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

**AMICUS CURIAE BRIEF OF THE BANK INSUREDS**

Certain holders (the "Bank Insureds")[1] of financial guaranty insurance policies (the "Policies") issued by Ambac Assurance Corporation ("AAC") respectfully submit this amicus curiae brief in opposition to the emergency motions for injunctive and other expedited relief (the "Emergency Motions") filed by certain holders of residential mortgage-backed securities (the "RMBS Bondholders") and certain holders of the Las Vegas Monorail Project Revenue Bonds (the "LVM Bondholders"), respectively.

## INTRODUCTION

The Policies guarantee payments by Ambac Credit Products, LLC ("ACP"), a wholly-owned subsidiary of AAC, under certain credit default swap agreements between ACP and the Bank Insureds (the "CDS Agreements"). The Bank Insureds have had for some time, and continue to have, the right to assert claims against ACP and AAC that exceed $12 billion in the aggregate.[2] The Bank Insureds have agreed to forbear temporarily from terminating the CDS Agreements and asserting claims against AAC to permit time to finalize the proposed settlement that the RMBS Bondholders and LVM Bondholders (collectively, the "Movants") now

[1] The Bank Insureds consist of the following financial institutions: Banco Bilbao Vizcaya Argentaria, S.A.; Banco Santander, S.A.; Barclays Bank PLC; BNP Paribas; Canadian Imperial Bank of Commerce; Citibank, N.A.; Citigroup Global Markets Limited; Commerzbank AG London Branch; Crédit Agricole Corporate and Investment Bank; Natixis; Natixis Financial Products Inc.; The Royal Bank of Scotland PLC; Société Générale; and UBS AG, London Branch.

[2] All references herein to the value of aggregate claims include the claims of the Bank Insureds and the claims of other similarly-situated financial institutions. (*See* Affidavit of Roger A. Peterson ("Peterson Aff.") ¶¶ 16-24 (filed May 20, 2010).)

challenge. Although the Movants assert that they will suffer irreparable harm if the proposed settlement is consummated, the opposite is true. The proposed settlement is beneficial to all policyholders and, if it is enjoined, the Bank Insureds will be forced to assert their multi-billion dollar claims against the general account of AAC, causing significant collateral damage that will detrimentally affect all policyholders, including the Movants.

The Movants repeatedly cite irrelevant law (or no law at all) and fail to address those portions of Wisconsin insurance law that do not advance their arguments. The *relevant* portions of Wisconsin insurance law[3] make clear that the proposed settlement agreement is entirely consistent with the insurance liquidation priority scheme. With respect to the Policies at issue, the Bank Insureds have "insurable interests" and "losses" under Wis. Stat. §§ 631.07(1) and 645.68(3), respectively. The Policies were created, regulated, and treated as insurance policies from the outset, as expressly provided under Wisconsin law and administrative interpretations, and the Movants provide no principled rationale to overcome this well-established fact. Further, the CDS Agreements entered into by ACP and the Policies issued by AAC cannot be collapsed into a single transaction to support the fiction that the Bank Insureds hold some unidentified non-insurance interest. For these reasons, the Emergency Motions should be denied.

## BACKGROUND

The Bank Insureds are counterparties to the CDS Agreements with ACP and, separately, beneficiaries of the Policies issued by AAC. Under the CDS Agreements,[4] ACP agreed to compensate the Bank Insureds for losses resulting from defaults or other credit events related to

[3] The Bank Insureds do not concede that Wisconsin law governs the arguments set forth in the Emergency Motions or the CDS Agreements, the Policies, or any related matters. Because the Movants limit their arguments to Wisconsin law, however, the Bank Insureds assume for purposes of this amicus curiae brief only that Wisconsin law applies.

[4] The terms of the CDS Agreements are contained primarily in the standard International Swaps and Derivatives Association, Inc. Master Agreement (the "ISDA Master Agreement") and an associated Schedule and Confirmation to the ISDA Master Agreement specific to each CDS Agreement.

the underlying reference obligations. Under the Policies, AAC insured all amounts due to the Bank Insureds from ACP under the CDS Agreements, including any payments due in the event of the termination of any CDS Agreement.[5] In other words, the Policies guarantee the obligations of ACP for the benefit of the Bank Insureds.

