SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Rehabilitation of	:	Index No. 401265/2012
	:	I.A.S. No. 36
FINANCIAL GUARANTY INSURANCE COMPANY,	:	Hon. Doris Ling-Cohan
	:	Motion Seq. 004

OBJECTION OF ASSURED GUARANTY CORP., ASSURED GUARANTY RE LTD. AND ASSURED GUARANTY RE OVERSEAS LTD. TO PLAN OF REHABILITATION PROPOSED BY BENJAMIN M. LAWSKY, SUPERINTENDENT OF FINANCIAL SERVICES OF THE STATE OF NEW YORK, AS REHABILITATOR OF FINANCIAL GUARANTY INSURANCE COMPANY

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Assured Guaranty Corp. ("AGC"), Assured Guaranty Re Ltd. ("AGRe") and Assured Guaranty Re Overseas Ltd. ("AGRO") (collectively, "Assured"), by and through their undersigned attorneys, respectfully submit this objection ("Objection") to the Plan of Rehabilitation of Financial Guaranty Insurance Company ("FGIC") filed on September 27, 2012 (the "Plan") by Benjamin Lawsky, Superintendent of the Department of Insurance of the New York Department of Financial Services, as rehabilitator of FGIC (the "Rehabilitator").[1/]

PRELIMINARY STATEMENT

The Plan cannot be confirmed as currently drafted because it fails to respect FGIC's contractual obligations to reinsurers, such as Assured, in two fundamental ways. **First,** it ignores FGIC's obligations to account for and to pay over to reinsurers' their share of salvage, subrogation and other recoveries on reinsured claims. **Second,** it does not give effect to reinsurers' rights under Article 74 of the Insurance Law and the "Insolvency Clause" in FGIC's reinsurance agreements to investigate claims and interpose defenses with respect to FGIC's liability for or the value of policyholder Claims. Thus, the Plan as drafted raises the real prospect that FGIC would breach its reinsurance agreements and jeopardize potentially significant reinsurance assets. In a rehabilitation case of this character, the likelihood that FGIC would breach its obligations to reinsurers can manifest itself in several ways, including with defenses to the allowance of claims, commutations or alternative resolutions, and the acceleration of insured obligations.

As a ***third*** concern, the structure for rehabilitating FGIC is unusual, if not unique. Unlike in the case of the usual New York rehabilitation proceeding, the Rehabilitator proposes that the rehabilitation proceeding against FGIC will cease once the Plan become effective and control of

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1/ Capitalized terms not otherwise defined herein shall have the meanings given them in the Plan.

FGIC will return to FGIC management until the run-off of FGIC's business is completed, which is acknowledged could take up to 40 years. As a result, the Rehabilitator, the New York State Department of Financial Services ("NYSDFS"), and the rehabilitation court will not have day-to-day involvement and oversight over FGIC and the Plan, as is typical after cases like this. Because FGIC management naturally cannot be expected to have the same broad perspective as the Rehabilitator and NYSDFS with respect to the impact of the rehabilitation on the financial guaranty industry as a whole and the New York licensed financial guaranty insurers and their affiliates, such as Assured (which continues to provide valuable financial guaranty insurance to the market), the proposed return to FGIC management raises the potential for actions by FGIC that could have an unfair and/or adverse impact on Assured as reinsurer. The Rehabilitator states at page 3 of the Disclosure Statement that "termination of the Rehabilitation Proceeding will avoid significant administrative burden associated with an ongoing Article 74 proceeding for the benefit of all of FGIC's Policyholders." Assured agrees that the proposal will result in some benefit, and of course expects that the management of FGIC intends to act and will act fairly and appropriately in the exercise of their duties under the Plan. Nevertheless, Assured believes that the changes to the Plan requested below are necessary and appropriate to ensure that the interests of the industry and reinsurers of the industry are taken into account and respected during the implementation of the Plan.

To correct defects in the Plan relating to reinsurance (and thus to preserve these potential assets), the Plan must be amended to include provisions addressing the following issues:

1. FGIC must credit and pay over to the reinsurer its proportionate share of any recovery in respect of the insured liability:

   (a) To the extent FGIC receives value in Cash in respect of subrogation, salvage and other recoveries, FGIC shall segregate the reinsurer's

proportionate share of such Cash to be held in trust for the benefit of the reinsurer and to be paid to the reinsurer as a secured claim.

