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DANE COUNTY CIRCUIT COURT

STATE OF WISCONSIN

CIRCUIT COURT

DANE COUNTY

In the Matter of the Rehabilitation of:

**SEGREGATED ACCOUNT OF
AMBAC ASSURANCE CORPORATION**

**Case No. 10 CV 1576
Hon. Richard G. Niess**

**2017 ANNUAL REPORT ON THE REHABILITATION OF THE
SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION**

Dated: June 5, 2017

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**ANNUAL REPORT ON THE REHABILITATION OF THE
SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION**

Prepared by:

**The Commissioner of Insurance of the State of Wisconsin,
as the Court-Appointed Rehabilitator of the
Segregated Account of Ambac Assurance Corporation**

Dated: June 5, 2017

Disclaimers: This Annual Report, prepared by the court-appointed Rehabilitator of the Segregated Account, summarizes and describes developments in the Rehabilitation Proceeding since the 2016 Annual Report. It does not contain an exhaustive discussion of the Rehabilitation Proceeding, which is discussed in further detail in the relevant papers and pleadings filed with the Rehabilitation Court. Those papers and pleadings are available for review on the website (the "Website"), <http://www.ambacpolicyholders.com>.

This Annual Report is not required to be prepared in accordance with federal or state securities laws or other applicable law. None of the Securities and Exchange Commission ("SEC"), any state securities commission, or any similar public, governmental or regulatory authority has approved this Annual Report, or has passed on the accuracy or adequacy of the statements contained herein. Persons trading in or otherwise purchasing, selling or transferring securities of the Segregated Account should evaluate this Annual Report in light of the purpose for which it was prepared, and should also consider other publicly available information, including the materials on file with the SEC prepared by Ambac Financial Group, Inc.

No registration statement under the Securities Act of 1933, as amended, or any other federal or state securities or "blue sky" laws have been filed with the SEC or any other agency by the Rehabilitator or the Segregated Account with respect to any securities that may be issued by the Segregated Account.

Except as specifically and expressly stated herein, this Annual Report does not reflect any events that may occur subsequent to the date hereof. Such events may have a material impact on the information contained in this Annual Report. The financial information provided herein or incorporated herein by reference was not prepared with a view toward compliance with published guidelines of the SEC, the American Institute of Certified Public Accountants or Accounting Principles Generally Accepted in the United States of America ("GAAP"), or in accordance with U.S. statutory accounting principles prescribed or permitted by the State of Wisconsin Office of the Commissioner of Insurance.

This Annual Report may not be relied upon for any purpose other than to obtain information about the status of the Rehabilitation Proceeding generally. Nothing contained herein will constitute an admission of any fact or of any liability by any party with regard to any claim or litigation, including, but not limited to, any proceeding involving the Rehabilitator, the Segregated Account or any other party, or any proceeding with respect to any legal effect of the rehabilitation of the Segregated Account.

Neither Ambac Assurance Corporation, the Segregated Account, nor the Rehabilitator makes any warranty, express or implied, as to the accuracy or completeness of the information contained herein. In particular, events and forces beyond the control of the Rehabilitator may alter the assumptions upon which the disclosures in this Annual Report are based.

This Annual Report may contain statements that are, or may be deemed to be, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include those regarding consummation of transactions in conjunction with the Rehabilitation Proceeding. Although the Rehabilitator believes that any such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Any such forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance or achievements of the Segregated Account to be different from any future results, performance and achievements expressed or implied by these statements.

The Rehabilitator's Loss Projections (found in Section VI herein) are based upon estimates and assumptions developed in good faith by the Rehabilitator based upon certain materials provided by Ambac Assurance Corporation and other information that was determined to be relevant. THE REHABILITATOR'S LOSS PROJECTIONS AND UNDERLYING ASSUMPTIONS DO NOT REFLECT THE VIEWS OF AMBAC ASSURANCE CORPORATION OR AMBAC FINANCIAL GROUP, INC. OR ITS MANAGEMENT. The estimates and assumptions incorporated in the Rehabilitator's Loss Projections may not be realized and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Rehabilitator's control. No representations can be or are made as to whether the actual results will be within the range set forth in the Rehabilitator's Loss Projections. Some assumptions will not materialize and events and circumstances occurring subsequent to the date on which the Rehabilitator's Loss Projections were prepared may be different from those assumed or may be unanticipated, and therefore may affect financial results in a material and possibly adverse manner. Accordingly, due to the inherently unpredictable nature of such projections, no representation can be or is being made with respect to the accuracy of the Rehabilitator's Loss Projections, and the Rehabilitator's Loss Projections, therefore, may not be relied upon as a guarantee or other assurance of the actual results that will occur.

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I. INTRODUCTION & BACKGROUND

On March 24, 2010 (the “**Petition Date**”), the Circuit Court for Dane County, State of Wisconsin (the “**Rehabilitation Court**”) entered an order placing the Segregated Account of Ambac Assurance Corporation (the “**Segregated Account**”) into rehabilitation pursuant to the provisions of the Wisconsin Insurers Rehabilitation and Liquidation Act, codified under Chapter 645 (the “**Rehabilitation Proceeding**”). The Rehabilitation Court appointed the Commissioner as Rehabilitator of the Segregated Account, with full powers and authority granted pursuant to Wis. Stat. §§ 645.33 to 645.35 and all other applicable laws as are reasonable and necessary to fulfill his duties and responsibilities. As part of the Decision and Final Order Confirming the Rehabilitator’s Plan of Rehabilitation (entered January 24, 2011) (at page 60, ¶ 8), the Court directed the Rehabilitator to file a report each year by June 1st “advising on the status of the rehabilitation.”

The Rehabilitator hereby submits the enclosed 2017 Annual Report (the “**Annual Report**”) on the Rehabilitation of the Segregated Account of Ambac Assurance Corporation to advise the Court and all interested parties about certain developments in the rehabilitation proceeding since the filing of the 2016 Annual Report and supplement.

A. Ambac Assurance Corporation

Ambac Assurance Corporation (“**AAC**”) is a Wisconsin-domiciled insurance company. It was incorporated under the laws of Wisconsin as CMI Credit Insurance, Inc. on February 25, 1970, and is a wholly-owned subsidiary of Ambac Financial Group, Inc. (“**AFG**”), a corporation headquartered in New York City.

B. Establishment of the Segregated Account and Petition for Rehabilitation

On March 24, 2010, AAC established the Segregated Account. Under Wisconsin insurance law, the Segregated Account is a separate insurer from AAC for purposes of the Rehabilitation Proceeding (as described above). The Commissioner of Insurance for the State of Wisconsin (the “**Commissioner**”) approved the establishment of the Segregated Account by letter dated March 24, 2010.

AAC allocated the following to the Segregated Account: (i) certain policies insuring or relating to credit default swaps; (ii) policies insuring residential mortgage-backed securities (“**RMBS**”); (iii) certain student loan policies, some of which were allocated to the Segregated Account on March 24, 2010 (or shortly thereafter), and some of which were allocated on October 8, 2010, after undergoing an assessment process; (iv) certain other policies insuring obligations with substantial projected impairments or relating to transactions which have contractual “triggers” based upon AAC’s financial condition or the commencement of a rehabilitation proceeding, which triggers, if exercised, could have materially and adversely affected AAC’s financial condition; (v) remediation claims, defenses, offsets, and/or credits (except with respect to recoveries arising from remediation efforts or reimbursement or collection rights), if any, in respect of policies allocated to the Segregated Account; (vi) AAC’s disputed, contingent liability, if any, under the long-term lease with One State Street, LLC, and its contingent liability, if any, under the Ambac Assurance UK Limited (“**Ambac UK**”) lease with British Land; (vii) AAC’s limited liability interests in Ambac Credit Products, LLC (“**ACP**”), Ambac Conduit Funding, LLC, Aleutian Investments, LLC (now liquidated), and Juneau Investments, LLC (together, the “**Allocated Subsidiaries**”); (viii) all of AAC’s liabilities as reinsurer under reinsurance agreements (except for reinsurance assumed from Everspan Financial Guarantee Corp.); and (ix) effective November 7, 2010, any liability to AFG relating to tax refunds and any liability to the Internal Revenue Service (“**IRS**”)

relating to taxes. A list of the insurance policy liabilities allocated to the Segregated Account is available on the Website.

The Segregated Account is operated in accordance with the Plan of Operation for the Segregated Account as it has been amended, and may be further amended from time to time in the future (the “**Plan of Operation**”). Pursuant to the Plan of Operation, the liabilities of the Segregated Account are supported by a Secured Note issued by AAC to the Segregated Account on March 24, 2010 (the “**Secured Note**”) and an Aggregate Excess of Loss Reinsurance Agreement between the Segregated Account and AAC dated as of March 24, 2010 (the “**Reinsurance Agreement**”). AAC issued the Secured Note to the Segregated Account in the initial principal amount of \$2 billion, due in 2050. Pursuant to the Secured Note, the Segregated Account had the ability to demand payment from AAC from time to time to pay claims and other liabilities. Once the Secured Note is exhausted, which occurred in May 2014, and is discussed further below in Section II.B.3, the Segregated Account has the ability to demand payment from time to time under the Reinsurance Agreement to pay claims and other liabilities. The Secured Note together with the Reinsurance Agreement have effectively rendered all of the claims-paying resources of AAC’s General Account (the “**General Account**”) available to pay all claim liabilities of the Segregated Account (including any payments with respect to SA Surplus Notes (as defined below) and junior surplus notes), with the exception that AAC is not obligated to make payments on the Secured Note or under the Reinsurance Agreement if its surplus as regards to policyholders is (or would be) less than \$100 million, or such higher amount as the Wisconsin Office of the Commissioner of Insurance (“**OIC**”) permits pursuant to a prescribed accounting practice (the “**Minimum Surplus Amount**”). As long as the surplus as regards to policyholders is not less than the Minimum Surplus Amount, payments by the General Account to the Segregated Account under the Reinsurance Agreement are not capped.

In connection with the Secured Note and the Reinsurance Agreement, the Segregated Account also has a perfected security interest in the following receivables: installment premiums received by AAC in respect of policies allocated to the Segregated Account, reinsurance premiums received in respect of assumed reinsurance agreements with AAC, where AAC’s liabilities thereunder have been allocated to the Segregated Account, recoveries under third party reinsurance agreements in respect of policies allocated to the Segregated Account, recoveries arising from remediation efforts and reimbursement or collection rights with respect to policies allocated to the Segregated Account, and all identifiable products and proceeds of the foregoing. For those categories of assets which are material, estimates of the amounts, and to the extent predictable, the timing for collection, can be found in Section IV below. Notwithstanding the aforementioned security interest, all of the claims-paying resources of the General Account are available to pay permitted claims of the Segregated Account, subject to maintenance of the Minimum Surplus Amount.

During the Rehabilitation Proceeding of the Segregated Account (as described above), the Commissioner controls the management of the Segregated Account. AAC provides certain management and administrative services to the Segregated Account and the Commissioner as Rehabilitator of the Segregated Account (the “**Rehabilitator**”) pursuant to a Management Services Agreement, including information technology services, credit exposure management, treasury, accounting, tax, management information, risk management, loss management, internal audit services and business continuity services. Services are provided at cost, subject to mutual agreement of the Segregated Account and AAC.

AAC and the Segregated Account have also entered into a Cooperation Agreement, pursuant to which the parties have agreed to certain matters related to decision-making, information sharing, tax compliance and allocation of expenses (including an agreement by AAC to reimburse the Segregated Account for specified expenses to the extent not reimbursed under the Secured Note, subject to the Minimum Surplus Amount). AAC has made certain covenants to the Segregated Account, including an agreement to not

enter into any transaction with, or use any asset or property of, any third party involving consideration or other proceeds of more than \$5 million (or such higher amount as is agreed with the Segregated Account) without the Segregated Account's prior written consent (other than policy claim payments made in the ordinary course of business and investments in accordance with AAC's investment policy), and providing the Segregated Account with an annual operating expense budget for AAC and its subsidiaries, as well as quarterly analyses of variances.

On the Petition Date, the Rehabilitation Court also issued an injunction effective until further order of the Rehabilitation Court enjoining certain actions by Segregated Account policyholders and other counterparties, including, without limitation, the assertion of damages or acceleration of losses based on early termination and the exercise of control rights in transactions that, but for the occurrence of the Rehabilitation Proceeding or the financial condition of AAC, the General Account, the Allocated Subsidiaries or the Segregated Account, would have been exercised by AAC, the Allocated Subsidiaries or the Segregated Account (the "**Injunction Order**").

