
In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**NOTICE OF MOTION AND REHABILITATOR'S
MOTION FOR APPROVAL TO COMMENCE MAKING INTERIM CASH
PAYMENTS ON PERMITTED POLICY CLAIMS**

I. NOTICE OF MOTION

TO: All Parties-in-Interest

PLEASE TAKE NOTICE that the Court has scheduled a hearing on the motion by the Rehabilitator described below. That hearing will take place on Monday, June 4, 2012, commencing at 2:00 p.m., and shall proceed in the courtroom for the Lafayette County Circuit Court in Darlington, Wisconsin, the Honorable William J. Johnston, presiding by judicial designation.

PLEASE TAKE FURTHER NOTICE that any interested parties may appear telephonically pursuant to the Court's standard tele-court procedure. Any parties interested in appearing telephonically should make the appropriate arrangements in advance of the hearing by calling 800-924-5680.

PLEASE ALSO TAKE FURTHER NOTICE that any objections to the relief requested in this Motion by the Rehabilitator should be in writing, and filed and served by no later than noon (Central Time) on Thursday, May 31, 2012.

II. MOTION TO APPROVE INTERIM PAYMENTS ON POLICY CLAIMS

The Commissioner of Insurance of the State of Wisconsin, as the court-appointed rehabilitator (the “Rehabilitator”) of the Segregated Account (“Segregated Account”) of Ambac Assurance Corporation (“Ambac”), hereby moves this Court as detailed below for approval to commence making interim payments on policy claims submitted to the Segregated Account in an amount, in cash, equal to 25% of the permitted amount of each policy claim, as approved for payment by the Rehabilitator. Although the Rehabilitator brings this motion in contemplation of the commencement of the Plan of Rehabilitation confirmed by this Court on January 24, 2011 (the “Plan”) and amendments thereto, if any, this motion does not signify the commencement of the Plan. The Plan is not yet “effective” as that term is defined in the Plan at Section 1.22, and nothing in this motion or the relief sought herein should be construed as establishing an effective date for the Plan.

The grounds for this motion are as follows:

THE PAYMENT MORATORIUM

1. Since the commencement of this rehabilitation on March 24, 2010, loss claims on policies allocated to the Segregated Account (“Policies”) have not been paid pursuant to the provisions of this Court’s Order for Temporary Injunctive Relief dated March 24, 2010 and its Order dated November 8, 2010 for Supplemental Injunctive Relief.

2. The Plan provides for payment of claims on Policies in a mix of cash and surplus notes from the Segregated Account. The cash percentage specified in the Plan is 25 percent, with the remainder of each claim paid in surplus notes.

3. The Rehabilitator has not yet put the 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 assessing 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. (Seventh Affidavit of Roger A. Peterson (“Peterson Aff.”) ¶ 4.)

4. Although the Rehabilitator believes those 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. (*Id.*)

ADVERSE EFFECTS OF THE MORATORIUM

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, who have gone without any payment on their claims since the rehabilitation commenced on March 24, 2010. 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. (*Id.* ¶ 5.)

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 principal balances of the underlying mortgages. The Segregated Account's non-payment of claims for under-collateralized RMBS 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. (*Id.* ¶ 6.)

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 for those

transactions where no claims have been paid during the moratorium, the excess spread 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 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, resulting in no benefit to policyholders or the Segregated Account. (*Id.* ¶ 7.)

THE REHABILITATOR'S REQUEST TO MAKE INTERIM PARTIAL PAYMENTS

8. To mitigate the adverse effects of the moratorium during this interim period in which the Plan is not yet put into formal effect, the Rehabilitator proposes to make interim payments on policy claims submitted to the Segregated Account in an amount, in cash, equal to 25% of the amount of each policy claim, as approved by the Rehabilitator. These partial interim cash payments would be made as to the permitted policyholder claims that have accumulated during the moratorium and continue prospectively as new policyholder claims are submitted and allowed.

