereby made to the terms of the Settlement Agreement (the "Settlement Agreement") dated as of June 7, 2010 among Ambac Assurance Corporation ("AAC"), Ambac Credit Products ("ACP"), certain other affiliates of AAC and certain financial institutions. Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Settlement Agreement.

██████████ ("██████████") has agreed to enter into this Letter Agreement with AAC to support the restructuring of AAC. In furtherance of such restructuring, effective as of the Closing, ██████████ (on behalf of itself and its transferees and assigns, as provided below) hereby grants to AAC an irrevocable option (the "Call Option") to purchase any or all of ██████████ right, title and interest in and to \$150 million in principal amount of AAC Surplus Notes issued to ██████████ at or in connection with the closing of the Settlement Agreement (collectively, the "██████████ Surplus Notes") for a cash purchase price equal to the sum of (i) \$.30 per dollar (the "██████████ Rate") of the outstanding principal amount (excluding for purposes of this part (i) any capitalized interest) of the purchased ██████████ Surplus Notes and (ii) any accrued but unpaid interest on the ██████████ Surplus Notes (irrespective of whether such interest has been capitalized), as provided in the last sentence of this paragraph (the amounts in parts (i) and (ii) being the "Call Option Purchase Price"). The Call Option may be exercised by AAC on multiple dates, in whole or in part, by notice in writing to ██████████ at its address set forth above, deliverable in accordance with the notice provisions set forth in the Commutation Agreement of even date herewith among ██████████, AAC and Ambac Credit Products, Inc., at any time or from time to time from the hereof until 3:00 p.m., New York time, on Friday, November 30, 2012 (the "Call Option Term"). Any interest that accrues on any of the ██████████ Surplus Notes or portion thereof held by a Holder (as hereinafter defined) prior to the settlement of the Call Option for such Notes or portion thereof shall be for the account of such Holder. Any interest that accrues on any of the ██████████ Surplus Notes or portion thereof acquired by AAC shall after the settlement of the Call Option for such ██████████ Notes or portion thereof, be for the account of AAC. To effectuate the foregoing, AAC agrees that on the date of acquisition by AAC of the ██████████ Surplus Notes or portion thereof pursuant to this Letter Agreement, in the event there shall be accrued and unpaid interest on the ██████████ Surplus Notes or portion thereof being acquired, it shall pay the Holder thereof, as part of the Call Option Purchase Price for such ██████████ Surplus Notes or portion thereof, an amount equal to such accrued and unpaid interest (including, without limitation, the amount of any capitalized interest) as of the date of acquisition of such ██████████ Surplus Notes or portion thereof, and such payment shall be in full satisfaction of accrued interest due to the Holder in respect of such ██████████ Surplus Notes or portion thereof acquired by AAC.

If, prior to or during the Call Option Term, AAC shall acquire a call option from any other Commuting Policy Beneficiary for a purchase price at a rate per dollar higher than the ██████████ Rate (any such higher rate, a "Higher Call Option Rate"), then the ██████████ Rate solely for any ██████████ Surplus Notes subject to this Letter Agreement not previously purchased at the date of such other call option exercise shall be adjusted to equal such Higher Call Option Rate. In addition, if prior to or during the Call Option Term, AAC shall acquire a call option from any other Commuting Policy Beneficiary and the term of

such option shall end prior to the termination date of the Call Option Term, then the Call Option Term shall be adjusted to end on such earlier termination date.

██████ agrees that the rights of AAC to purchase ██████ Surplus Notes shall be binding upon any subsequent transferee from ██████ or holder of such ██████ Surplus Notes (██████ or any such transferee or other holder of ██████ Surplus Notes being a "Holder") and, accordingly, that as a condition to any transfer or other disposition of any of its interest in ██████ Surplus Notes, ██████, or any subsequent Holder, as the case may be, shall require such transferee to execute and deliver to AAC an acknowledgement in form and substance reasonably satisfactory to AAC pursuant to which such transferee shall acknowledge that it is acquiring such ██████ Surplus Notes subject to the rights of AAC hereunder, that such transferee agrees to be bound by the obligations undertaken by ██████ herein with respect thereto, and that such obligations shall be enforceable by AAC as against such transferee.

