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In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

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**Affidavit of Iain H. Bruce**

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

Iain H. Bruce, being duly sworn, deposes and states as follows:

1. I am a Senior Managing Director in the Risk Group of Ambac Assurance Corporation (“Ambac”). My responsibilities include managing Ambac’s exposure to insured residential mortgage-backed securities (“RMBS”). Except where noted, the statements in this affidavit are based on my personal knowledge or on my review of business records maintained by Ambac for RMBS transactions for which I have managerial responsibility.

2. I have worked at Ambac since 1994. While my responsibilities and job descriptions have changed over the years, I have been part of the organization within Ambac having responsibility for managing insured RMBS exposures from 1998 to 2006, and since 2009. During the time that I have worked within this organization, I have had a supervisory role with respect to RMBS transactions.

3. I am submitting this affidavit at the request of the Commissioner of Insurance of the State of Wisconsin, as court-appointed rehabilitator (the “Rehabilitator”) of the Segregated Account (the “Segregated Account”) of Ambac.

4. All policies issued by Ambac insuring RMBS have been allocated to the Segregated Account.

**A. The Policies and the Transactions**

5. As part of my duties at Ambac, I am familiar with the following transactions in which Ambac issued policies to guarantee the payment of principal and interest on certain classes of RMBS (called “Certificates”) issued by trusts created by Chevy Chase Funding LLC: Series 2006-2, 2006-3, 2006-4, 2007-1 and 2007-2 (individually each a “Transaction,” collectively, the “Transactions”). The Certificates are long-term obligations, with final maturities in 2047 and 2048, depending on the Transaction.

6. For each Transaction, Ambac issued a policy insuring two senior classes of Certificates: the Class A-II Certificates and the Class A-NA Certificates (collectively the “Insured Certificates”). The policies issued in connection with the five Transactions listed above are identified as Financial Guaranty Insurance Policy Nos. AB1003BE, AB1022BE, AB1049BE, AB1065BE, and AB1088BE (each a “Policy,” collectively the “Policies”). True and correct copies of these Policies are attached hereto as Exhibits 1 through 5.

7. In each of the Transactions, Chevy Chase Bank, F.S.B. (“Chevy Chase Bank”) used an entity it controlled, Chevy Chase Funding LLC (“Chevy Chase Funding”), to pool residential mortgage loans originated or purchased by Chevy Chase Bank and deposit them in trusts established for each Transaction. A second layer of trusts, which hold interests in the trusts holding the mortgage loans, then issued to investors numerous classes of certificates that were to be repaid from the principal and

interest payments generated by the underlying mortgage loans. Payments from the underlying mortgage loans are distributed to policy beneficiaries and other parties, including Ambac, according to the terms of Pooling and Servicing Agreements (“PSAs”) between U.S. Bank National Association (“U.S. Bank”) as Trustee, Chevy Chase Bank, and Chevy Chase Funding.<sup>1</sup> True and correct copies of the PSAs for the five Transactions are attached hereto as Exhibit 6 through 10.

8. U.S. Bank is the Trustee for each of the trusts and, in that capacity, it is responsible for the receipt and distribution of funds flowing through the trusts according to the terms of the PSA for each Transaction.

9. The official disclosure documents for the Transactions were known as “Private Placement Memoranda” (“Memoranda”). True and correct copies of the Memoranda for the five Transactions in question are attached hereto as Exhibits 11 through 15.

**B. “Write Down Amounts” and Coverage Under the Policies**

10. Section 4.02 of the PSA for each Transaction specifies the order in which principal and interest payments received for mortgage loans are to be distributed to the holders of the various classes of Certificates and other parties. Those provisions are commonly referred to as the “waterfall.” U.S. Bank makes waterfall distributions on a monthly basis.

11. Section 4.02 provides that, each month, Ambac is entitled to be reimbursed for any insurance payments it made during previous months. Provisions for

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<sup>1</sup> My understanding based on public announcements and filings is that Capital One, N.A. (“Capital One”) is the successor by merger to Chevy Chase Bank.

the reimbursement of Ambac from collateral cash flows are a common feature of Ambac's RMBS transactions and policies.

12. The PSAs refer to a "Write Down Amount," which results from a disparity between the "Certificate Principal Balance" and the "Principal Balance," as these terms are defined in the PSAs. Once the Segregated Account begins paying claims on the Policies, Write Down Amounts will accumulate as the Trustee credits Ambac with monthly reimbursements for previous claim payments and those reimbursements cause the aggregate Certificate Principal Balances of the Certificates to exceed the aggregate Principal Balances of the underlying mortgage loans. Those Write Down Amounts would eventually be allocated to the Insured Certificates, which imposes losses on insured policyholders to the extent of the Write Down Amounts.

13. U.S. Bank has informed Ambac that it reads the terms of the Policies in a manner that does not provide coverage for claims for "Write Down Amounts."

14. If the Policies do not provide coverage for losses resulting from the application of Write Down Amounts to the Insured Certificates, the imposition of losses in the form of Write Down Amounts could eventually erode the entire value of the Policies to policyholders.

15. It was Ambac's business practice to provide broad coverage of losses incurred by insured RMBS investors due to the failure of the collateral to generate sufficient cash, subject only to certain narrow, expressly-disclosed exclusions. This was the coverage that Ambac described itself as providing in the marketplace, and it was the coverage Ambac had agreed to provide in prior RMBS transactions involving the same participants, U.S. Bank, Chevy Chase Bank and Chevy Chase Funding. It was also the

same coverage described in the Memoranda for the Transactions, based on my understanding.

16. Based on my knowledge of Ambac's business practices and my review of the business records documenting Ambac's approval of the Transactions, I do not believe that Ambac intended to leave uncovered the losses incurred by the holders of Insured Certificates resulting from Write Down Amounts. Such a result would have been a departure from the coverage that Ambac typically provided, including in similar transactions involving the same participants. Based on my review of the business records documenting Ambac's approval of the Transactions, I have seen no evidence of communications from any of the other parties to the Transactions calling for Ambac to provide different coverage for the Transactions in question than it had provided in prior RMBS transactions between the same parties.

**C. Prior Chevy Chase RMBS Deals**

17. Before the Transactions in question, Ambac issued policies in connection with several similar transactions involving Chevy Chase Bank loans. With respect to those earlier transactions, U.S. Bank has advised Ambac that the certificateholders insured by Ambac will not be allocated any losses from Write Down Amounts.

18. Starting with the 2006-2 Transaction (the earliest of the Transactions identified above), there was a drafting change that called for the allocation of Write Down Amounts to Insured Certificates as well as uninsured Certificates. The premiums charged by Ambac, both immediately before and after this drafting change, were the same.

19. After reviewing the documentation of Ambac's approval of the Transactions, I did not see any evidence that, starting with the 2006-2 Transaction, Ambac intended to issue policies having a substantial gap in coverage, which would have been inconsistent with Ambac's general business practice at the time, and which would have represented a departure from the coverage that Ambac had agreed to provide in the earlier transactions involving the same parties. After reviewing the documentation of Ambac's approval of the Transactions, I did not see any evidence that the other parties to the Transactions asked Ambac to provide substantially less coverage than it had provided in prior deals, and potentially no coverage at all, but for the same premium charged in prior deals.

**D. The Pended Claims**

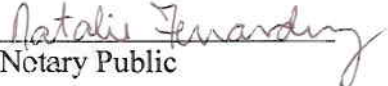
20. As of December 31, 2012, U.S. Bank, as Trustee, submitted claims under the Policies in an aggregated amount of \$103,014,949.58 relating to the period from March 24, 2010 through December 31, 2012. In accordance with the Policy Claim Rules governing the interim cash payment of claims, these claims have not been Permitted, Disputed or Disallowed by the Rehabilitator while the Rehabilitator and Ambac have been investigating the issues discussed in the Rehabilitator's accompanying motion. Instead, they have remained Pending Policy Claims. Ambac, as the Management Services Provider for the Segregated Account, notified the Trustee of the pendency of the claims following their submission.



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Iain H. Bruce

Sworn to before me this 18th day  
of January, 2013.

  
Notary Public

My commission expires 8/29/2015

**NATALIE A FERNANDEZ**  
**NOTARY PUBLIC-STATE OF NEW YORK**  
**No. 02FE6247503**  
**Qualified In New York County**  
My Commission Expires 8/29/2015