
In the Matter of the Rehabilitation of:

Case No. 10 CV 1576

Segregated Account of Ambac Assurance Corporation

**BRIEF IN SUPPORT OF MOTION
OF CARVAL HOLDERS FOR ORDER TO SHOW CAUSE**

CVI GVF (Lux) Master S.a.r.l., CVF Lux Securities Trading S.a.r.l., CVI CVF II Lux Securities Trading S.a.r.l., CVI CVF III Lux Securities S.a.r.l., CVIC Lux Securities Trading S.a.r.l., CVIC II Lux Securities Trading S.a.r.l., CVI AA Lux Securities S.a.r.l., CVI CHVF Lux Securities S.a.r.l., CarVal GCF Lux Securities S.a.r.l., and CVI HH Investments LP (collectively the “CarVal Holders”) submit this brief in support of their motion for an order directing the Commissioner of Insurance of the State of Wisconsin (“Commissioner”), as Court-appointed rehabilitator (“Rehabilitator”) of the Segregated Account of Ambac Insurance Corporation (“Ambac”) under the Amended Plan of Rehabilitation of June 12, 2014 (the “Plan”), to show cause why the “Interim Payment Percentage” set forth in the Amended Plan should not now be substantially increased, and additional distributions promptly made to all those who hold obligations of Ambac’s so-called “Segregated Account” (“Holders”). For the reasons set forth herein, CarVal’s motion should be granted.

INTRODUCTION

Pursuant to Wis. Stat. § 645.72(1), the Rehabilitator’s duty is to make prompt distributions to Holders. For more than 18 months he has not approved distributions of any kind, even though his own worst-case calculations show that **more than \$3.847 billion of excess capital is now available to fund immediate distributions to Holders**. This is almost *40 times*

the amount of necessary surplus established by the Rehabilitator in the Amended Plan. Although, as of September 30, 2015, the Rehabilitator projected *worst-case* all-in recoveries of 83.6% on the relevant pool of claims, he has limited distributions to 45%, in violation of his duties under the Amended Plan and Wisconsin law. He should be directed to promptly show cause to the Court and to Holders why an immediate increase in distributions is not warranted.

PARTIES AND JURISDICTION

The Movants. Each of the CarVal Holders holds an allowed claim against the Segregated Account that, after more than four years, has received only a 45% distribution. Each therefore has a significant personal stake in distributions made and to be made by the Segregated Account pursuant to the Amended Plan and related documents. Specifically, the CarVal Holders hold “Permitted Policy Claims,” matured, non-contingent, due-and-payable obligations arising from insurance policies or other underlying instruments or contracts. Affidavit of Daniel Kersten (“Kersten Aff.”) ¶ 2. In consideration of their Permitted Policy Claims, the CarVal Holders and other Holders have been issued “Deferred Payment Obligations,” payment obligations of the Segregated Account that can be satisfied only to the extent that the Rehabilitator approves transfers from Ambac’s “General Account” to the Segregated Account in the manner described below. *Id.*

Respondent. Relief is sought against respondent Commissioner in his official capacity. He serves as Rehabilitator of the Segregated Account of Ambac by Order of this Court dated March 24, 2010, and in that official capacity resides in Dane County, Wisconsin.

Continuing Jurisdiction. Pursuant to Article 6 of the Amended Plan and Wis. Stat. §§ 645.33(3), 645.33(5), and 645.72(1), this Court has jurisdiction over the Rehabilitation, the parties, and the motion for an order to show cause.

BACKGROUND

A. Relevant History of the Rehabilitation

Ambac is a regulated financial guaranty insurance company. Like other financial guarantors, it began in business by guarantying the bond obligations of municipalities. It veered into guarantying riskier asset classes when competition in the financial guaranty market grew heavy, and became a major guarantor of real estate mortgage backed securities (“RMBS”) and student loans. Like others in its industry, Ambac was forced to curtail its underwriting as a result of the 2007 melt-down in the RMBS market caused by the massive fraud that beset the industry.