The parties agree that a closing of the purchase of any ██████ Surplus Notes pursuant to this Letter Agreement, AAC and the Holder shall occur within fifteen (15) days of AAC's exercise of the Call Option. In connection with such closing, AAC shall pay ██████ the Call Option Purchase Price in immediately available funds, and AAC and Holder will execute and deliver a transfer agreement reasonably satisfactory to each, which transfer agreement will include customary representations and warranties, including that such Holder owns the sole legal and beneficial right, title and interest, free and clear of all liens and encumbrances, in such ██████ Surplus Notes.

Each of ██████ and Ambac agrees to keep the terms of this Letter Agreement confidential, provided that such party may disclose such information to (1) its legal and accounting advisors, (ii) the proposed purchaser of any ██████ Surplus Notes or (iii) as required or requested by any governmental or regulatory authority; provided that in each case the recipient of such disclosure is notified that such information must be kept confidential and, in the case of a proposed purchase, agrees to do so for the benefit of AAC.

The parties hereto agree to do such further things and to execute such further documents as may be reasonably necessary so that, upon payment (or satisfaction) of the Call Option Purchase Price in respect thereof, AAC may obtain full legal and beneficial title to the ██████ Surplus Notes being purchased.

This letter shall be in all respects governed by and construed in accordance with the law of the State of New York. This letter may be executed in counterparts (including by facsimile transmission or electronic transmission of a PDF file), each of which shall be an original and all of which together shall constitute a single letter. Notices shall be delivered to each party hereto at the address for such party as is set forth below its signature line hereto and shall be deemed effective if delivered via overnight courier, with a copy via email electronic transmission. Each of the parties hereto waives trial by jury in any litigation in any court with respect to, in connection with, or arising out of, this Letter Agreement, or the validity, protection, interpretation, collection or enforcement thereof. Each of the parties hereto irrevocably consents that any legal action or proceeding against it under, arising out of or in any manner relating to this Letter Agreement shall be subject to the exclusive jurisdiction of any court of the State of New York sitting in the County of New York or the United States District Court for the Southern District of New York. The rights of AAC under this letter agreement shall not be assignable by AAC.



Please indicate your acceptance of the provisions hereof by signing the enclosed copy of this letter and returning it to AAC at the address specified below.

Very truly yours,

Ambac Assurance Corporation

By: 

Name: Kevin J. Doyle

Title: Senior Counsel

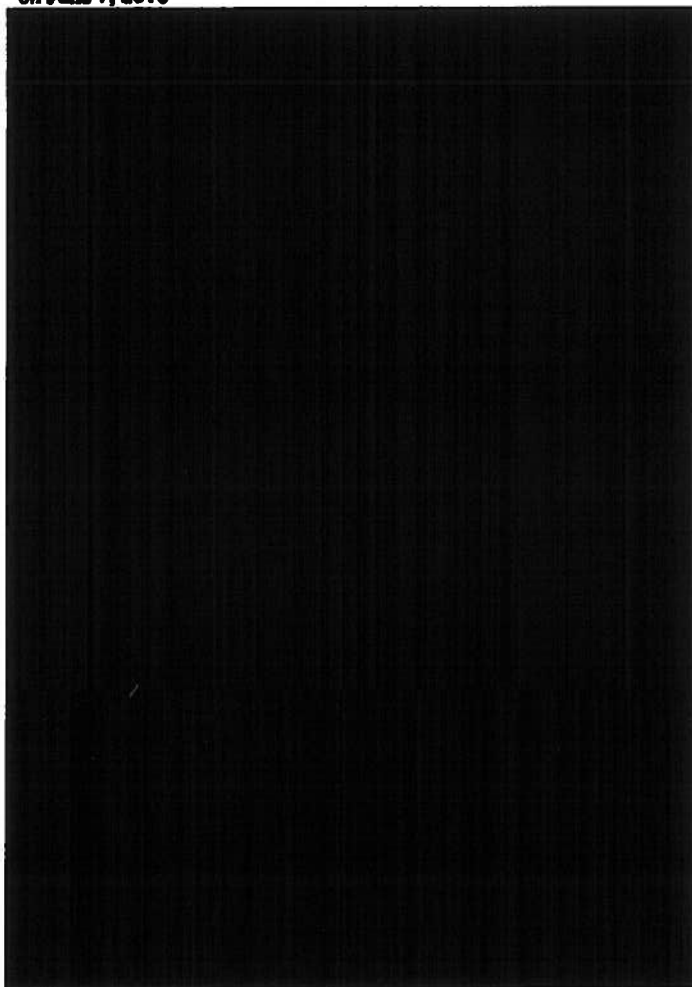
Address:

One State Street Plaza  
New York, New York 10004

Attention: Kevin J. Doyle, General Counsel

Email: [kdoyle@ambac.com](mailto:kdoyle@ambac.com)

**ACCEPTED AND AGREED**  
on June 7, 2010



# **EXHIBIT C**

Execution Version

April 18, 2011

**Re: Fourth Amended and Restated Letter Agreement re: Call Option**

Ladies and Gentlemen:

Reference is hereby made to the Settlement Agreement, dated as of June 7, 2010 (the "Settlement Agreement") and our Third Amended and Restated Letter Agreement re: Call Option dated February 18, 2011 (the "Third Amended Call Option Agreement"). Capitalized terms used but not defined herein shall have the meanings ascribed thereto in the Settlement Agreement.

Pursuant to the Settlement Agreement, [REDACTED] ("[REDACTED]") was issued AAC Surplus Notes in an original aggregate principal amount separately disclosed by [REDACTED] to AAC (collectively, the "[REDACTED] Surplus Notes"). Each of [REDACTED], its transferees of [REDACTED] Surplus Notes, and its and such transferees' respective successors, assigns and subsequent transferees of [REDACTED] Surplus Notes (each, a "Holder" and collectively, the "Holders") hereby grants an irrevocable option (the "Call Option") to Ambac Assurance Corporation ("AAC") to purchase any or all of such Holder's right, title and interest in and to all [REDACTED] Surplus Notes from time to time held by such Holder for a cash purchase price equal to the sum of (x) \$.20 per dollar (the "[REDACTED] Rate") of the principal amount of the [REDACTED] Surplus Notes being purchased and (y) any accrued but unpaid interest on such principal amount (including interest on unpaid interest at the interest rate set forth in the [REDACTED] Surplus Notes) through the date of payment. At the time of the purchase of any [REDACTED] Surplus Notes pursuant to this Letter Agreement from a Holder, AAC and such Holder will execute and deliver a transfer agreement reasonably satisfactory to each which will include customary representations and warranties, including a representation and warranty from such Holder that it has sole right, title and interest, free and clear of all liens and encumbrances, in such [REDACTED] Surplus Notes.

The rights of AAC to purchase [REDACTED] Surplus Notes pursuant to this Letter Agreement shall be binding upon each Holder of [REDACTED] Surplus Notes at any time and, accordingly, as a condition to any transfer or other disposition of a Holder's interest in [REDACTED] Surplus Notes, such Holder shall require any transferee, successor or assign that has not already become a party to this Letter Agreement (by joinder or otherwise) to execute and deliver to AAC an acknowledgment and joinder in the form attached hereto as Exhibit A (the "Joinder"), pursuant to which such transferee, successor or assign acknowledges that it is acquiring such [REDACTED] Surplus Notes subject to this Letter Agreement, agrees to be bound by the terms of this Letter Agreement with respect to the [REDACTED] Surplus Notes and that such obligations shall be enforceable by

AAC against such transferee. Each Holder agrees further that, as a condition to the effectiveness of its transfer or other disposition of [REDACTED] Surplus Notes, to separately represent and warrant and, by execution and delivery of the Joinder, to require its transferee to separately represent and warrant, to AAC the current aggregate principal amount of [REDACTED] Surplus Notes held by such Holder (with respect to a representation and warranty of such Holder) or transferee (with respect to a representation and warranty of such transferee), in each case as of immediately prior to and after giving effect to, each such transfer or disposition.