(b) To the extent FGIC receives value in the form of reduction in DPOs in respect of subrogation, salvage and other recoveries, the reinsurer's proportionate share of such value shall be credited by means of offset and recoupment against any of the reinsurer's payment obligations to FGIC or may be recovered by the reinsurer in Cash as an Administrative Expense Claim.

2. The amount owed by a reinsurer resulting from a policyholder's Permitted Claim (*i.e.*, the allowed value of FGIC's liability as insurer) must be reduced by the value of subrogation, salvage and other recoveries derived by such policyholder from Non-FGIC Payors.

3. FGIC must disclose to its reinsurers the value of all subrogation, salvage and other recoveries received by FGIC or credits for such recoveries applied by FGIC to reduce DPOs, whether as a result of direct action by FGIC, turnover of FGIC Payments, or downward adjustment of DPO.

4. With respect to the acceleration of any defaulted obligation:

(a) FGIC's right to accelerate a defaulted obligation and to permit a claim for the full amount of the accelerated obligation shall be subject to appropriate limits, including that such acceleration shall have an economic benefit that does not include an increase in FGIC's reinsurance recovery; and

(b) Amounts due from a reinsurer in respect of accelerated obligations shall be reduced by the amount of the reinsurer's proportionate share of the future recoveries expected with respect to the accelerated obligation.

5. With respect to any commutation by FGIC of its liabilities under a policy:

(a) If the commutation is with respect to a Claim that has been filed and previously allowed as a Permitted Claim, the reinsured amount of the Permitted Claim shall be reduced to the amount of the commutation payment, and FGIC shall pay the reinsurer in full in Cash as an Administrative Expense Claim, or the reinsurer may offset or recoup any amount paid by the reinsurer in excess of the reinsured amount of the reduced Permitted Claim; or

(b) if the commutation occurs prior to the time that a Claim on the policy is filed, FGIC shall enter a Permitted Claim in the amount of the commutation payment, and the reinsurer's obligations shall be based upon the value of such Permitted Claim (*i.e.*, the commutation payment).

6. The Plan or a contemporaneous order of the Rehabilitation Court must, as required by the Insolvency Clause and other requirements of FGIC's reinsurance agreements, include (i) appropriate procedures providing that FGIC shall give reinsurers notice of Claims and permitting reinsurers to exercise their rights to investigate claims and interpose defenses available to FGIC or the Rehabilitator, and (ii) appropriate procedures for notice to reinsurers of, rights of reinsurers to object to, and limitations protecting reinsurers in regard to commutations by FGIC and exercise by FGIC of acceleration rights as to insured obligations;

7. The Plan must provide for offset of mutual debts or recoupment, as the case may be, of amounts owed between the parties under the various reinsurance agreements.

Assured is prepared to work with FGIC and the Rehabilitator to draft the necessary Plan provisions to give effect to the protections described in 1 through 7 above (the "Proposed Amendments"). As drafted and without the Proposed Amendments, the Plan will surely result in FGIC breaching its reinsurance obligations and risking the loss of significant reinsurance assets. The loss of these assets to FGIC would also presumably affect FGIC's ability to meet the CPP. Indeed, the statements and projections in the Disclosure Statement and the Rehabilitator's Memorandum of Law may very well be inaccurate if they failed to account for amounts due to reinsurers or the breaches that would result from the Plan as drafted.

Accordingly, the Court should require that the Rehabilitator incorporate the Proposed Amendments prior to any confirmation of the Plan.

FGIC'S OBLIGATIONS UNDER ITS REINSURANCE CONTRACTS

FGIC and Assured are parties to reinsurance agreements covering a combined gross par outstanding amount of several billion dollars in ceded liabilities.[2]/ Each of these agreements contains provisions governing the parties' respective rights, duties and obligations in respect of subrogation, salvage and other recoveries and claims handling. For example, the 2004 Facultative Reinsurance Agreement (Agreement No. 60002), to which FGIC and Assured Guaranty Re International, Ltd. are parties (the "2004 Facultative Agreement", attached as Exhibit A to the Affidavit of Philip R. Kastellec submitted in support of this Objection), provides in Article IV, entitled "Losses and Loss Adjustment Expense", that:

> For purposes of this Agreement, "Recovery" shall mean any amount actually received by the Company in reimbursement of any Loss covered by the Reinsurer under this Agreement, whether by subrogation, salvage, reimbursement or other recovery from the Issuer or otherwise. The Company shall credit the Reinsurer with a percentage of any Recovery received or recovered by the company, such percentage to equal the Reinsurer's Share of the Loss to which the Recovery relates. If any Recovery [is] in a form other than cash when received by the Company, the cash value of such Recovery shall be credited to the reinsurer when such Recovery or salvage is converted to cash by the Company. The cash value of such Recovery shall be the cash value as of the date of conversion to cash by the Company. This provision shall remain in effect until all Recoveries have been made, in the Company's sole discretion.

In Article VII, entitled "Reports and Remittances", the 2004 Facultative Agreement further provides that:

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[2]/ The Disclosure Statement lists ceded gross par outstanding at March 31, 2012 as $5,473.7 million for AGRe, $1,928.3 million for AGC and $99.2 million for AGRO. As set forth in the Kastellec Affidavit, according to Assured's records, FGIC ceded outstanding par as of March 31, 2012 of the following amounts: (1) $1,740.32 million to AGRe, (2) $406.65 million to AGC, and (3) $1.728 million to AGRO. These amounts reflect a discrepancy, which will need to be reconciled, between FGIC's and Assured's records.

> [w]ithin forty-five (45) days of the end of each quarter, the Company shall pay the Reinsurer the Reinsurer's portion of the subrogation, salvage and other Recoveries received by the Company with respect to the Covered Policies for the Quarter.

Although the provisions in each of the reinsurance agreements between FGIC and Assured are not identical, all require accounting and turnover of the Reinsurer's portion of subrogation, salvage and other recoveries, regardless of the manner or form in which such recoveries are realized by FGIC.

Each of the reinsurance agreements also contains an Insolvency Clause, which is required by New York law to be contained in every reinsurance contract in order for the ceding insurer to receive statutory credit for the reinsurance. The Insolvency Clause binds the reinsurer to pay losses in full without diminution based on the cedent's insolvency (*i.e.*, to pay its reinsured share of the cedent's full liability even if, because of insolvency, the cedent pays its policyholder less than the full liability). As authorized by section 1308(a)(3) of the NY Insurance Law, the Insolvency Clause also imposes obligations on FGIC. For example, the terms of the Insolvency Clause taken from Article XVI of the 2004 Facultative Reinsurance Agreement provide:

> the [rehabilitator] shall give written notice to the reinsurers of the pendency of a claim against the insolvent Company indicating the Policy or Policies reinsured within a reasonable time after such claim is filed in the [rehabilitation proceeding], and during the pendency of such claim any Reinsurer may investigate such claim and interpose, at its own expense, in the proceedings where such claim is to be adjudicated any defense or defenses which it may deem available to the Company or its [rehabilitator]. The expense thus incurred by the Reinsurers shall be chargeable subject to court approval against the insolvent Company as part of the expense of liquidation to the extent of the share of the benefit which may accrue to the Company solely as a result of the defense undertaken by the Reinsurer.

As drafted and without the Proposed Amendments, the Plan will breach these requirements of FGIC's reinsurance agreements.

NECESSARY PLAN AMENDMENTS

By omitting recognition of Assured's contractual, legal, and equitable rights under the reinsurance agreements with FGIC, the Plan retains for FGIC benefits that are or will be due to Assured. If not amended to comport with applicable legal obligations owed by FGIC to its reinsurers, the Plan will result in FGIC breaching its reinsurance agreements. The Plan as drafted thus threatens the loss of FGIC's reinsurance assets because reinsurers will have defenses to subsequent reinsurance billings that FGIC might present following the breaches.

For example, failure of FGIC to allow a reinsurer to investigate and to interpose defenses ***before*** a Claim is determined to be a Permitted Claim could result in the reinsurer asserting breach of the Insolvency Clause ***after*** FGIC presents the reinsurer with a billing on the Permitted Claim. And, if FGIC does not allow a reinsurer to investigate and to interpose a defense prior to permitting a Claim, the reinsurer could refuse to pay a subsequent billing on the Claim on the basis that the Claim was wrongly permitted because it was outside the scope of coverage of the reinsured FGIC policy as well as the reinsurance agreement. Similarly, if FGIC were to accelerate or to allocate defaulted insured obligations for the purpose of inflating reinsurance recoveries, a reinsurer could be justified in refusing to pay any resulting reinsurance claim based on breaches of the reinsurance agreement and FGIC's duty of utmost good faith to its reinsurer in the handling of claims. In addition, FGIC's failure to pay over to reinsurers their proportionate share of a recovery on a Permitted Claim could result in the reinsurers recouping such amounts by reducing payments on future reinsurance bordereaux or billings or by refusing to pay future claims based upon the breach. The Proposed Amendments are intended to anticipate these foreseeable circumstances under which FGIC could be caused by the current draft of the Plan to breach its obligations to reinsurers.

In order to preserve potential reinsurance assets, the Proposed Amendments must be included in the Plan to address the following points. Absent the amendments, the Plan cannot be confirmed because it would jeopardize FGIC's reinsurance and, thereby, FGIC's ability to satisfy claims as contemplated in the Plan and the Disclosure Statement.

POINT I

THE PLAN MUST PROVIDE FOR PAYMENT TO REINSURERS OF THEIR PROPORTIONATE SHARE OF ANY RECOVERIES ON REINSURED CLAIMS

The fundamental aspect of the Plan is its restructuring of policies. Under each "Restructured Policy", FGIC will pay the allowed amount of claims ("Permitted Claims") by making an initial payment in Cash of an initial percentage, which the Plan estimates to be 15% and defines as a "CPP", and by issuing a Deferred Payment Obligation ("DPO") for the remainder of each allowed claim. With respect to many Claims, there will be opportunities for FGIC or for the policyholder to make recoveries, in the nature of subrogation, salvage or otherwise, and thereby to reduce the amount of the loss to FGIC or the Policyholder. The Plan addresses the possibility of such recoveries in several provisions.

For example, claimants are prohibited from recovering from Non-FGIC Payors more than the amount of the distributions by FGIC on their claims. In addition, claimants that owe amounts to FGIC for premiums or recoveries from third parties (such amounts defined by the Plan as "FGIC Payments") are required to turnover such payments to FGIC or are subject to reduction of DPO distributions. *See* Plan Section VI.B.I. Pursuant to section 4.7(B) of the Plan, the DPO with respect to a Permitted Claim is to be reduced to the extent that a policyholder recovers from a Non-FGIC Payor and FGIC determines, in good faith, that it is owed a FGIC Payment. The Plan does not, however, provide that such a recovery, whether by turnover, reduction in future DPO Payment or if retained by the policyholders in an amount in excess of FGIC's ultimate

Cash payment on its DPO, will reduce the amount of a policyholder's Permitted Claim for purposes of collecting reinsurance.

As set forth above, FGIC has obligations under its reinsurance agreements with Assured to credit Assured for the reinsured share of any recovery in respect of a reinsured claim. But the proposed Plan does not contain *any* provisions requiring FGIC to pay to reinsurers, such as Assured, their proportionate share of any recoveries on reinsured claims. This is not a hypothetical issue. For example, the Rehabilitator recently filed with the Court the "Preliminary Analysis of FGIC Payments Not Paid to FGIC and Resulting in Reductions of Cash Payments on Certain Permitted Policy Claims." This "Preliminary Analysis" estimates the values (totaling $55,220,000) currently expected by the Rehabilitator to be derived from FGIC Payments, but it makes no mention of reinsurers' rights to receive their proportionate shares of any FGIC Payments in respect of reinsured Claims. While the penultimate descriptive paragraph contained in the "Preliminary Analysis" acknowledges that the ultimate value to policyholders from FGIC Payments will be impacted by a variety of factors not taken into account, it does not disclose that one of the factors is that each reinsurer of a loss on which there are FGIC Payments will be entitled to its proportionate share of such FGIC Payments.

Nor is this issue of reinsurers' right to their share of recoveries solely addressed by contract. It is also well-established under New York law that an insurer holds in trust for the benefit of its reinsurer the proportion of subrogation or salvage recoveries as to which reinsurance has covered the insured loss. *See, e.g., Pink v. American Surety Co. of N.Y.*, 28 N.E. 2d 842, 844-45 (N.Y. 1940) ("[i]n relation to any salvage collected to recoup losses on a specific risk under the reinsurance contracts the reinsured was a *trustee* for the reinsurer as to moneys in its hands belonging to the latter or to be applied to a specific purpose and an action at law might

be maintained to recover the proportion to which [reinsurer] was entitled") (emphasis added). The Court of Appeals in *Pink* made clear that the reinsurer is entitled to the full value of its proportional share of subrogation recoveries, even from an insolvent cedent in receivership. *Pink*, 28 N.E. at 844-45.

As a matter of law, subrogation and salvage recoveries are held in trust by the insured for FGIC, and in turn by FGIC for the reinsurer of the paid loss, in each case to the extent of the amount of loss borne. As on court has explained:

> The equitable considerations which give rise to a right of subrogation in favor of an insurer who pays the loss insured against apply in favor of a reinsurer who complies with his obligation to his reassured, whether that obligation is for the whole or part of the amount of the loss incurred by the latter in favor of his assured. In the circumstances disclosed the original insurer could not plausibly have contended that it was entitled to recover for itself the entire amount paid under its policy, the reinsurer having furnished one-half of that amount.

Universal Ins. Co. v. Old Time Molasses Co., 49 F.2d 925, 927 (5th Cir 1931) (internal citation omitted). *See also Glacier General Assurance Co. v. G. Gordon Symons Co., Ltd.*, 631 F.2d 131, 134 (9th Cir. 1980) ("Glacier's recovery is impressed with a trust for the reinsurers in the amounts they are entitled to receive by principles of subrogation"); *National Garment Co. v. New York, C. & St.L. R. Co.*, 173 F.2d 32, 35 (8th Cir. 1949) ("the recovery is impressed with a trust for the insurer to the amount to which it is entitled to subrogation").

Thus, pursuant to the terms of its agreements with reinsurers and under applicable case law, FGIC is required to account for the value of such benefit to the reinsurer of the paid loss and to turn over to the reinsurer its share of the recovery. *See Pink*, 28 N.E. 2d 844-45; *In re Preferred Accident Ins. Co. of N.Y.*, 147 N.E.2d 476 (N.Y. 1957) (cedent must turn over appropriate share of salvage recoveries to the reinsurer); *Automobile Ins. Co. of Hartford v. St.*

Paul Fire & Marine Ins. Co., 89 F.2d 163 (2d Cir. 1937) (affirming decision requiring turnover of a salvage recovery to the reinsurer of the loss).

Moreover, the definition of "Secured Claim" set forth in the New York Insurance Law provides that "'Secured claim' means any claim secured by mortgage, *trust*, deed, pledge, deposit as security, escrow, other security interest, or otherwise, but not including special deposit claims or claims against general assets." N.Y. Ins. L. § 7408(10) (emphasis added). FGIC is a subrogee of any policyholder that recovers a paid loss from a Non-FGIC Payor, and through the Plan, FGIC enforces its subrogation rights by (a) requiring turnover, and/or (b) reducing DPO payments. As a matter of law as set forth above, FGIC is a trustee for the benefit of its reinsurers with respect to recoveries, and the N.Y. Insurance Law treats the claims to trust proceeds as a secured claim. But the Plan provides no protection of a reinsurer's secured claim to its share of the benefit derived from such recoveries. Again, this is not a hypothetical issue. For example, FGIC has paid reinsured policy claims relating to certain defaulted obligations of Jefferson County, Alabama. Reinsurers, including Assured, have contributed their portions of the loss. FGIC, as subrogee of the insured's rights, has received warrants issued by Jefferson County and currently holds those warrants. The Plan provides no express protection of reinsurers' interests in those warrants or their proceeds.[3]/

Because the Rehabilitator has not rejected the reinsurance agreements with Assured and seeks the benefit of those agreements in order to benefit the rehabilitation effort, the rehabilitation must also bear the burdens of those agreements, including by affording administrative expense priority to reinsurers' claims for their share of the value derived from

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[3]/ The Plan in Section 4.7(C) provides for the filing of Secured Claims. Assured will submit a secured claim in the ordinary course as described by the Plan, and will also file a proof of claim with the Rehabilitator to detail both the secured and unsecured portions of its claim.

subrogation, salvage and other recoveries. The U.S. Supreme Court announced this principle in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531-32, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984) when it held that "[s]hould the debtor-in-possession elect to assume the executory contract ... it assumes the contract *cum onere*, and the expenses and liabilities incurred may be treated as administrative expenses, which are afforded the highest priority on the debtor's estate." The principle has been applied in insurance company rehabilitations in circumstances where the rehabilitator leaves a pre-petition contract in place in order to benefit the rehabilitation effort. *See, e.g., In re Rehabilitation of Mutual Benefit Life Ins. Co.*, 1993 N.J. Super. LEXIS 940 (N.J. Super. Ct. 1993), (administrative priority status granted to post-receivership claims for $58 million due to bank counterparties in respect of interest rate hedges, which the Court found to have been intentionally kept in effect by the rehabilitator as a beneficial hedge against risk to the rehabilitation effort); *see also Nostas Assocs. v. Costich (In re Klein Sleep Prods.)*, 78 F.3d 18, 35 (2d Cir. 1996) (concluding that unpaid, post-assumption obligations become an administrative claim against the estate).

It is notable that in arguing that the Plan should be confirmed the Rehabilitator relies in his Memorandum of Law on similarities between the FGIC Plan and the Plan of Rehabilitation filed by the Segregated Account of Ambac Assurance Corp. (the "AAC Plan").[4]/ The Rehabilitator is correct that the proposed FGIC Plan shares certain features of the AAC Plan. Specifically, under the AAC Plan, full payment of distributions to policyholders is similarly deferred and may not ever equal the face amount of original policy liabilities. In both cases, the rehabilitators assert that policyholders will recover more than could be distributed if the respective insurer were in liquidation. The Wisconsin court overseeing the AAC rehabilitation

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[4]/ The AAC Plan is available at http://ambacpolicyholders.com/court-filings/.

found the restructuring of policies to be fair and equitable and in the best interest of policyholders. *See* Decision and Final Order Confirming the Rehabilitator's Plan of Rehabilitation, With Findings of Fact and Conclusions of Law, Case No. 10-CV-1576, ¶104 (Wis. Cir. Ct. Jan 21, 2011) (appeals pending), *available at* http://ambacpolicyholders.com/court-filings/.

But the AAC Plan and this proposed Plan differ significantly with respect to the issues in this Objection. The AAC Plan, for example, defines "Permitted Claim" to exclude the portion for which a claimant is entitled to recover from a source other than the AAC Plan. *See* AAC Plan, section 1.42 ("... Permitted Claims shall not include ... (iv) that portion of any loss for which indemnification is provided by other benefits or advantages recovered or recoverable by the Holder."). By definition, the AAC Plan thereby automatically deducts amounts of recoveries from the value of a Permitted Claim, *i.e.*, from the value of the AAC Segregated Account's insured loss. Although reinsurers are required by both the AAC Plan and the proposed FGIC Plan to pay the full value of Permitted Claims, in the case of AAC, that amount is reduced by recoveries by policyholders from other (non-Segregated Account) sources. In contrast, the proposed FGIC Plan does not reduce the amount of Permitted Claims by recoveries or otherwise expressly preserve the value of such recoveries for reinsurers, such as by basing the amount of reinsurance owed on the Permitted Claim by calculating the amount of the Permitted Claim less any amounts recovered or recoverable from other sources.

As set forth above, the procedures for handling FGIC Payments and DPO and CPP adjustments result in the value of a Permitted Claim potentially including more than the insured loss, while section 3.6(a) of the Plan nevertheless requires reinsurers "to pay in full in Cash for such reinsurer's reinsured portion of the entire amount of each Policy Claim, without giving

effect to the Policy Restructuring." But the Policy Restructuring is the mechanism for paying Claims with Cash plus deferred DPO payment and for reducing FGIC's liabilities based on policyholder's recoveries from Non-FGIC Payors. Accordingly, requiring a reinsurer to pay in full without giving effect to the provisions that reduce FGIC's insured liabilities would require a reinsurer to pay amounts in excess of insured/reinsured losses whenever a policyholder recovers from a Non-FGIC Payor. Such a requirement would breach the reinsurance agreements.

Accordingly, the Plan must be amended in two ways to address this issue. **First,** the Plan must provide that, whenever FGIC receives a recovery in Cash, FGIC must calculate the reinsurer's portion of such Cash recovery and segregate that amount from its general assets as held in trust for the reinsurer. The Plan must further provide that the Cash will be paid to the reinsurer as a Secured Claim. **Second,** the Plan must provide that, whenever FGIC realizes a recovery by reducing the amount of a DPO issued to a policyholder, FGIC must accord the reinsurer its proportionate share of such recovery. If the reinsurer has current obligations to FGIC, the reinsurer may recoup its share of the recovery by setting off the amount of its proportionate amount of the reduction in DPO against any amount owed by the reinsurer to FGIC. If the reinsurer has no current obligation to FGIC at the time of the recovery, the reinsurer's proportionate amount in reduction of the DPO shall be paid to the reinsurer in Cash as an Administrative Expense Claim.