Recognizing the cash drain on Ambac’s assets and fearing for Ambac’s ultimate insolvency, the Commissioner took unique and unprecedented action, employing a strategy from failed-bank cases.¹ Prior to formal proceedings, the OCI ordered Ambac to create a “Segregated Account,” to which all of its RMBS and student-loan-related liabilities would be assigned. The OCI then placed that Segregated Account -- but not Ambac itself -- in Rehabilitation proceedings. The Commissioner allowed Ambac to keep its municipal bond obligations and other financially-viable obligations in what it refers to as its “General Account,” outside the rehabilitation process. Many creditors protested this arrangement, pointing out that it effectively subordinated one set of policy claims against the insurer to another, which contravened the insurance contracts themselves. These objections were unsuccessful. Ultimately the Wisconsin Supreme Court approved the arrangement, but the net effect is that the CarVal Holders, and all other Holders, have already been subordinated once in these proceedings. The statutory

¹ In a “good-bank/bad-bank” restructuring, the regulator creates a new bank, transfers to it all of the troubled bank’s performing loan assets and its guaranteed liabilities, and then sets up a mechanism whereby, when the new, or “good bank” has sufficient or excess resources, the old bank may access them for distributions to its creditors.

provisions directing the Rehabilitator to make distributions to them as promptly as possible were meant to mitigate this subordination. As we show below, that mitigation has been undermined by unwarranted delays in distribution.

More than five years ago, the Commissioner commenced in this Court formal rehabilitation proceedings, but with respect to the Segregated Account only. Ambac, through its Segregated Account, immediately ceased payment of its obligations in the ordinary course. This placed Holders into a uniquely-impaired class, because Ambac continued to operate the General Account and pay policyholders thereunder in the ordinary course of business. Obligations of the General Account were paid as and when due, and reserves were established and maintained as required by law.

A Rehabilitation Order was entered by this Court on March 24, 2010, naming the Commissioner as Rehabilitator of the Segregated Account. He thereby received the authority established by Wis. Stat. §§ 645.33 to 645.35, and undertook the duties attendant thereto. The Rehabilitator filed a Plan of Rehabilitation (“Plan”) on October 8, 2010, which the Court confirmed on January 24, 2011. The Plan was later amended, and the Amended Plan became effective on June 11, 2014. The Amended Plan, which governs today, incorporates the same structure as the Plan through various related documents, including Payment Guidelines and Segregated Account Operational Documents.

The underlying rationale of the Plan and Amended Plan was to subordinate the interests of the Holders and allow the liabilities of the Segregated Account to stabilize over time. To mitigate this adverse treatment, the Commissioner, as Rehabilitator, was given oversight by this Court so that, pursuant to the requirements of Wisconsin law, he could cause the General

Account to transfer available capital to the Segregated Account, and thereby make distributions to Holders “as promptly as possible.” Wis. Stat. §645.72(1).

The Plan and Amended Plan provided two mechanisms whereby surplus assets of the General Account (unnecessary for its reserves, payment obligations and minimum capital) would be transferred to the Segregated Account so that distributions could be made to Holders. First, on confirmation, the General Account issued a \$2 billion Secured Note to the Segregated Account, which the Segregated Account could draw to fund “Interim Payments” at the rate of 25% of Permitted Policy Claims (the “Interim Payment Percentage” or “IPP,” *see* Amended Plan § 1.304). Second, under a Reinsurance Agreement, the Rehabilitator had discretion to make further demands upon the General Account for distributions of its available cash. Kersten Aff. ¶ 5; Ex. A at 29.

According to the Disclosure Statement, the intent of these arrangements was that “[t]he Secured Note together with the Reinsurance Agreement *effectively render all of the claims-paying resources of the General Account available to pay liabilities of the Segregated Account ... subject to the maintenance of the Minimum Surplus Amount.*” *Id.* Ex. A at 13 (emphasis added). With this additional funding, the Rehabilitator can either increase the IPP, thence making further distributions to holders of Permitted Policy Claims, or make a Deferred Payment (that is, a payment to those holders of Deferred Payment Obligations made without increasing the IPP, or made in conjunction with an increased IPP). *Id.* at ¶ 7; Ex. B at § 2.2, 2.3, 2.7.²

² The “Minimum Surplus Amount” -- \$100 million -- is an amount that the Commissioner must ensure is available in surplus funds to policyholders of the General Account at all times. Kersten Aff. Ex. A at 14. As we show below, the General Account currently holds more than *thirty times that sum* in excess assets.

The rehabilitation process has already greatly delayed even the subordinated treatment that it forced upon the Holders. When the Plan was confirmed in 2011, the ultimate losses that would be experienced by Ambac on its guaranties of RMBS was unknown, and its litigation against the originators of RMBS securities was just getting underway. Accordingly, the distribution percentage on claims was set at a conservative 25%. In part because of appeals and a dispute with the Internal Revenue Service, that percentage held at 25% for three years.

B. Belated Increase of the IPP and Ambac Management's Subsequent Delays

In April 2014, relying upon Ambac's improved financial condition and his projections as of year-end 2013, the Rehabilitator at last amended the Plan and increased the IPP from 25% to 45%. On June 11, 2014 the Court approved the Amended Plan, triggering a 45% Interim Payment for newly-determined Permitted Policy Claims, and a catch-up payment for those policy holders who had already received an Interim Payment.

The Rehabilitator stated that "substantial progress ha[d] been made mitigating risks and uncertainties" associated with both the Segregated Account and the General Account through December 31, 2013. Rehabilitator's Motion to Amend at 13. Specifically, the Special Deputy Commissioner for the Rehabilitation noted that the combination of "[r]educed uncertainty regarding Segregated Account loss development," "[e]ffective preservation of claims-paying resources," and "[g]reater confidence in the likelihood of prospective R&W [r]ecoveries" supported the Rehabilitator's decision to increase the IPP. Tenth Affidavit of Roger A. Peterson In Support of the Rehabilitator's Motion to Amend the Plan at 10-11. In the two full years that have elapsed since the release of financial data upon which the Rehabilitator made this increase, the Rehabilitator's stated factors supporting an increase in the IPP have substantially improved

due to better than projected loss performance, successful risk remediation efforts, and favorable R&W recoveries. The Segregated Account's exposure on RMBS guaranties is now well understood, because most loans in a default position have already defaulted and been foreclosed. Kersten Aff. ¶ 9. The balance of the mortgages (and hence, of the guaranteed securities that depend on those mortgages for payment) will perform with a high degree of predictability. *Id.*

Despite the improved ability to make distributions, after mid-2014, the Rehabilitation process required by Wisconsin law ground to a second halt. For the balance of 2014 and the *entirety* of 2015, values continued to improve, liabilities became even more precisely understood, but no further distributions were made, nor explanations given justifying the absence of distributions.

Instead, the Rehabilitator permitted Ambac's management to use its improved financial condition to attempt to negotiate a transaction for the benefit of its ultimate equity holders. Throughout the Rehabilitation, Ambac's management has maintained control over the General Account. More recently, it has sought to use that power as leverage to negotiate a deal on behalf of equity holders and to the detriment of parties protected by the Amended Plan. Ambac is a wholly-owned subsidiary of Ambac Financial Group, Inc. ("AFGI"), which emerged from chapter 11 in 2013. In 2015, the Rehabilitator permitted AFGI to attempt to negotiate a transaction with major Holders (including the CarVal Holders) to exchange their claims for restructured Ambac subordinated debt securities. While the negotiations progressed, no distributions were made from the Segregated Account. By October, the negotiations had failed. In November members of Ambac's management told the market that they were continuing to

“explore options regarding a recapitalization of [sic] ways to otherwise conclude the rehabilitation process of the Segregated Account.” *Id.* at ¶ 44, Ex. I at 5.

C. The Litigation Assets

Among Ambac’s assets are valuable litigation claims (“R&W Litigation”) against Countrywide Securities Corp. and affiliates (with Bank of America Corp. as successor in interest), and against EMC Mortgage LLC (with J.P. Morgan Chase & Co. as successor in interest) (collectively, the “R&W Counterparties”). *See* Kersten Aff. ¶ 11.

A core assertion of the R&W Claims is that mortgage originators “fraudulently induced Ambac to issue insurance policies that have and will require Ambac to make ... [substantial] claims payments” *Ambac Assurance Corp., et. al. v. Countrywide Home Loans, Inc.*, Dane County Circuit Ct., Complaint at 6, Case No. 14CV3511 (December 30, 2014). As Ambac has accurately alleged, the documents underlying its guaranties of certain RMBS securities contain representations and warranties (“R&Ws”) made by the mortgage originator regarding, “among other things, the accuracy of information that [the mortgage originators] ... provided to Ambac [and] the quality of the [underlying] mortgage loans If these R&Ws were incorrect ... the [originator can be required] to repurchase non-conforming mortgage loans.” *Ambac Assurance Corp., et. al v. Countrywide Home Loans, Inc. et. al.*, Sup. Ct., NY County, Oct. 27, 2015, Bransten, J., index. No. 651612/2010 at 3.

In the annual financial statements published in mid-2015, the Rehabilitator permitted Ambac to record its R&W Litigation assets on its statutory balance sheet at a value of \$2.317 billion. Kersten Aff. ¶ 13. However, the value and liquidity of this asset class has recently improved significantly. In January, 2016, Ambac announced a \$995 million settlement of its

action against J.P. Morgan. *Id.* at ¶ 14. This settlement will secure nearly \$1 billion in additional liquidity. Mr. Kersten has attached to his affidavit as Schedule 1 a schedule that shows that this settlement improves the value of the R&W Litigation Assets -- even in the worst-case scenario, by approximately \$336 million. *Id.* at ¶ 14; Schedule 1.

Ambac's claims against Bank of America Corp. remain active. *Id.* at ¶ 20. This and other pending R&W Claims are similar to claims asserted by numerous other financial guarantors that have either been litigated to a successful conclusion or favorably settled. *Id.* As Judge Bransten of the Supreme Court of New York for New York County put it, "the issues presented [by Ambac] . . . are nearly identical to those covered in prior decisions" *Ambac Assurance Corp.* at 4 (citing to *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, No. 602825/08, 39 Misc. 3d 1220(A) (Sup. Ct. N.Y. Cnty. April 29, 2013).

Ambac's largest remaining outstanding R&W Litigation is a claim against Bank of America, which has a track record of settling claims with financial guarantors favorably. Kersten Aff. ¶ 20; Ex. E.³ The successful resolution of Ambac's claim against JP Morgan Chase, coupled with the success other litigants have had against Bank of America, improves both the pool of assets available for immediate distribution, and the visibility the Rehabilitator has into the total value of Ambac's assets.

D. "Scenario Four:" The Rehabilitators *Worst-Case* Assessment of Ambac's Current Financial Condition

After the Court approved the increase of the IPP to 45% in 2014, the General Account made great progress in mitigating risks and strengthening value.

³ Assured Guaranty, MBIA, FGIC, Private Investors and FHA have all settled claims against Bank of America. *See id.*

On June 1, 2015, the Rehabilitator filed his 2015 Annual Report. Kersten Aff. ¶ 21. He updated the report in September, 2015. *Id.*; Ex. F. This report provides four scenarios, incorporating a range of projected losses, asset values, and R&W Litigation recoveries. Scenario Four, also referred to as the “stress case” scenario, is the Rehabilitator’s worst-case scenario, incorporating “(i) the Rehabilitator’s stress case loss estimates for both the General Account and Segregated Account and (ii) the realization of R&W Recoveries equal to 75% of the amounts stated in AAC’s Statutory financial statements as of December 31, 2014.” *Id.* at Ex. F at Ex. B, 25-26. Under Scenario Four, the Rehabilitator projects 70.2% recoveries on Deferred Amounts, and an all-in recovery of 83.6%. *Id.*

Worst-case Segregated Account losses are projected at \$1.9 billion, of which 45% will be paid in cash as claims are established, with the remaining 55% (or \$1.045 billion) deferred. *Id.* at ¶ 23-24; Schedule 2. As of December 31, 2014, there were approximately \$3.3 billion of accrued but unpaid deferred amounts, and approximately \$1.1 billion of Surplus Notes outstanding. *Id.* at Schedule 2. Thus, according to the Rehabilitator’s stress case, the total claims pool (of current and future claims) of the Segregated Account amounts to approximately \$5.5 billion. *Id.* Multiplying this claims pool by the Rehabilitator’s worst-case recovery of 70.2%, *see* Kersten Aff. Ex. F at Ex. B, 25-26, shows that he calculates that more than \$3.8 billion of excess capital is available today. *Id.* at Schedule 2.

Mr. Kersten has attached to his Affidavit as Schedule 2 a chart that shows how the Rehabilitator’s own estimates confirm that a massive \$3.847 billion is immediately available for present and future Holders. The data in the column entitled “Rehabilitator’s Scenario Four as of 12/31/2014,” is drawn from the Rehabilitator’s Scenario Four as of December 31, 2014, shown

at pages 25 and 26 of the Rehabilitator’s Corrected 2015 Annual Report. *Id.* at ¶ 24; Schedule 2. The next two columns entitled, “Adjusted Rehabilitator’s Scenario Four as of 9/30/2015” and “JPM Settlement Est. Impact,” are drawn from the most current reported financial information from Ambac’s statutory filings, and the J.P. Morgan settlement. *Id.* at ¶¶ 23, 34. Below, Movant describes the elements summarized in Schedule 2:

a. Assets. As of December 31, 2014, the Rehabilitator reported that the General Account held liquid claims-paying resources valued at \$4.9 billion. *Id.* at ¶ 26. The Rehabilitator’s stress case scenario also accounts for Ambac’s aforementioned R&W Litigation claims, which the Rehabilitator conservatively valued at \$1.705 billion, or 75% of the actual value the Rehabilitator assigns to these claims. *Id.* at ¶ 27.⁴ The combined value of these assets is \$6.605 billion. *Id.* at ¶ 28.

b. Asset adjustments. To arrive at the Rehabilitator’s projected worst-case recovery rates of 70.2% of deferred amount recoveries, Mr. Kersten assumed that operating expenses and taxes of \$303 million must also be deducted from the General Account’s assets. *Id.* at ¶ 29. Adjusting asset values by these amounts, the Rehabilitator’s stress case scenario concludes that the assets available to the General Account total \$6.302 billion. *Id.*

c. Liabilities. Relevant liabilities have also been calculated by the Rehabilitator and reported in his public filings. The Rehabilitator first accounts for liabilities in the General Account, which he values at \$1.6 billion in his worst-case scenario. *Id.* at ¶ 30. Deducting these liabilities from the assets available to the General

⁴ In just one settlement, Ambac will recover more than half of this sum in cash. *See supra* p. 8.

Account, the value of assets available to the Segregated Account under Rehabilitator's worst-case is \$4.702 billion. *Id.*

d. Resources Available to Holders. The remaining liabilities are claims of Holders and the claims in the Segregated Account that have yet to mature (and for which the Rehabilitator therefore must reserve). The Rehabilitator's worst-case records the unmatured liabilities at \$1.9 billion, which, at the previous IPP of 45%, would generate distributions (which must now be reserved) of \$855 million. *Id.* at ¶ 31-32. Reserving for this sum, the surplus capital available to the Rehabilitator to satisfy claims in the Segregated Account is \$3.847 billion. *Id.* at ¶ 33. These funds are immediately available to increase the IPP and make a substantial distribution to Holders.

Since the publication of the 2014 results (in the 2015 Annual Report), Ambac's financial condition, and its ability to make immediate distributions has only improved. Net assets available for unpaid loss claims in the Segregated Account have increased by \$563 million, to \$4.411 billion, while current and projected net claims have modestly increased by a mere \$7 million to \$5.489 billion. *Id.* at ¶ 36; *see id.* Schedule 2 (column entitled "Adjusted Rehabilitator's Scenario Four as of 9/30/2015"). These improvements, which include the recent J.P. Morgan settlement, bring the Rehabilitator's Scenario Four recoveries to over 89% on all-in recoveries. *Id.* at ¶ 37; Schedule 2.

Given that these projections are based on, and account for, the Rehabilitator's *worst case scenario* for losses and R&W Litigation recoveries, it follows that an increase of the IPP to *at least* 83.6% would be even more conservative. It is long overdue.

E. Other Financial Metrics Show That Ambac's Financial Condition is Extremely Favorable

Ambac bears other strong indicia of financial strength. At least four significant metrics show that Ambac's Financial Condition is sound and its ability to pay claims much improved.

Profoundly-Improved CPR. One measure common in the insurance industry is the Claims Paying Ratio ("CPR") -- that is, total Net Par Exposure divided by Claims-Paying resources. The lower the ratio, the stronger the insurer. Over the course of this rehabilitation, the General Account's CPR has dropped from 64:1 to a current rate of 21:1. *Id.* at ¶ 39. No major bond insurance company -- including competitors with A or better credit ratings that compete to be able to write new business, currently maintains CPR levels this low. *Id.* at ¶ 40. For example, National Public Finance Guarantee Corporation (AA-/A3 rated), Assured Guaranty Municipal Corporation (AA/A2) and Assured Guaranty Corporation (AA/A3) report directly-comparable CPRs of 65:1, 40:1 and 28:1, respectively. *Id.*

Improved Predictability and Reduced Exposure. A component of the Rehabilitator's monitoring of Ambac is his ability to project the total amount of insurance loss for which the Segregated Account will ultimately be liable. With the passage of time, the Rehabilitator's ability to model future policy losses has improved markedly. When the Segregated Account entered Rehabilitation in 2010, only 7% of projected total losses had already been experienced. *Id.* at ¶ 10. Most of the projected losses lay in the future, so that the scope of potential losses was largely an estimate. The percentage of realized losses rose to 44% as of December 31, 2013 and, as of September 30, 2015, to 52%. *Id.* Today, more than half of the total loss that will ever be experienced has already occurred. Further, Ambac's total insured exposure has declined by 69% since it entered Rehabilitation in 2010, and by 34% since the evaluation date of the last

approved distribution. *Id.* The current preponderance of actual to projected loss, detailed knowledge of actual loss *experience* and reduced exposure, lowers overall risk and improves the Rehabilitator's ability to model future losses with greater precision.

Minimum Surplus Unaffected. The Disclosure Statement provides that the General Account's liability to the Segregated Account, under both the Secured Note and the Reinsurance Agreement, is "capped so that no payments are required ... that would result in the surplus as regards policyholders of the General Account falling below the amount of \$100 million ... (the 'Minimum Surplus Amount')." If the Rehabilitator were to increase the IPP as requested by this motion, he would not be impairing Ambac's surplus. Payments to Holders, while decreasing assets of the General Account, also decrease the liabilities of the Segregated Account (and thus its ultimate need to draw on assets of the General Account).

Liquidity Improvement of \$1 billion. According to his 2015 Annual Report, the Rehabilitator considers \$2.125 billion fair market value, or \$2.039 billion at carrying value, of the General Account's assets to be either highly or medium liquid. *Id.* at ¶ 41. The recent settlement will add almost \$1 billion in cash. Thus, a distribution of over \$3 billion could be made without having to access illiquid securities. A substantial improvement in the IPP and further distributions to holders will not impair the liquidity of Ambac.

F. The Harm Caused to Ambac By a Delay in Distributions

The Rehabilitator's failure to make prompt distributions, as the statute requires, does not simply further delay recoveries to Holders. It markedly *impairs* the financial condition of Ambac itself. Deferred obligations earn interest, accreting at an effective annual rate of 5.1%, Amended Plan at 2, while the General Account reports an average annual yield of 2.8% on \$3.1

billion of its assets. *Id.* at ¶ 43. This creates an annual negative carry of approximately \$70 million. *Id.*

Ironically, the reason for this dramatic negative carry is that the General Account's assets are largely comprised of highly liquid assets like U.S. government bonds, municipal bonds, corporate bonds, asset-backed securities, and cash, that are appropriate for distribution, not earnings. *Id.* at ¶ 42. *The Rehabilitator's failure to comply with his statutory mandate costs the Segregated Account and its stakeholders approximately \$70 million a year.* Paying more in interest on its Deferred Payment Obligations than it is earning on its held securities, holding \$3.847 billion in Surplus Cash, while Deferred Amounts are earning 5.1% interest, the General Account causes the overall financial condition of the Segregated Account in Rehabilitation to worsen.

ARGUMENT

A. Movants Have Standing to Seek An Order to Show Cause

The CarVal Holders have a direct stake in the Segregated Account and the Rehabilitator's performance of his statutory obligation, and thus have standing to be heard. Wis. Stat. subsections 645.33(2) & (3) place the Court in a supervisory role over the Rehabilitator and subject him to the Court's jurisdiction.

B. Grounds Exist for the Entry of An Order to Show Cause

1. The Court Retains Jurisdiction to Enforce the Plan.

Article 6 of the Amended Plan reserved to the Court a supervisory power to "ensure that the ... intent of [the] Plan and the payment Guidelines are carried out" and to "enter such orders ... as are necessary to impose such limitations, restrictions, terms and conditions on" "the

respective title, rights, and powers of the Segregated Account, the terms of [the] Plan and the Payment Guidelines.” Amended Plan § 6.01(d). The Court further retained exclusive jurisdiction “to consider any amendment or modification of the Plan or any documents related to the Plan” and “to determine controversies, suits, and disputes that may arise in connection with the interpretation, enforcement, or consummation of [the] Plan or the Payment Guidelines.” Amended Plan § 6.01(h) and (i).

2. The Rehabilitator Has Not Complied With His Obligations.

Section 645.72(1) provides, in pertinent part, that “under the direction of the court, the liquidator shall pay dividends as promptly as possible to ... creditors in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including 3rd-party claims.” Thus the Rehabilitator’s core obligation is to make payments to holders “as promptly as possible” *Id.* The Disclosure Statement -- a document crucial to obtaining this Court’s confirmation of the Plan, put it this way more than five years ago: The proceeding was intended to “*effectively render all of the claims-paying resources of the General Account available to pay liabilities of the Segregated Account ... subject to the maintenance of the Minimum Surplus Amount.*” Kersten Aff. Ex. A at 13 (emphasis added).

The Segregated Account does not write insurance or otherwise operate an insurance business. It exists for the sole purpose of liquidating assets and liabilities and to distribute proceeds to those creditors allocated to the Segregated Account. In connection with the Segregated Account, the Rehabilitator serves effectively as a liquidator.

So that the Rehabilitator might carry out his obligations, this Court authorized him to increase the IPP and/or make Deferred Payments as the financial condition of the General Account permits. Amended Plan § 10.04. To be sure, the Rehabilitator is clothed with broad discretion, *see* Kersten Aff. Ex. B at §§ 2.3, 2.7, but that discretion goes to the calculation of assets and liabilities, not to whether the interests of policy holders should be subordinated to the interests of AFGI's equity holders, or to whether to fulfill the statutory mandate to distribute available funds "as promptly as possible." As the Rehabilitator has previously conceded, and the Plan and related documents confirm, the equitable interests of the Holders are a key consideration when determining when and how to make distributions. *See* Tenth Affidavit of Roger A. Peterson at ¶ 31; Kersten Aff. Ex. B at 4; Kersten Aff. Ex. A at 31.

Creditors of the Segregated Account are at significant risk, given the power left to Ambac's management to try to exact value for its parent equity holder. Ambac's "rehabilitation" is *sui generis*: a proceeding in which the Commissioner permitted Ambac's so-called "General Account" to remain outside of formal Rehabilitation, while the "Segregated Account" is effectively liquidated through the Rehabilitation process. Given the practical influence of Ambac's board, and its demonstrated history of attempting to use the General Account's assets to effect a restructuring, special vigilance, both of the Rehabilitator and of this Court, is required. The Segregated Account must not be held hostage to the interests of equity holders seeking to recapitalize the General Account. It was established more than four years ago, to pay creditors when money became available.

Money is available, and has been for some time. Although his own calculations show that those claims-paying resources exist, and that many multiples of the Minimum Surplus

Amount exist, the Rehabilitator is not using these resources to pay liabilities “as promptly as possible,” as Wisconsin law requires.

3. CarVal Does Not Ask This Court to Substitute Its Discretion for the Rehabilitator’s Discretion.

This motion depends *entirely* on the Rehabilitator’s own calculations, and description of the recent litigation settlement. It does not ask the Court to substitute the judgment of the CarVal Holders, or of the Court itself, in seeking relief. The Rehabilitator’s own 2015 Report contains *his* stress case, which errs on the conservative side in striking “a reasonable balance” between completion of the case and the protection of unliquidated and undetermined claims. *Id.* Time has only made this stress case *more* conservative. The third-quarter financials show improvement, and the recently-announced J.P. Morgan settlement adds still greater improvement. The Rehabilitator’s own calculations have already incorporated “the proper recognition of priorities and a reasonable balance,” and nevertheless he is not paying dividends “as promptly as possible,” as the statute requires.

The Rehabilitator has discretion, but he has *exercised* that discretion -- by calculating the assets and liabilities of the General Account and Segregated Account and establishing highly conservative reserves. His calculations take into account all liabilities, current and projected, both of the ongoing insurance business at the General Account, and the liabilities at the Segregated Account. *His* computations, not movants’, show an overwhelming amount of liquid capital available to the Segregated Account. The Rehabilitator, within his discretion, has set forth the projected status of the General Account under the most conservative, “stress case” scenario. That scenario leaves at least \$3.847 billion in surplus capital available to the Segregated Account to satisfy Permitted Policy Claims. The available surplus -- as *the*

Rehabilitator calculates it -- is so large that failure to make a substantial distribution is an abuse of the Rehabilitator's discretion.

The Rehabilitator has previously stated, and the Plan and related documents confirm, that the equitable interests of the holders of Permitted Policy Claims in the Segregated Account are a key consideration when determining when and how to make distributions *See* Tenth Affidavit of Roger A. Peterson at ¶ 31; Kersten Aff. Ex. B at 4; Kersten Aff. Ex. A at 31. Unfortunately, those interests have not been considered for a very long time.

At this juncture, movants ask for limited relief: merely that the Court direct the Rehabilitator account for his failure to make a distribution. This limited request is well within the "direction of the Court" that the Legislature contemplated in subsection 645.72(1). The Court should direct the Rehabilitator to show cause why he should not increase the IPP to 83.6%, or such higher amount as the record warrants.

CONCLUSION

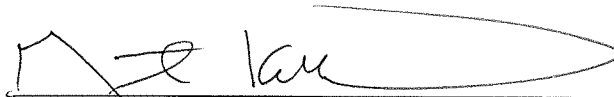
For the reasons set forth herein, the CarVal Holders request that its motion be granted and the Court issue an Order requiring the Rehabilitator to show cause why he should not increase the IPP to at least 83.6%, or such higher amount as the record warrants.

Dated this tenth day of February, 2016.

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