The Bank Insureds can terminate the CDS Agreements upon an event of default. An event of default under many of the CDS Agreements includes, but is not limited to, any situation in which either AAC or ACP becomes insolvent or is unable to pay its debts. Upon the insolvency of either AAC or ACP or any other event of default or termination event under the CDS Agreements, the Bank Insureds are entitled to receive a payment. If the Bank Insureds terminated the CDS Agreements, the aggregate payment due would be approximately $12.9 billion.[6]

AAC's financial condition deteriorated significantly during 2008 and 2009.[7] In the fall of 2009, the Bank Insureds began discussions with AAC and ACP regarding a potential commutation of the Policies. Many months of complex and arduous negotiations, which at times included the Wisconsin Office of the Commissioner of Insurance (the "OCI"), resulted in agreement on a non-binding term sheet on March 24, 2010. The term sheet provides that the parties will enter into a settlement agreement (the "Settlement Agreement"), pursuant to which the Policies will be commuted in exchange for $2.6 billion in cash and $2 billion in surplus

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[5] Many, if not all, of the Policies expressly provide for such payments.

[6] As of October 31, 2009. The $12.9 billion figure is a product of detailed analysis by an independent, highly-qualified appraisal firm. (*See* Peterson Aff. ¶¶ 19-23.)

[7] Rating agencies repeatedly downgraded AAC's financial strength during this period. More recently, AAC's parent company, Ambac Financial Group, Inc. ("AFGI"), which primarily depends upon AAC for liquidity, announced that (1) it has a negative equity position of over $1.6 billion; (2) "its liquidity may run out prior to the second quarter of 2011"; (3) it is considering a "negotiated restructuring of its outstanding debt through a prepackaged bankruptcy proceeding"; and (4) it "will be unable to pay dividends in 2010 absent special approval from the [OCI]." (*See* AFGI Form 10-K for 2009, at 3, 91, 117, 130 (Apr. 9, 2010) (attached as Ex. A).)

notes[8] issued to the Bank Insureds, and the referenced CDS Agreements will be terminated (the "Proposed Settlement").[9] To permit time to finalize the Settlement Agreement, the Bank Insureds entered into an agreement (the "Forbearance Agreement") to forbear temporarily from terminating the CDS Agreements and asserting any claims against AAC based on the creation of a segregated account of AAC (the "Segregated Account") or the commencement of rehabilitation proceedings related to the Segregated Account (the "Rehabilitation"). The Forbearance Agreement will expire imminently.

On March 24, 2010, AAC's Board of Directors voted to establish the Segregated Account and directed that any policies not transferred to the Segregated Account at that time (with limited exceptions) would remain in AAC's general account (the "General Account"). The OCI commenced the Rehabilitation the same day to facilitate an orderly run-off and/or settlement of liabilities in the Segregated Account. The Policies remain in AAC's General Account pursuant to the Forbearance Agreement and the Proposed Settlement and, therefore, are not subject to the Rehabilitation.

## ARGUMENT

The Bank Insureds limit their amicus brief to two issues raised by the Emergency Motions: (1) whether the Proposed Settlement of the Bank Insureds' multi-billion dollar claims benefits the Bank Insureds to the detriment of other policyholders; and (2) whether the Proposed Settlement is consistent with the Bank Insureds' priority status under Wisconsin law.[10] As set

[8] The surplus notes are scheduled to mature on the tenth anniversary of the closing date of the Settlement Agreement and bear interest at a rate of 5.1% per annum.

[9] The Proposed Settlement involves the Bank Insureds and other similarly-situated financial institutions. (*See* Peterson Aff. ¶¶ 16-24.)

[10] The Bank Insureds reserve their rights to address any other issues raised by the Emergency Motions.

forth below, the Proposed Settlement is beneficial to *all* policyholders and consistent with the Bank Insureds' status as policyholders.

## I. THE PROPOSED SETTLEMENT IS BENEFICIAL TO ALL POLICYHOLDERS.

The Proposed Settlement is a carefully constructed compromise based upon months of complex negotiations among the Bank Insureds, AAC, ACP and the OCI. Those negotiations were further complicated because the financial institutions that constitute the Bank Insureds have divergent interests vis-à-vis AAC and ACP. The parties' interest in continuing negotiations despite these obstacles was influenced by the significant collateral damage that would result from the failure to reach a resolution. If AAC is enjoined from commuting the Policies and the Bank Insureds assert aggregate claims worth approximately $12.9 billion, all policyholders, including the Movants, will suffer as a result.[11] Indeed, the OCI's approval of the Proposed Settlement reflects its conclusion that, in light of that collateral damage, the Proposed Settlement benefits not just the Bank Insureds, but *all* policyholders.[12]

## II. THE PROPOSED SETTLEMENT IS CONSISTENT WITH THE BANK INSUREDS' STATUS AS POLICYHOLDERS.

Even though the Policies are not in the Segregated Account that is the exclusive subject of the Rehabilitation, the LVM Bondholders challenge the Proposed Settlement on the ground that it is inconsistent with the priority scheme established for the order of distribution in a liquidation under Wis. Stat. § 645.68. In the LVM Bondholders' view, the Bank Insureds are not entitled to policyholder priority but rather general creditor priority and, therefore, the Bank Insureds should receive nothing if AAC has insufficient assets to pay its policyholders in full.

[11] The OCI estimates that the collateral damage to AAC as a result of the Proposed Settlement being enjoined would exceed $9.3 billion. (*See* Peterson Aff. ¶¶ 9(a), 35.) In contrast, consummating the Proposed Settlement would "immediately create substantial additional statutory surplus, which will help better support the Segregated Account . . . ." (*Id.* ¶ 43.)

[12] (*See* Peterson Aff. ¶ 29.)

That conclusion is premised on the LVM Bondholders' assertion that the Policies do not constitute "insurance" under Wisconsin law. Such an assertion is unsupported by the facts and is untenable as a matter of law.

### A. The CDS Agreements And The Policies Cannot Be Collapsed To Support The Fiction That AAC Issued The CDS Agreements Directly.

Without citing any factual or legal support, the LVM Bondholders contend that the transactions culminating in the CDS Agreements and the Policies "were nothing more than disguised [credit default swaps] with [AAC]." (LVM Bondholders' Emergency Mot. 15.) The LVM Bondholders further contend that "[s]uch transactions are not 'insurance'" [13] and, therefore, the Bank Insureds are not entitled to policyholder priority under Wisconsin law. *Id.* These contentions ignore both the form and the substance of the CDS Agreements and the Policies, and are contrary to Wisconsin law.

To be clear, the Bank Insureds entered into the CDS Agreements with ACP, a non-insurer affiliate of AAC, in order to mitigate credit risk related to the obligations underlying the CDS Agreements. Additionally, the Bank Insureds obtained the Policies from AAC to insure against ACP's default on payments under the CDS Agreements. There were two separate sets of transactions with two separate entities that created two separate types of obligations. The form and substance of those transactions cannot be ignored simply because doing so advances the

[13] The LVM Bondholders do not cite a single statute or case in Wisconsin or elsewhere to support their contention that the transactions at issue here are not "insurance." Instead, they cite an amicus brief submitted by ISDA in *Aon Financial Products, Inc. v. Société Générale*, 476 F.3d 90 (2d Cir. 2006). The *Aon* case involved only stand-alone credit default swaps, however, not credit default swap obligations insured by financial guaranty insurance policies. The LVM Bondholders' failure to acknowledge that financial guaranty insurance polices, rather than credit default swaps, are at issue here is disingenuous at best.

LVM Bondholders' self-serving argument.[14] Indeed, as described below, everyone involved has said the Policies are "insurance" policies under Wisconsin law and has treated them accordingly.

*First*, the OCI has expressly concluded that the Policies are insurance policies and has consistently treated them as such. Before entering into any of the transactions at issue here, AAC asked the OCI to review a hypothetical arrangement entailing the issuance of insurance policies by AAC with respect to the obligations of an affiliate (such as ACP), which would act as a seller of credit protection in connection with certain credit derivative transactions. The OCI approved that arrangement in 1998, stating that AAC insurance policies issued under those circumstances would constitute "insurance contracts entered into in the ordinary course of the insurer's business" under Wis. Admin. Code. § Ins. 40.03(3)(c)(4). (Letter from Brian Hogan, Insurance Examiner Supervisor, Financial Analysis and Examinations Bureau, the OCI, to Stephen D. Cooke, Senior Vice President, General Counsel and Secretary of AAC (Apr. 29, 1998) (attached as Ex. B).)

More recently, in a compliance examination of AAC, the OCI acknowledged that AAC wrote "policies [that] guarantee the obligations of [ACP], an affiliate, to its counterparties in structured credit derivative transactions." (Report of the Examination of AAC, at 6-7 (Dec. 31, 2006) (attached as Ex. C).) Other insurance regulators have reached similar conclusions with respect to policies covering credit default swaps entered into by subsidiaries of an insurance

[14] An analogy to surety law, which is the basis for financial guaranty insurance, proves the absurdity of the LVM Bondholders' argument. In a surety arrangement in the construction context, for example, there are always two transactions—the transaction between the general contractor and the insured, and the transaction between the surety and the insured—with the surety guaranteeing the obligation of the general contractor. Such an arrangement does not result in the surety being deemed to be the general contractor merely because it guarantees the general contractor's obligation to perform.

company. For example, the New York Insurance Department[15] has specifically approved such policies and has consistently treated them as insurance,[16] like the OCI has done here.

*Second*, AAC's representations and course of conduct make clear that the Policies are "insurance" policies. The Policies expressly provide that they are "Financial Guaranty Insurance Polic[ies]." (*E.g.*, Financial Guaranty Insurance Policy (attached as Ex. F).) AAC issued the Policies in the "ordinary course of business" as a "Wisconsin-domiciled stock *insurance* corporation." (Letter from Stephen D. Cooke, Senior Vice President, General Counsel and Secretary of AAC, to Brian J. Hogan, Insurance Examiner Supervisor, Bureau of Financial Analysis and Examinations, the OCI, at 1 (Apr. 3, 1998) (attached as Ex. G) (emphasis added).) At the time of issuance, AAC's General Counsel's Office provided opinion letters stating that the Policies were valid, binding, and enforceable obligations of AAC, "a stock *insurance* company . . . duly qualified to conduct an *insurance* business . . . ." (*E.g.*, Letter from Lee Ann Duffy, Vice President and Assistant General Counsel of AAC, at 1 (Apr. 13, 2005) (attached as Ex. H) (emphasis added).) Furthermore, AAC has accounted for the Policies like it has for all of its other financial guaranty insurance policies for purposes of the statutory accounts required under Wisconsin law. The foregoing representations and course of conduct leave no doubt that the Policies are, in fact, "insurance" policies.

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[15] Because AAC is licensed to do business in New York as a financial guarantor, it is also subject to regulation by the New York State Insurance Department ("NYID"). (*See* Ex. A, at 31.)

[16] *See, e.g.*, Letter from Bruce E. Stern, General Counsel and Managing Director of Financial Security Assurance Inc., to Paul M. De Robertis, Supervising Insurance Examiner, Property/Casualty Bureau, NYID (Nov. 20, 1998), *and* Letter from Kenneth Gingrass, Principal Insurance Examiner, Property Bureau, NYID, to Bruce Stern (Apr. 8, 1999) (attached as Ex. D). The New York State Legislature subsequently amended N.Y. Ins. Law Art. 69 in order to codify the NYID's approval of such arrangements. *See, e.g.*, N.Y. Ins. Law § 6905(a)(1) ("[P]olicies may insure amounts payable under a credit default swap . . . ."). That the NYID presently treats financial guaranty insurance as "insurance" is beyond dispute. *See, e.g.*, NYID Report on Organization of Syncora Capital Assurance Inc., at 2 (July 15, 2009), *available at* http://www.ins.state.ny.us/exam_rpt/OF7687f09.pdf (last visited May 20, 2010) (attached as Ex. E) (acknowledging that Syncora Capital Assurance Inc. will assume "insurance policies covering existing credit default swaps between affiliates of [its] Parent and certain financial counterparties").

### B. The Bank Insureds Have An "Insurable Interest" In ACP's Performance Under The CDS Agreements.

Despite an abundance of authority to the contrary, the LVM Bondholders contend that the Bank Insureds do not have an "insurable interest" and, therefore, should be subordinated to other policyholders. (LVM Bondholders' Emergency Mot. 16.) This argument is premised on the assertion that the Bank Insureds do not own the reference obligations underlying the CDS Agreements. *Id.* However, as noted below, the Policies do not insure the reference obligations but rather ACP's obligations to the Bank Insureds under the CDS Agreements.[17] In any event, the LVM Bondholders' argument is flawed for the following reasons.

*First*, the LVM Bondholders' reliance on Wis. Stat. § 631.07 is misplaced. Wis. Stat. § 631.07 is not relevant to a rehabilitation or liquidation under chapter 645. Indeed, the concept of "insurable interest" is not mentioned anywhere in chapter 645. Thus, the absence of an

[17] Furthermore, the Bank Insureds' ownership of the underlying obligations is not ultimately relevant to the Court's analysis of the "insurable interest" issue. The expectation of payment is an "insurable interest" regardless of whether the policyholder holds legal or equitable title to the underlying property. *See, e.g.*, *Prince v. Royal Indem. Co.*, 541 F.2d 646, 649 (7th Cir. 1976) ("All that is necessary is an interest in property by the existence of which the insured receives a benefit . . . . [C]ourts have held that an insurable interest exists in a variety of situations in which the insured lacks either title or possession, or both.") (citations, quotation marks, and alteration omitted); *Commerce Bank, N.A., v. Amco Ins. Co.*, No. 08-cv-669-JPG, 2009 WL 702220, at *4 (S.D. Ill. Mar. 17, 2009) ("Generally speaking, a person has an insurable interest in property whenever he would profit by or gain some advantage by its continued existence and suffer loss or disadvantage by its destruction.") (quotation marks omitted).

"insurable interest," however that term is defined, should not in any way affect the priority scheme established in Wis. Stat. § 645.68.[18]

*Second*, even if Wis. Stat. § 631.07 were relevant to the priority analysis under Wis. Stat. § 645.68, the case law flatly contradicts the LVM Bondholders' narrow definition of "insurable interest." For example, the U.S. District Court for the Eastern District of Wisconsin recently defined an "insurable interest" as "one where a person would reasonably expect to suffer a loss from its destruction or derive a benefit from its continued existence." *Bankr. Estate of Lake Geneva Sugar Shack, Inc. v. Gen. Star Indem. Co.*, No. 91-C-0163, 2000 WL 1048789, at *5 (E.D. Wis. July 26, 2000) (citing *Stebane Nash Co. v. Campbellsport Mut. Ins. Co.*, 27 Wis. 2d 112, 118-20, 133 N.W.2d 737 (Wis. 1965)). Other courts in Wisconsin and elsewhere have taken a similarly expansive view of what constitutes an "insurable interest."[19]

The "insurable interest" here—for which the Bank Insureds paid handsomely—is the Bank Insureds' entitlement to payment under the CDS Agreements in accordance with their terms. In other words, the financial guaranty insurance provided under the Policies insures

[18] The LVM Bondholders appear to acknowledge this flaw in their argument when they state that Wis. Stat. § 631.07(4) only "*suggest[s]* the subordination of such claims to policyholder claims." (LVM Bondholders Emergency Mot. 16 n.8 (emphasis added).) Of course, Wis. Stat. § 631.07(4) does not even "suggest" the subordination of such claims to policyholder claims; it merely addresses the appropriate recipient of payments related to policyholder claims. One need look no further than this Court to recognize that the punitive interpretation of Wis. Stat. § 631.07(4) asserted by the LVM Bondholders is unsupportable as a matter of law. *See Wis. Office of Comm'r of Ins. v. Wis. Office of Comm'r of Ins.*, No. 02 CV 2398, 2003 WL 25694424, slip op. at 14-15 (Dane County Cir. Ct. Aug. 4, 2003) ("[T]he best way to discourage insurers from issuing insurance policies to persons without insurable interest is to make them pay if they do, not to permit them freely to issue such policies knowing that they have a good public policy defense that lets them off the hook whenever a loss occurs.") (quoting Legislative Comment to Laws 1975, c. 375, § 41); *see also* Wis. Stat. § 631.07(4) ("No insurance policy is invalid merely because the policyholder lacks insurable interest . . . ."); *Milwaukee Metro. Sewage Dist. v. Sedgwick of Ill., Inc.*, No. 05-C-1352, 2008 WL 927571, at *11 (E.D. Wis. Apr. 4, 2008) ("Wisconsin law is clear that, although an insurable interest is a prerequisite for coverage, any coverage extended in violation of this statutory requirement remains valid . . . .") (citation omitted).

[19] *See also Prince*, 541 F.2d at 649 ("That the person may suffer loss is a sufficient foundation for his claim to an insurable interest.") (quotation marks omitted); *Ben-Hur Mfg. Co. v. Firemen's Ins. Co. of N.J.*, 18 Wis. 2d 259, 262, 118 N.W.2d 159 (Wis. 1962) (stating that, in order for Wisconsin courts to find an insurable interest, "[i]t is sufficient if a person's relationship to the property is such he would reasonably be expected to suffer a loss by the destruction of the property or to derive a benefit from its continued existence.").

against ACP's "failure to pay" the Bank Insureds on the CDS Agreements. That "insurable interest" is present regardless of whether a given Bank Insured owns the obligations referenced in a given CDS Agreement because that Bank Insured still has an "insurable interest" in the CDS Agreement itself (*i.e.*, the performance of ACP under that CDS Agreement).[20]

### C. The Bank Insureds Have Billions Of Dollars Of Potential "Losses" That Are Insured By The Policies.

Without citing any authority, the LVM Bondholders also contend that the Bank Insureds do not have a "loss" within the meaning of Wis. Stat. § 645.68(3) and, therefore, are not entitled to policyholder priority. This contention lacks merit for several reasons.

*First*, Wis. Stat. § 645.68 is directly applicable only in a liquidation proceeding. *See Belongia v. Wis. Ins. Sec. Fund (In re Midland Ins. Co.)*, 195 Wis. 2d 835, 847, 537 N.W.2d 51 (Ct. App. 1995) (stating that "§ 645.68(3) excludes from the class of loss claims payable in a *liquidation*" a portion of certain losses not relevant here) (emphasis added).

*Second*, even if Wis. Stat. § 645.68 were dispositive in a rehabilitation proceeding, the LVM Bondholders' assertion that "any 'mark-to-market' termination damages claimed by the Bank Insureds beyond actual pecuniary losses" are "penalties or forfeitures" under Wis. Stat. § 645.68(5) is simply wrong. (LVM Bondholders' Emergency Mot. 15 n.7.) "Penalties and forfeitures," as used in Wis. Stat. § 645.68(5) and other Wisconsin statutes, refers to punishment meted out by governmental authorities, not to contractual remedies agreed to by two private

[20] Again, the surety analogy is illustrative. Surety bondholders, like the Bank Insureds, have an "insurable interest" in the performance of a third party under a separate contract. There is no doubt that surety bonds are "insurance" under Wisconsin law. *See* Wis. Stat. § 600.3(25)(a)(2) ("'Insurance' includes . . . [c]ontracts of guaranty or suretyship . . . ."); *see also Highlands Ins. Co. v. Hobbs Group, LLC*, 373 F.3d 347, 352 (3d Cir. 2004) ("[S]urety bondholders are equivalent to insurance policyholders.") (citations omitted). Similarly, there should be no doubt that the Policies are "insurance" under Wisconsin law.

parties.[21] The priority status of governmental authorities seeking enforcement of an order imposing civil or criminal penalties clearly has nothing to do with the priority status of the Bank Insureds.

*Third*, the assertion embedded in the LVM Bondholders' argument—that the Wisconsin State Legislature intended to provide priority status only to those claimants who had pure pecuniary loss policies as opposed to investment-related policies—does not hold water. Indeed, that assertion is undermined by Wis. Stat. § 645.68 itself, which expressly grants priority to claimants for "investment values" under life insurance and annuity policies. Wis. Stat. § 645.68(3). By treating investment values under these types of insurance policies as policyholder losses, the Wisconsin State Legislature made clear that it did not intend to limit priority treatment under Wis. Stat. § 645.68 to pure pecuniary loss policies.[22]

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[21] *See State v. Block Iron & Supply Co., Inc.*, 183 Wis. 2d 357, 367, 515 N.W.2d 332 (Ct. App. 1994) ("When construing a statute we give the words their common and ordinary meaning which may be established by their definition in a recognized dictionary. Webster's Third New International Dictionary . . . defines 'penalty' as 'punishment for crime or offense.'"); *id.* (holding that the state may seek civil forfeitures from a company after issuing an administrative order); Wis. Stat. § 939.12 (stating that "[c]onduct punishable only by a *forfeiture* is not a crime") (emphasis added).