The Call Option may be exercised by AAC in writing to the Holders at any time or from time to time from the date such AAC Surplus Notes are issued until 3:00 p.m., New York time, on November 30, 2012 (the "Call Option Term"); provided, however, that AAC shall not exercise the Call Option more than three (3) times during the Call Option Term. The Call Option shall be exercised on a *pro rata* basis with respect to all of the [REDACTED] Surplus Notes (based on the outstanding principal amount of the [REDACTED] Surplus Notes held by each Holder). If during the Extended Term (as defined below), AAC or any of its affiliates shall exercise a call option with any other Commuting Policy Beneficiary for a cash purchase price at a rate per dollar (the "Higher Call Option Rate") higher than the [REDACTED] Rate, then the [REDACTED] Rate shall be adjusted upward to equal the Higher Call Option Rate and, if AAC shall have acquired [REDACTED] Surplus Notes pursuant to this Letter Agreement prior to such adjustment, AAC shall pay to the applicable Holders, in addition to the purchase price paid to AAC for such [REDACTED] Surplus Notes previously purchased by AAC from such Holder, an amount equal to the excess of (x) the Higher Call Option Rate times the principal amount of the [REDACTED] Surplus Note so previously purchased over (y) the [REDACTED] Rate times such amount of the principal amount of the [REDACTED] Surplus Note so previously purchased. "Extended Term" means the date from which the AAC Surplus Notes are issued until the date on which any call option granted to AAC or any of its affiliates by a Commuting Policy Beneficiary prior to or contemporaneously herewith expires, whether pursuant to its original term or any extension of such original term.

As of the date hereof, neither AAC nor any of its affiliates has been granted or offered an option to purchase AAC Surplus Notes by any other Commuting Policy Beneficiary that expires on or after 3:00 p.m., New York time on November 30, 2012. The total number of Commuting Policy Beneficiaries that have entered into call option agreements to purchase AAC Surplus Notes as of or prior to the date hereof from a Commuting Policy Beneficiary besides [REDACTED] (but excluding any transferees under call option agreements) is 2. Schedule A hereto sets forth the rate per dollar for all options to purchase AAC Surplus Notes granted as of or prior to the date hereof to AAC or any of its affiliates by any other Commuting Policy Beneficiary. If AAC or any of its affiliates is granted a call option to purchase AAC Surplus Notes by another Commuting Policy Beneficiary on or after the date hereof but prior to the end of the Call Option Term or any Extended Term, or if exercise of such call option occurs prior to or during the Call Option Term or any Extended Term, AAC will reasonably promptly provide the Holders with notice via overnight courier of the rate per dollar of such call option. During the Call Option Term or any Extended Term, AAC will also reasonably promptly provide the Holders with notice via overnight courier of the occurrence of any event which would extend the Extended Term as then in effect (i.e., taking into account any prior extension of the Extended Term), or any increase in the rate per dollar of any call option with another Commuting Policy Beneficiary. The Holders agree to keep the fact and terms of this Letter Agreement (other than disclosure of the rate per dollar herein without identifying the counterparty to which this rate relates) and any rate per dollar disclosed with respect to any other call option confidential, provided that a Holder may disclose any such information to its legal and accounting advisors provided such advisors shall be notified that such information must be kept confidential, or as required by any governmental or regulatory authority.

This letter shall be in all respects governed by and construed in accordance with the law of the State of New York. This letter may be executed in counterparts (including by facsimile transmission or

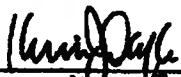
electronic transmission of a PDF file), each of which shall be an original and all of which together shall constitute a single letter. Notices shall be delivered to each party hereto at the address for such party as is set forth below its signature line hereto and shall be deemed effective if delivered via overnight courier, with a copy via email electronic transmission. Each of the parties hereto waives trial by jury in any litigation in any court with respect to, in connection with, or arising out of, this Letter Agreement, or the validity, protection, interpretation, collection or enforcement thereof. Each of the parties hereto irrevocably consents that any legal action or proceeding against it under, arising out of or in any manner relating to this letter shall be subject to the exclusive jurisdiction of any court of the State of New York sitting in the County of New York or the United States District Court for the Southern District of New York.

**This Letter Agreement supersedes the Third Amended Call Option Agreement in its entirety.**

Please indicate your acceptance of the provisions hereof by signing the enclosed copy of this letter and returning it to AAC.