Policy obligations not allocated to the Segregated Account are not subject to and, therefore, will not be directly impacted by, the Rehabilitation Proceeding.

C. Bank Settlement Agreement

In the fall of 2009, AAC became aware that several large financial institutions that were parties to credit default swaps with ACP in respect of collateralized debt obligations backed primarily by RMBS ("**ABS CDOs**") and collateralized loan obligations ("**CLOs**") and other collateralized debt obligations ("**CDOs**") were forming a group to negotiate with AAC regarding a global commutation of those exposures (the "**Bank Group**"). The obligations of ACP under these ABS CDOs, CLOs and CDOs were guaranteed by AAC pursuant to financial guaranty policies. These policies represented the greatest concentration of projected losses to AAC as well as the largest potential source of collateral damage through the possibility of "mark-to-market" damages. The Bank Group eventually consisted of fourteen financial institutions that, together with their direct affiliates, are among the largest financial institutions in the world.

On June 7, 2010, AAC, AFG, ACP and the Bank Group entered into a settlement agreement which effected the commutation of all of ACP's outstanding credit default swaps in respect of ABS CDOs with respect to the Bank Group, and all of AAC's related financial guaranty exposure (the "**Bank Settlement Agreement**"). In exchange for AAC and ACP commuting \$16.5 billion of net par exposure, AAC transferred to the Bank Group, in the aggregate, \$2.6 billion in cash and \$2 billion of surplus notes newly issued by AAC (the "**Bank Settlement Notes**"). AAC also paid \$96.5 million to the Bank Group to commute certain other obligations, including certain non-ABS CDO obligations, with par amounting to \$1.4 billion, in full satisfaction, but partial payment, of such obligations. Averaging the valuations of AAC's independent appraiser, the Bank Settlement Agreement ultimately paid the Bank Group 43.3% of the present value of expected losses, with 24.5% in cash and 18.8% in Bank Settlement Notes.

D. Allocation to the Segregated Account of Liabilities to AFG and the IRS

On November 3, 2010, the Rehabilitator learned that AFG had received an "Information Document Request" from the IRS asking AFG to describe its legal basis for claiming approximately \$700 million of income tax refunds that were subsequently paid to AAC pursuant to a Tax Sharing Agreement between AFG and AAC (the "**Tax Refund Payments**"). Out of concern that the IRS might have attempted to impose a levy on the proceeds of the Tax Refund Payments, an action which could have had severe consequences for AAC and the Segregated Account, the AAC board of directors voted, on November 7,

2010, to allocate to the Segregated Account: (i) any liabilities that AAC may have to AFG in regard to tax refunds including, but not limited to, any preference claim or fraudulent transfer claim pertaining to such subjects brought by, or on behalf of, AFG in any bankruptcy proceeding involving AFG; and (ii) any liabilities that AAC may have to the IRS in regard to certain taxes or tax refunds.

On November 8, 2010, the Rehabilitator filed a motion seeking to supplement the Injunction Order entered on the Petition Date to ensure that, among other things: (i) any disputes regarding claims of AFG or its bankruptcy creditors or the IRS pertaining to the tax refund payments to AAC will be litigated before the Rehabilitation Court; (ii) any remedies available for such liabilities would be implemented in accordance with the Plan (as described below); and (iii) the federal government's claims receive the appropriate priority under Wisconsin insurance laws. The Rehabilitation Court granted the Rehabilitator's motion by order dated November 8, 2010 (the "**Supplemental Injunction**").