9. Even though the Plan is not yet effective, the Rehabilitator has broad discretion under Wis. Stat. Ch. 645 to seek injunctive relief to protect policyholders, to take actions he deems necessary or expedient to reform or revitalize the insurer, and to deal with the property and business of the insurer. *See* Wis. Stat. §§ 645.05, 645.33(2). As with the numerous policy commutations that the Rehabilitator previously submitted for court approval, permitting the Rehabilitator to make interim partial payments to policyholders with current claims falls squarely within the Rehabilitator's statutory authority.

10. If this Motion is granted, the Rehabilitator will work with its management services provider to issue prompt guidance to all Segregated Account policyholders regarding the process for submitting and approving claims. That guidance will generally track the provisions of the Claims Processing Guidelines approved as part of the Plan Confirmation Order, but will be separately stated so there is no unnecessary confusion about these interim payments being made pursuant to the approval of this Motion rather than pursuant to the Plan being put into effect by the Rehabilitator.

11. The interim payments would not be accompanied by surplus notes or any other form of non-cash consideration. The unpaid balance of each policy claim approved for payment by the Rehabilitator would remain outstanding, to be satisfied pursuant to the provisions of the Plan (and amendments thereto, if any) once the Plan, in its present form or as amended, becomes effective.

12. The Rehabilitator does not reasonably foresee any circumstances that would reduce the initial payment, in cash, under the Plan to less than 25% of the amount of each policy claim. (*Id.* ¶ 8.) As noted by this Court—and supported by the testimony at the Plan confirmation hearing, the Disclosure Statement, and other materials submitted in connection with the Plan—the cash percentage under the Plan “was kept low at the outset to protect against the possibility of Ambac in the future finding itself unable to pay the cash portion”:

The split percentage incorporates a conservative approach to Ambac’s claims-paying resources and creates a cushion against worse-than-expected financial outcomes. For that reason, establishing reserves for long-term policies . . . would have been duplicative of OCI’s already-conservative approach to claims-paying resources.

(Plan Confirmation Order at 34 (¶ 103); *see id.* at 51-52 (¶ 148) (finding that the

Rehabilitator's Plan struck the right balance between the interests of short-tail claimants, who argued that the percentage of cash distributed in early years was too conservative, and long-term claimants, who argued that a certain percentage of each cash payment should have been paid into a long-term reserve.) The Rehabilitator believes that the same balance of interests remains appropriate at this time, and that there is no reasonable risk that effecting these proposed interim cash payments will provide policyholders with current or near-term policy claims a greater cash recovery than policyholders with long-term claims will receive under the Plan (and amendments thereto, if any) once it becomes effective. (See Peterson Aff. ¶¶ 8-15.)

13. By this motion, the Rehabilitator does not intend to moot any of the issues relating to this rehabilitation that are presently pending before the Wisconsin Court of Appeals. The percentage amount and fact of the interim payments proposed here by the Rehabilitator are consistent with the Plan and the best interests of policyholders.


CONCLUSION

For the foregoing reasons, the Rehabilitator respectfully requests that this Court enter the accompanying proposed order approving interim payments on policy claims submitted to the Segregated Account in an amount, in cash, equal to 25% of the amount of each policy claim, as approved for payment by the Rehabilitator.

Dated this 16th day of May, 2012.

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Segregated Account of Ambac Assurance
Corporation*

In the Matter of the Rehabilitation of:

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**ORDER GRANTING REHABILITATOR'S MOTION FOR APPROVAL
TO COMMENCE MAKING INTERIM CASH PAYMENTS
ON PERMITTED POLICY CLAIMS**

This matter came before the Court for hearing on the Rehabilitator's Motion for Approval to Commence Making Interim Cash Payments on Permitted Policy Claims (the "Motion"). The Motion came before the Court on proper advance written notice for hearing in open court. Appearances were noted on the record. All interested parties were afforded the opportunity to appear and be heard on the Motion.

The Court having considered the Rehabilitator's Motion and the information provided at the hearing, it is hereby **ORDERED** that:

1. The Rehabilitator's Motion is **GRANTED**; and
2. The Rehabilitator and the Segregated Account are authorized to proceed to effect the interim cash payments as detailed in the Motion.

Dated this ____ day of _____, 2012.

BY THE COURT:

Honorable William D. Johnston
Lafayette County Circuit Court Judge
Presiding by Judicial Appointment