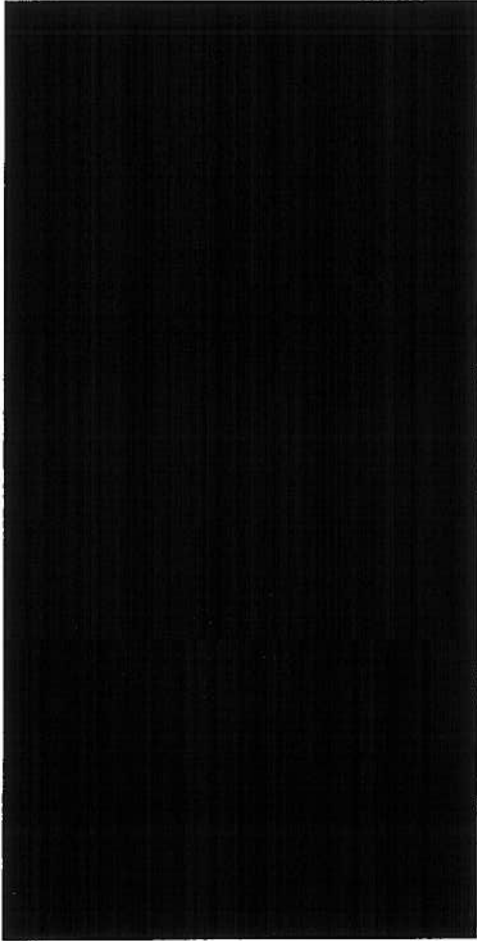
Very truly yours,

Ambac Assurance Corporation

By:   
Name: Kevin J. Doyle  
Title: Senior Vice President  
Address:

One State Street Plaza  
New York, New York 10004  
Attention: Kevin J. Doyle, General Counsel  
Email: [kdoyle@ambac.com](mailto:kdoyle@ambac.com)

**ACCEPTED AND AGREED**





**Schedule A**

<b>\$0.20</b>
<b>\$0.30</b>

**Exhibit A**

**Form of Acknowledgement and Joinder**

**ACKNOWLEDGEMENT AND JOINDER**

In connection with its purchase or other acquisition of [REDACTED] Surplus Notes (as such term is defined in that certain Fourth Amended and Restated Letter Agreement, dated April 18, 2011 (the "Letter Agreement"), to which this Acknowledgement and Joinder is attached), the undersigned hereby acknowledges, agrees and confirms that, by its execution of this Acknowledgement and Joinder, it is acquiring the [REDACTED] Surplus Note(s) subject to the rights of AAC under the Letter Agreement, it shall be bound by the terms of the Letter Agreement (including, without limitation, that the [REDACTED] Surplus Notes are subject to call on a *pro rata* basis) with respect to the [REDACTED] Surplus Note(s) from time to time held by it and that such obligations shall be enforceable by AAC against it to the same extent as if it had executed the Letter Agreement. It further confirms and agrees that as a condition to the effectiveness of this transfer it will separately represent and warrant to AAC the aggregate principal balance of [REDACTED] Surplus Notes held by it both before and after giving effect to any purchase or other acquisition of [REDACTED] Surplus Notes.

Notwithstanding anything to the contrary contained in the Letter Agreement, the undersigned shall be permitted to disclose the terms of the Letter Agreement and any rate per dollar disclosed with respect to any other call option (i) to its affiliates (which, for the avoidance of doubt, shall include its investment manager) and advisors provided that such entities shall be notified that such information must be kept confidential pursuant to the Letter Agreement (it being agreed by the undersigned that it shall be liable to AAC and/or [REDACTED] for any breach of such confidentiality obligations by the undersigned's affiliates or advisors) and (ii) to potential transferees of [REDACTED] Surplus Notes subject to an executed confidentiality agreement on the confidentiality terms of the Letter Agreement, which agreement shall name [REDACTED] and AAC as express third party beneficiaries and a copy of which executed agreement the undersigned agrees to provide to [REDACTED] and AAC prior to any such disclosure to such potential transferees.

[INSERT CORPORATE NAME]

By: \_\_\_\_\_

Name:

Title:

Date:

Address for notices: