
In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**REHABILITATOR'S NOTICE OF MOTION AND MOTION FOR APPROVAL
TO MAKE SUPPLEMENTAL CASH PAYMENTS AS TO CERTAIN POLICY
CLAIMS FOR THE PURPOSE OF MAXIMIZING REIMBURSEMENTS
FOR THE BENEFIT OF ALL POLICYHOLDERS**

**By the Commissioner of Insurance of the State of Wisconsin,
as Rehabilitator of the Segregated Account of Ambac Assurance Corporation**

NOTICE OF MOTION

TO: All Parties in Interest

PLEASE TAKE NOTICE that the Commissioner of Insurance of the State of Wisconsin, as the court-appointed Rehabilitator (the "Rehabilitator") of the Segregated Account (the "Segregated Account") of Ambac Assurance Corporation ("Ambac"), has moved the Court for an order approving supplemental cash payments as to certain policy claims for the purpose of maximizing reimbursements for the benefit of all policyholders, as set forth below. This motion is scheduled to be heard by the Court on August 2, 2013, commencing at 1:30 p.m. (Central Time) before the Honorable William D. Johnston at the Lafayette County Courthouse, 626 Main Street, Darlington, Wisconsin.

PLEASE TAKE FURTHER NOTICE that any objections to the relief requested by the Rehabilitator in this Motion should be in writing, and filed and served by no later than Noon (Central Time) on July 29, 2013. Any parties in interest may appear at the hearing in person or telephonically. Anyone interested in appearing telephonically

should make the appropriate arrangements in advance of the hearing by calling 800-924-5680.

MOTION

By this motion (the “Motion”), the Rehabilitator requests that the Court authorize the Rehabilitator to make payments in excess of the current 25% permitted cash payment percentage from time to time, in one lump sum or in varying proportions in certain months or time periods as appropriate (“Supplemental Payments”), for certain permitted policy claims. Those Supplemental Payments may include, on a case-by-case basis, payment of all or a portion of any outstanding unpaid permitted policy claims. The purpose of making the Supplemental Payments is to maximize cash reimbursements available to the Segregated Account, which will benefit all Segregated Account policyholders.

In support of this Motion, the Rehabilitator states as follows:

A. INTRODUCTION

1. For certain policies allocated to the Segregated Account that insure residential mortgage-backed securities (“RMBS”), there is cash flow available under the transaction’s payment “waterfall” to reimburse Ambac and the Segregated Account¹ for claims paid pursuant to the financial guaranty policies. However, reimbursements are only permitted for the amount of claims the Segregated Account has actually satisfied.

¹ Although Ambac is contractually entitled to these reimbursements pursuant to the transaction documents relating to the financial guaranty policies allocated to the Segregated Account, all such reimbursements received are pledged for the benefit of the Segregated Account pursuant to the Secured Note (the “Secured Note”) and the Aggregate Excess of Loss Reinsurance Agreement (the “Reinsurance Agreement”), both dated as of March 24, 2010 between Ambac and the Segregated Account, as amended and/or supplemented from time to time. Therefore, such reimbursements are available to the Segregated Account for the benefit of policyholders generally.

This means that amounts, such as those in excess of the Segregated Account's current 25% cash payments to policyholders, may not be reimbursed until, and only insofar as, a further permitted policy claim payment is made.

2. The Rehabilitator brings the present Motion because he has currently identified 14 RMBS transaction policies (the "Policies") for which he believes Supplemental Payments are appropriate. If the Segregated Account does not increase its cash payments to more than the current 25% of certain unpaid and outstanding claims and/or future claims relating to the 14 Policies, the Rehabilitator estimates that approximately \$310 million of excess-interest spread reimbursements (on a present value basis) which would have been available to Ambac, will be distributed to uninsured security holders. Should such cash flows be distributed to uninsured security holders, the Segregated Account will be unable to recover those amounts in the future. On the other hand, if the Court grants this Motion and authorizes the Rehabilitator to make cash payments in excess of 25% on some or all of those Policies (and any other such policies that may be identified by the Rehabilitator in the future), those additional claims payments will effectively pay for themselves and, as a result, reduce the outstanding unpaid permitted policy claims owed on the Policies, while also increasing the claims-paying resources available in the future for other Segregated Account policy claimants by an equal amount. In short, the Rehabilitator believes the Motion is a "win-win," that will make all Segregated Account policyholders better off at no cost to the Segregated Account.

B. BACKGROUND

3. Consistent with his practice throughout the course of these rehabilitation proceedings, with this Motion the Rehabilitator seeks this Court's approval to exercise

the discretion necessary to maximize the claims-paying resources available to all Segregated Account policyholders. Over the last three years, this Court has addressed and approved numerous motions by the Rehabilitator to make discretionary decisions as to individual policies, categories of policies, and/or processes and proceedings for administering policies for the rehabilitation. Those motions were all grounded on the common principle that the relief sought by the Rehabilitator was in the best interest of all Segregated Account policyholders because it was reasonably crafted to improve the ultimate amount of policy claims received by the Segregated Account's policyholders as a whole. Such improved outcomes for all Segregated Account policyholders can come about in a variety of ways, including the reduction of claims, increase of claims-paying resources and/or the mitigation of costs or other exposures.

4. For example, that principle was a key feature of the Rehabilitator's Plan of Rehabilitation, confirmed by this Court by final order dated January 24, 2010. Section 3.06 of the Plan authorizes the Rehabilitator to engage in a broad range of "alternative resolutions of claims" respecting particular policies "through the arrangement, negotiations, effectuation and execution of an amendment, restructuring, refinancing, purchase, repurchase, termination, settlement, commutation, tender, synthetic commutation or tear-up, or any similar transaction that results in the extinguishment or reduction of the Segregated Account's liability." *See also* Findings of Fact Nos. 128 and 129 of the Confirmation Order.

5. Consistent with the same best-interest-of-policyholders principle, the Rehabilitator has sought and obtained this Court's approval for a wide variety of other discretionary actions, including determining the proper construction of certain policies in

the Segregated Account, pursuing synthetic commutations, settling claims in lawsuits being advanced by the Segregated Account and Ambac against certain third parties with respect to certain RMBS exposures, and authorizing the commencement of interim cash payments on permitted policy claims. *See, e.g.*, Orders dated March 4, 2013, October 5, 2012, October 4, 2012, and June 4, 2012. Similarly, the Court has authorized the Rehabilitator to settle non-policy obligations such as those described in the Mediation Agreement, the settlement agreement with the United States as to certain tax matters, and the exercise of certain call options. *See, in sequence*, this Court's approval Orders dated November 10, 2011, June 5, 2012, and June 14, 2012.

6. The Rehabilitator has previously noted the importance of reimbursements to all Segregated Account policyholders. In the Rehabilitator's May 16, 2012 Motion for Approval to Commence Making Interim Cash Payments on Permitted Policy Claims, the Rehabilitator explained that the potential loss of excess interest reimbursements was one of the factors weighing in favor of commencing interim cash payments. (*See* May 16, 2012 Motion at ¶ 7.) From October 1, 2012 through April 30, 2013, reimbursements relating to RMBS transactions totaling approximately \$194 million have been received.

C. SOURCE OF REIMBURSEMENTS

7. "Excess interest spread" is one of the primary sources of reimbursements which the Rehabilitator seeks to protect with this Motion. In RMBS transactions, "excess interest" (also known as "excess-interest spread") is generated when the monthly gross interest collected on the underlying mortgages exceeds the amounts necessary to pay monthly interest on the RMBS securities and other contractually-permitted expenses.

8. Under the pooling and servicing agreements governing the RMBS transactions related to the 14 Policies, excess-interest spread is used, among other things,

to reimburse Ambac, and by extension the Segregated Account, for claims paid on the Policies. Significantly, if the amount of monthly excess-interest spread available is greater than the amount of the Segregated Account's unreimbursed permitted policy claim cash payments, some or all of the remaining excess interest is distributed to uninsured holders and neither the Segregated Account nor its insured holders benefit from that excess interest spread. In circumstances where excess interest spread is paid to uninsured security holders, the Segregated Account cannot later recover those funds to reimburse future cash payments on permitted policy claims, nor can it benefit from a reduction in its future permitted policy claim liabilities.

9. In addition, other cash flow (such as principal and/or other recoveries) may also be used to reimburse Ambac, and by extension the Segregated Account, for claims paid pursuant to its RMBS policies. For example, on the IndyMac INDX Mortgage Loan Trust 2005-AR18 transaction, reimbursements from both excess interest spread and principal are available to Ambac and the Segregated Account. If Ambac and the Segregated Account are unable to recover all available reimbursements, then some or all of that cash flow will be distributed to uninsured holders. As with excess interest spread, the Segregated Account cannot later recover these funds to reimburse future cash payments on permitted policy claims, nor benefit from a reduction in its future permitted policy claim liabilities. In those circumstances, it is necessary for the Segregated Account to pay more than 25% of claim amounts in order to receive the full amount of reimbursements available.

10. As a result, for the 14 Policies (and any others that the Rehabilitator may from time to time identify), in order to receive the maximum available financial benefit

the Segregated Account must have the flexibility to satisfy permitted policy claims (whether currently unpaid and outstanding, and/or future claims) in amounts greater than 25% and at such times as necessary, to ensure that it recoups the expected excess interest spread and/or other cash flow available for reimbursement from those transactions. The Segregated Account would need to effect Supplemental Payments on a case-by-case basis and in respect of specified identified permitted policy claims from time to time.

11. The optimum cash-payment percentage necessary to maximize the amount of reimbursements will vary by transaction and may also vary on a monthly basis and/or over time. In order to have the flexibility necessary to achieve the optimum benefit for all Segregated Account policyholders, the Rehabilitator is requesting the authority to exercise his informed discretion in setting those variable amounts as needed. If, in a given month, Supplemental Payments exceed the amounts available for reimbursement, the excess will be carried over and available for reimbursement in a subsequent month. Over time, the Rehabilitator expects to monitor and manage Supplemental Payments to maximize reimbursements and minimize any Supplemental Payments in excess of the available reimbursements.

12. The 14 Policies and transactions currently identified for Supplemental Payments are set forth in the table below. The Rehabilitator requests authorization to make Supplemental Payments for other policies where similar reimbursements are available, should such policies be identified in the future.

TRANSACTION	POLICY NUMBER
Lehman XS Trust Mortgage 2005-7N	AB0947BE
IMPAC Secured Assets Corp. 2005-2	AB0955BE

Lehman XS Trust Mortgage 2005-9N	AB0967BE
Lehman XS Trust Mortgage 2006-2N	AB0970BE
IndyMac INDX Mortgage Loan Trust 2006-AR2	AB0973BE
Harborview Mortgage Loan Trust 2006-7	AB1014BE
IMPAC Secured Assets Corp. 2006-3	AB1032BE
Harborview Mortgage Loan Trust 2006-9	AB1037BE
Harborview Mortgage Loan Trust 2006-14	AB1057BE
IMPAC Secured Assets Corp. 2007-2	AB1069BE
Harborview Mortgage Loan Trust 2007-2	AB1072BE
IMPAC Secured Assets Corp. 2007-3	AB1076BE
Lehman XS Trust Mortgage 2007-7N	AB1081BE
IndyMac INDX Mortgage Loan Trust 2005-AR-18	AB0921BE

13. The Rehabilitator currently estimates that if the Segregated Account continues to pay only 25% of permitted policy claims for the 14 Policies listed above, reimbursements with a present value of approximately \$310 million will be lost.

14. However, if the Court grants this Motion, and authorizes the Rehabilitator to make cash payments greater than 25% for the Policies, it will reduce the obligations of the Segregated Account without a reduction in claims-paying resources and, as a result, increase the future claims-paying resources available for all other Segregated Account policyholders by an equivalent aggregate amount. That is because the additional payments for these 14 Policies would be funded from the internal cash flows of the underlying RMBS transactions with amounts that otherwise would be unavailable to the Segregated Account or Ambac, while at the same time the additional payments would

reduce outstanding claims on the Policies. In other words, if the Court grants this Motion, all Segregated Account policyholders will be in a better financial position, and none will be in a worse financial position.

15. Confirming the Rehabilitator's authority to proceed as proposed in this Motion is consistent with the broad discretionary authority contemplated by the authors of Chapter 645. The Rehabilitator is not a private party with a self-interested perspective relative to the Claims; he is a highly qualified public servant charged with carrying out the duties specified in Chapter 645, Wis. Stats.

16. The official comments to Chapter 645 confirm the Legislature's intent to grant the Rehabilitator broad discretion in matters such as this, explaining that

[Chapter 645] is designed to make rehabilitation a very flexible procedure. It is essential that it be regarded as *a management rather than as a legal task*. Though it is called a formal proceeding because it begins with a formal petition to a court and a hearing, thereafter it should be essentially informal in operation. The order is formulated to emphasize flexibility and informality, and *the rehabilitator is given broad powers*. He must act under the supervision of the court, of course, but *the court's control should be liberal, not strict, and should be provided without cumbersome procedures*.

WIS. STAT. ANN. § 645.32 cmt. (1967) (emphasis added).

17. As this Court has noted in its prior rulings (consistent with settled Wisconsin law and the legislative history underlining Wis. Stat. Chapter 645), the Rehabilitator and his Special Deputy Commissioner should be accorded broad discretion to carry out the rehabilitation as they deem necessary and appropriate. As noted in another portion of the legislative history, the Rehabilitator and his Special Deputy Commissioner for the rehabilitation:

should have great freedom of operation . . . court supervision must be liberal and general, not strict or detailed The Rehabilitator may take such action as he deems necessary or expedient. . . . He shall have all the powers of the officers and managers. . . . He shall have full power to direct and manage. . . . and to deal with the property and business of the insurer Broad and flexible powers are needed. The Rehabilitator can obtain early instruction by the court respecting the range of action he may take without specific approval. . . . Court control of the rehabilitation process should be very liberal. Success may depend on the court's understanding of the imperative need for the Rehabilitator to have broad discretion and freedom to act quickly. The Rehabilitator, not the court, must make the day-to-day decisions.

See L. 1967, c. 89, § 17, eff. Aug. 5, 1967.

18. Consistent with the above-quoted legislative history about rehabilitation, this Court previously explained that:

A rehabilitation proceeding is not an adversarial litigation designed to adjudicate the diverse and divergent interests of each policyholder. It is a formal remedial measure to “rehabilitate the business of a domestic insurer.” Wis. Stat. §645.32(1). Accordingly, rehabilitation is “a very flexible procedure” that is “regarded as a management rather than a legal task. . . . [The rehabilitator] must act under the supervision of the court, of course, but the court’s control should be liberal, not strict, and should be provided without cumbersome procedures.” Wis. Stat. Ann. §645.32 cmt.

(July 16, 2010 Order; R.258).

19. The Rehabilitator’s proposed process for making Supplemental Payments as to certain policy claims as appropriate to maximize reimbursements available to the Segregated Account is in the best interests of the policyholders and creditors of the Segregated Account. The Rehabilitator and his management services provider have an appropriate group of professionals familiar with the transactions which are the subject of this Motion to assist in making proper determinations as to which transactions will yield the benefit from this Motion for Segregated Account policyholders generally.


20. Time is of the essence for approval of this Motion. The total amount of reimbursements at risk of loss will continue to grow over time. If the Motion is not approved, the Rehabilitator expects the loss of approximately \$70 million of reimbursements by the end of January 2015.

WHEREFORE, for the reasons stated above, the Rehabilitator respectfully requests that the Court grant this Motion and approve the Rehabilitator's request to make Supplemental Payments as to certain policy claims to maximize reimbursements for the benefit of all policyholders.

Dated: July 11, 2013

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