On April 30, 2013, the Rehabilitator, OCI, the Segregated Account, AFG, AAC, the Official Committee of Unsecured Creditors of Ambac Financial Group, Inc. (the "**Creditors Committee**") and the IRS settled the lawsuit brought by AFG against the IRS seeking: (i) to enjoin the IRS from attempting to levy AFG's assets in connection with the Tax Refund Payments, and (ii) to determine the amount, if any, of AFG's tax liability (the "**IRS Dispute**"). The terms of this settlement (the "**IRS Settlement**") included: (i) a payment to the IRS by the Segregated Account of \$100 million; (ii) a payment to the IRS by AFG of \$1.9 million; and (iii) AFG's consolidated tax group, including AAC and the Segregated Account (the "**Ambac Group**"), relinquishing its claims to loss carry-forwards resulting from losses on credit default swap contracts arising on or before December 31, 2010 to the extent that such carry-forwards exceed \$3.4 billion. On April 30, 2013, AFG and the IRS executed a closing agreement for the IRS Settlement. As a result, the IRS Settlement has been consummated and the IRS Dispute is resolved.

E. The Commissioner and Special Deputy Commissioner

On January 3, 2011, Theodore K. Nickel replaced Sean Dilweg as Commissioner. Thereafter, Mr. Nickel assumed all roles and duties as Rehabilitator. References in this Annual Report to the Commissioner or the Rehabilitator are to Mr. Dilweg or Mr. Nickel, as appropriate. On February 17, 2016, the Rehabilitator appointed Daniel J. Schwartz as Special Deputy Commissioner for the Segregated Account, and Mr. Schwartz assumed all authority of the Special Deputy Commissioner as set forth in the Rehabilitation Order. On May 23, 2016, the Rehabilitation Court approved Mr. Schwartz's engagement as a consultant to serve as Special Deputy Commissioner. Mr. Schwartz replaced former Special Deputy Commissioner Roger A. Peterson, who in turn replaced former Special Deputy Commissioner Kimberly A. Shaul. References in this Annual Report to the Special Deputy Commissioner are to Mr. Schwartz, Mr. Peterson or Ms. Shaul, as appropriate.

II. STATUS OF REHABILITATION PROCEEDING

A. Plan of Rehabilitation

(1) Confirmation of the Plan of Rehabilitation

On October 8, 2010, the Rehabilitator filed the Plan of Rehabilitation (the "**Plan**"), together with a Disclosure Statement Accompanying Plan of Rehabilitation (the "**Disclosure Statement**"), and a Motion for Confirmation of the Plan in the Rehabilitation Court. The Plan sets forth the terms and conditions for the settlement and payment of claims against the Segregated Account. The Plan provided for holders of permitted policy claims to receive 25% of their permitted claims in cash and 75% in surplus notes issued

by the Segregated Account, and that delivery of such cash and surplus notes would constitute satisfaction in full of the Segregated Account's obligations in respect of each claim.

An evidentiary hearing regarding confirmation of the Plan took place in the Rehabilitation Court during the week of November 15-19, 2010. All policyholders and other parties-in-interest were permitted to attend and were afforded an opportunity to be heard, to call, examine and cross-examine witnesses, and to provide oral argument about confirmation on November 30, 2010. More than 20 parties appeared, examined witnesses, filed written objections to confirmation, and presented oral argument.

The Rehabilitation Court confirmed the Plan by order dated January 24, 2011 (the "**Confirmation Order**") finding, among other things, that: (i) the Rehabilitator's disclosures regarding the Plan were sufficient; (ii) the Plan follows the priority scheme required by Wisconsin insurance law; (iii) the initial cash/note split for policy claims is reasonable and more favorable to policyholders than liquidation; (iv) the Plan's use of surplus notes is fair; and (v) the Plan is fair and equitable to policyholders.

Since the entry of the Confirmation Order, the Rehabilitator has taken steps to address certain risks and uncertainties facing the rehabilitation, which include amendments to the Plan which were confirmed on June 11, 2014, as discussed below in Section II.A.4 (the "**Amendments**").

(2) Interim Cash Payments on Permitted Policy Claims

On June 4, 2012, the Rehabilitation Court approved the Rehabilitator's Motion for Approval to Commence Making Interim Cash Payments on Permitted Policy Claims. Starting on September 20, 2012 but before the Effective Date, the Rehabilitator made interim cash payments equal to 25% of the permitted amount of each policy claim, as approved for payment by the Rehabilitator ("**Interim Claim Payments**").

(3) Resolution of Tax Uncertainties

A number of potential tax issues arose from the Plan as originally confirmed, including: (i) the potential deconsolidation of AAC from the AFG consolidated tax group for U.S. federal income tax purposes resulting from the treatment of the surplus notes as equity rather than debt, (ii) the imposition of original issue discount treatment on holders of surplus notes, and (iii) AAC's recognition of significant cancellation of indebtedness income with respect to the surplus notes as of the time of their issuance. The Rehabilitator, AAC and AFG have taken three major actions to mitigate these tax issues and to achieve certainty regarding the tax consequences of the Rehabilitation. First, OCI and the Rehabilitator reached an agreement with AAC, AFG and The Official Committee of Unsecured Creditors of Ambac Financial Group, Inc. (the "**AFG Settlement**") which resolved all outstanding tax and expense-related issues between AFG and AAC, and which, among other things, allocated certain net operating losses ("**NOLs**") generated by the AFG consolidated tax group prior to September 30, 2011 to AAC and provided for AAC to compensate AFG for the use of such NOLs above a defined threshold. The AFG Settlement is described in detail in motion papers available on the Website and in the 2012 Annual Report. Second, the Rehabilitator and AFG sought a Private Letter Ruling (the "**PLR**") from the IRS to the effect that: (i) the Rehabilitation, the Plan and the Amendments have not and will not result in a disaffiliation of AAC from AFG for federal tax purposes; (ii) policies allocated to the Segregated Account will continue to be treated as insurance contracts for federal tax purposes; and (iii) the obligations to pay both Cash Payments and Deferred Amounts, including accretion, (both as defined and discussed below) are taken into account in computing "losses incurred" for federal tax purposes. On March 12, 2014, the IRS issued a favorable PLR with respect to all three issues. Finally, the Rehabilitator filed the Amendments Motion with the Rehabilitation Court on April 21, 2014 seeking approval of the Amendments, as discussed in detail

below.

(4) Amendments to the Plan of Rehabilitation

With the receipt of a favorable PLR from the IRS and the favorable outcome of the appellate proceedings discussed below in Section III, the Rehabilitator moved forward with proposed Amendments to the Plan, which were filed with the Rehabilitation Court on April 21, 2014, along with a Motion to Amend the Plan of Rehabilitation (the "**Amendments Motion**") and an affidavit of Roger A. Peterson in support of the Amendments Motion. The Amendments were supplemented by filings with the Rehabilitation Court on May 20, 2014 and June 5, 2014. The Amendments modified the mechanism for handling claims under the Plan. Instead of a combination of cash payments and surplus notes, as under the Plan as originally confirmed, holders of permitted policy claims now receive cash payments ("**Cash Payments**"), and the Segregated Account establishes on its books deferred amounts equal to the remaining balance of such claims, reduced from time to time by recoveries and/or payments made by the Segregated Account ("**Deferred Amounts**"). Payment of Deferred Amounts (each such payment a "**Deferred Payment**") are made at such times as the Rehabilitator deems appropriate, in his sole discretion, based on an analysis of estimated liabilities, available claims-paying resources, and other considerations relevant to equitable treatment of claims and the best interests of policyholders. With the exception of adjustments for certain under-collateralized transactions as described below in footnote 1, Deferred Amounts currently accrete at an effective annual rate of 5.1%. The Rehabilitator reserves the right to amend the Plan or take such other action as he deems necessary or appropriate to adjust the rate of accretion on Deferred Amounts from time to time based on such factors as he considers relevant. Additionally, the Segregated Account shall, if required in satisfaction of any junior claims, establish on its books junior deferred amounts accruing at 5.1% per year instead of issuing junior surplus notes bearing interest at 5.1% per year.

The Amendments require proportionate payments to be applied in redemption of certain surplus notes issued by the Segregated Account in commutation of Policy liabilities (the "**SA Surplus Notes**" which, together with the Bank Settlement Notes, are the "**Surplus Notes**") as and when payments are made on Deferred Amounts, including the Equalizing Deferred Payment paid to policyholders on December 22, 2014 (described later in this Section). Pursuant to the Bank Group Settlement, AAC is also required to make proportionate payments in redemption of the Bank Settlement Notes as and when the Segregated Account makes a payment in redemption of the SA Surplus Notes.

After a hearing on June 11, 2014, the Rehabilitation Court approved the Amendments by an order dated June 11, 2014 (the "**Amendments Order**"). Pursuant to Section 5.02 of the Plan, the Plan, as amended by the Amendments, became effective on June 12, 2014 (the "**Effective Date**").

(5) Guidelines Issued Pursuant to the Plan of Rehabilitation

As part of the commencement of the Interim Claim Payments, the Rehabilitator promulgated the Rules Governing the Submission, Processing and Payment of Partial Payment of Policy Claims in Accordance with the June 4, 2012 Interim Cash Payment Order and the Rules Governing the Submission, Processing and Partial Payment of Claims under Financial Guaranty Policy No. 17548BE in Accordance with the June 4, 2012 Interim Cash Payment Order (collectively the "**Interim Rules**"). The Rehabilitator also issued a statement on September 6, 2012 clarifying that policyholders may not submit claims under the Interim Rules subject to a reservation of rights.

Concurrent with the development of the Amendments, the Rehabilitator developed the Payment Guidelines for Plan of Rehabilitation, as Amended (the "**Plan Payment Guidelines**") and the LVM Payment Guidelines for Plan of Rehabilitation, as Amended (the "**LVM Payment Guidelines**") and the

Guidelines Governing Ceded Reinsurance Contracts Following the 2014 Amendments (the “**Reinsurance Guidelines**”), along with proof of claim forms, claim schedules, and allocation schedules for both the Plan Payment Guidelines and the LVM Payment Guidelines (collectively, the “**Payment Guidelines**”). The Payment Guidelines were based in part on the Interim Rules. On the Effective Date, the Payment Guidelines became effective and superseded and replaced the Interim Rules, and the Reinsurance Guidelines also became effective and superseded and replaced the Rules Governing Ceded Reinsurance Contracts Following June 4, 2012 Interim Cash Payment Order.

(6) Interim Payment Percentage and Equalizing Deferred Payments

After the Effective Date, the Rehabilitator increased the portion of permitted policy claims to be paid in cash from 25% to 45% (the “**Interim Payment Percentage**”) effective July 21, 2014. Accordingly, on and after July 21, 2014, (i) holders of permitted policy claims receive Cash Payments equal to 45% of their claims, and (ii) the Segregated Account records Deferred Amounts on its books in favor of the respective holders in an amount equal to 55% of such claims, which accretes in accordance with the Payment Guidelines at an effective annual rate of 5.1%.¹

In order to maintain parity among all policyholders, including those whose permitted policy claims were accepted and paid prior to July 21, 2014, a Deferred Payment (the “**Equalizing Deferred Payment**”) was made on December 22, 2014 to policyholders that received Interim Claim Payments (as defined in Section II.A.2). The amount of the Equalizing Deferred Payment was 26.67% of such holder’s Deferred Amounts, including the value of accretion, in each case, as at July 20, 2014. This Equalizing Deferred Payment constituted the amount necessary to provide policyholders who received Interim Claim Payments with a total payment of 45% of their permitted policy claim amounts, the amount which is now paid as Cash Payments to policyholders with permitted policy claims under the Payment Guidelines. This resulted in equal treatment of those policyholders whose permitted policy claims were processed under the Interim Rules prior to July 21, 2014 and policyholders whose policy claims are processed under the Plan and the Payment Guidelines.

The Rehabilitator provided notice of the Equalizing Deferred Payment and the increase in Interim Payment Percentage, as required by the Plan, on June 20, 2014.

With the Rehabilitator’s permission, the proportionate Surplus Note redemption payments required by the Amendments and the Bank Settlement Agreement to be made in conjunction with any Deferred Payment were made on November 20, 2014, rather than on December 22, 2014 when the Equalizing Deferred Payment was made. This early payment date for Surplus Notes resulted in interest savings to AAC that benefit all policyholders, and facilitated the orderly processing and disbursement of all payments to policyholders.

B. Other Significant Aspects of the Rehabilitation Proceeding

(1) Supplemental Payments

In certain RMBS transactions, AAC is contractually entitled to be reimbursed from various cash flows in

¹ There are certain limited situations involving under-collateralized obligations where Deferred Amounts may not accrete at an effective annual rate of 5.1%, as set forth in more detail in the Amendments.