[22] Even if the Bank Insureds' claims exceed their actual pecuniary losses under the CDS Agreements, they still would be entitled to policyholder priority under Wis. Stat. § 645.68, as would many other types of policyholders. For example, a home insurance policy that provides for replacement value may well provide the insured with an amount in excess of the actual pecuniary loss of the home in the event that the home is destroyed. Yet, there is no doubt that the holder of that type of policy would be entitled to policyholder priority under Wis. Stat. § 645.68 for the entire replacement value claim. Similarly, the Bank Insureds have policies that provide for the replacement value of the billions of dollars of reference obligations underlying the CDS Agreements. And, similarly, they are entitled to policyholder priority under Wis. Stat. § 645.68 for the entire value of those claims.

## CONCLUSION

For the reasons stated above, and based on the entire record in this action, the Bank Insureds, as amicus curiae, respectfully request that this Court deny the Emergency Motions.

Dated this 24th day of May 2010.

Respectfully submitted,

GODFREY & KAHN, S.C.

By: ______________________________

James A. Friedman, State Bar #1020756
Brady Williamson, State Bar #1013896
Anthony G. Gaughan, State Bar #1056509
One East Main St., Suite 500
Post Office Box 2719
Madison, Wisconsin 53701-2719
Tel: (608) 257-3911

*Attorneys for the Bank Insureds*

Of Counsel:
DAVIS POLK & WARDWELL LLP
Donald S. Bernstein
Michael P. Carroll
Avi Gesser
450 Lexington Avenue
New York, New York 10017
Tel: (212) 450-4000

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# EXHIBIT A

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# Form 10-K

## AMBAC FINANCIAL GROUP INC - ABK

Filed: April 09, 2010 (period: December 31, 2009)

Annual report which provides a comprehensive overview of the company for the past year

Part I

## Item 1. Business.

### INTRODUCTION

Ambac Financial Group, Inc. ("Ambac" or the "Company"), headquartered in New York City, is a holding company incorporated in the state of Delaware. Ambac was incorporated on April 29, 1991. Ambac, through its subsidiaries, provided financial guarantees and financial services to clients in both the public and private sectors around the world. The long-term senior unsecured debt of Ambac is rated CC with a negative outlook by Standard & Poor's Ratings Service ("S&P"), and C by Moody's Investors Services, Inc. ("Moody's"). See "Rating Agencies" for more information regarding Ambac's ratings. As a holding company, Ambac is largely dependent on dividends from Ambac Assurance Corporation ("Ambac Assurance"), its principal operating subsidiary, to pay principal and interest on its indebtedness and to pay its operating expenses. Ambac Assurance was unable to pay dividends to Ambac in 2009 and will be unable to pay dividends in 2010 absent special approval from the Office of the Commissioner of Insurance of the State of Wisconsin ("OCI"), which is not expected, thus constraining Ambac's principal source of liquidity for paying its operating expenses and debt service obligations. See "Insurance Regulatory Matters—Wisconsin Dividend Restrictions" section and "Management's Discussion and Analysis—Liquidity and Capital Resources" located in this Item 1 and Part II, Item 7, respectively, for further information. Furthermore, Ambac Assurance's ability to pay dividends has been significantly restricted by the creation, and subsequent rehabilitation, of the Segregated Account (as hereinafter defined and described in more detail below). In addition, Ambac Assurance's ability to pay dividends would be further restricted pursuant to the terms of the Proposed Settlement (as hereinafter defined) with counterparties of CDO of ABS transactions, if consummated. See "Recent Developments" located in this Item 1.

Ambac's activities are divided into two business segments: (i) Financial Guarantee and (ii) Financial Services. Ambac provided financial guarantee insurance for public and structured finance obligations through Ambac Assurance. While Ambac Assurance historically had AAA financial strength ratings, its ratings have been downgraded multiple times, beginning in 2008. As a result, Ambac Assurance currently has a Caa2 financial strength rating on review for possible upgrade from Moody's and an R (Regulatory Intervention) financial strength rating from S&P.

Through its financial services subsidiaries, Ambac provided financial and investment products, including investment agreements, funding conduits, interest rate, currency and total return swaps, principally to the clients of its financial guarantee business. Ambac Assurance has insured all of the obligations of its subsidiaries which wrote financial services business. As of December 31, 2009, all total return swaps have been terminated and settled. The interest rate swap and investment agreement businesses are in active runoff, which may result in transaction terminations, settlements, restructurings, assignments and scheduled amortization of contracts. In the process of running off these businesses, we may execute hedging transactions to mitigate risks in the respective books of business to the extent that we are able to do so; however, the Segregated Account Rehabilitation Proceedings (as hereinafter defined) and the financial condition of Ambac Assurance will make execution of any such hedging transactions more difficult. To the extent we are unable to hedge such risks, adverse financial impacts may result.

Financial information concerning our business segments for each of 2009, 2008 and 2007 is set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the notes thereto, included elsewhere in this Annual Report on Form 10-K. Our Internet address is www.ambac.com. We make available free of charge, on or through the investor relations section of our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission. Our Investor Relations Department can be contacted at Ambac Financial Group, Inc., One State Street Plaza, New York, New York 10004, Attn: Investor Relations, telephone: 212-208-3222.

years for municipal bonds and 15 years for all other obligations. Such contributions may be discontinued if the total reserve established for all categories exceeds the sum of the stated percentages contained therein multiplied by the unpaid principal balance. This reserve must be maintained for the periods specified above, except that the guarantor may be permitted to release reserves under specified circumstances in the event that actual loss experience exceeds certain thresholds or if the reserve accumulated is deemed excessive in relation to the guarantor's outstanding guaranteed obligations, with notice to or approval by the insurance commissioner. Under the Wisconsin Administrative Code, a municipal bond insurer is required to establish a contingency reserve consisting of 50% of earned premiums on policies of municipal bond insurance. The only exemption is when another jurisdiction in which the insurer is licensed requires a larger contingency reserve than required by the Wisconsin Administrative Code. Accordingly, Ambac Assurance and Everspan calculate contingency reserves based on the above noted rules as well as other jurisdictions that have contingency reserve regulations, such as California, and record the highest contribution amount.

Ambac Assurance requested and received approvals from OCI to release contingency reserves in both 2008 and 2009. The 2008 approval allowed for Ambac Assurance to (a) release its non-municipal contingency reserves (including contingency reserves for credit default swap contracts issued by Ambac Assurance's subsidiary, Ambac Credit Products) in consideration of incurred losses in excess of 65% of earned premiums resulting in a release $1.2 billion of contingency reserves; and (b) cease making further contributions to the contingency reserves with respect to such insurance policies. The 2009 approval allowed for Ambac Assurance to (a) release contingency reserves of $1.6 billion for municipal financial guarantee insurance policies to reduce such reserves to $336.1 million, which represents our estimate of expected losses on non-defaulted municipal financial guarantee insurance policies; and (b) cease making further contributions to the contingency reserves with respect to expired or defaulted municipal financial guarantee insurance policies. Ambac will continue to compute expected losses on non-defaulted municipal financial guarantee insurance policies and is required to ensure that contingency reserves will not be less than expected losses.

**New York Financial Guarantee Insurance Law and Financial Guarantee Insurance Regulation in Other States**

New York's comprehensive financial guarantee insurance law defines the scope of permitted financial guarantee insurance and governs the conduct of business of all financial guarantors licensed to do business in New York, including Ambac Assurance. Financial guarantors are also required to maintain case basis credit loss and loss expense reserves and unearned premium reserves on a basis established by the statute.

The New York financial guarantee insurance law establishes single risk limits with respect to obligations insured by financial guarantee insurers. Such limits are specific to the type of insured obligation (for example, municipal or asset-backed). The limits generally compare the insured principal amount outstanding and/or average annual debt service on the insured obligations, net of reinsurance and collateral, for a single risk to the insurer's qualified statutory capital, which is defined as the sum of the insurer's policyholders' surplus and contingency reserves. As a result of decreased statutory capital resulting from the significant losses experienced by Ambac Assurance and terminations of reinsurance arrangements and related recaptures of previously reinsured exposures, Ambac's net insured exposure under a significant number of policies exceeded the applicable single risk limits prescribed by New York State Insurance Law. Ambac Assurance will seek to reduce its exposure to no more than the permitted amounts.

Aggregate risk limits are also established on the basis of aggregate net liability and policyholders' surplus requirements. "Aggregate net liability" is defined as the aggregate of the outstanding insured principal, interest and other payments of guaranteed obligations, net of reinsurance and collateral. Under these limits, policyholders' surplus and contingency reserves must at least equal a percentage of aggregate net liability that is equal to the sum of various percentages of aggregate net liability for various categories of specified obligations. The percentage varies from 0.33% for municipal bonds to 4.00% for certain non-investment grade obligations.