POINT II

THE PLAN MUST PROVIDE THAT THE AMOUNT OWED BY A REINSURER FROM A PERMITTED CLAIM MUST BE REDUCED BY ANY RECOVERY BY THE POLICYHOLDER FROM NON-FGIC PAYORS

The Plan recognizes that in certain situations a policyholder may make a recovery that is not turned over to FGIC. For example, the Plan carves out holders of RMBS instruments from the Plan's priority scheme and allows claimants to exercise certain control rights to enforce the

RMBS issuers' "Trust Loan Repurchase Obligations". *See* Plan, section 3.7. As is the case with respect to recoveries by other policyholders from Non-FGIC Payors, there is no mechanism in the Plan to recognize reinsurers' reduce the amount of reinsurance by the reinsurer's share of such recoveries collected by the Ad Hoc Instrument Holders. The Plan also provides that FGIC's contractual rights of subrogation "shall be for an amount equal to the Cash [defined as U.S. legal tender] that FGIC ultimately pays ... [.]" *See* Plan, section 4.13. This provision ensures that FGIC is subrogated to the entire amount that it pays in Cash on account of a claim, regardless of whether the Cash is paid as an initial distribution or based on a DPO. In an instance where a recovery is made by, or may be available to, a policyholder that enables the policyholder to recover *more* than the Cash it would have been due from FGIC on its Permitted Claim, the Plan provides no protection for a reinsurer that has paid the full amount of the Permitted Claim, and allows the policyholder to retain a greater share recovery than other similarly situated policyholders who have no such non-FGIC recourse.[5]/

Neither of these provisions makes clear that the reinsurer's liability to FGIC in respect of such Claims must be reduced to accord with the actual amount of insured loss. The proposed Plan could thus result in reinsurers paying more than their proportionate shares of the actual insured losses incurred by FGIC policyholders in violation of the reinsurance agreements. Accordingly, the Plan must be amended to provide that, for purposes of calculating any amount owed from a reinsurer, FGIC must reduce the amount of the Permitted Claim by the amount of

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[5]/ In contrast, the AAC Plan, in section 4.04(g), preserves *all* subrogation and salvage recovery rights of the Segregated Account, not just (as is the case in the FGIC Plan) to the extent of Cash payments ultimately made under the AAC Plan. Thus, even if not recovered by AAC, and even if only "recoverable" by the policyholder, recoveries available to a policyholder from sources other than the ceding insurer can be recovered by the AAC estate and are preserved for the benefit of a reinsurer of the loss.

recovery received and retained by a policyholder. To the extent that the recovery is made by the policyholder after FGIC has recovered reinsurance in respect of the Claim, the Plan must provide that FGIC pay over to the reinsurer its proportionate share of the policyholders' recovery by means of recoupment or an Administrative Expense Claim as set forth in Point I above.

POINT III

THE PLAN MUST PROVIDE THAT FGIC MUST DISCLOSE TO REINSURERS THE VALUE OF ALL RECOVERIES RECEIVED BY FGIC OR POLICYHOLDERS

A necessary corollary to FGIC's obligation to pay to reinsurers their share of any recoveries is that FGIC must account to reinsurers for any recoveries received on reinsured Claims. Such accounting is necessary to ensure the effective administration of the Plan and FGIC's obligations to reinsurers. It is also required by the operative reinsurance agreements. Article VI of the 2004 Facultative Reinsurance Agreement, for example, requires FGIC to furnish a quarterly statement within 30 days of the end of each quarter that shows, *inter alia*, all Losses for the quarter, which include Recoveries received within the quarter.

Accordingly, the Plan must be amended to require that FGIC provide each reinsurer of a Claim as to which any recovery has been made by FGIC or a policyholder with prompt notice that the recovery has been made.

POINT IV

THE PLAN MUST PROVIDE FOR APPROPRIATE LIMITS ON FGIC'S RIGHT TO ACCELERATE A DEFAULTED OBLIGATION AND FOR REDUCTION OF THE AMOUNT DUE FROM THE REINSURER BY ITS SHARE OF EXPECTED FUTURE RECOVERIES

Under certain of the policies issued by FGIC insure underlying obligations, FGIC has the right upon default of the underlying obligations to pay a claim to the policyholder and then control the acceleration of the underlying obligations and make recoveries from the obligations. Under FGIC's reinsurance agreements, it usually retains discretion to handle policyholder claims

and to make decisions such as whether and when to pay claims in order to accelerate underlying obligations. Because FGIC is now insolvent and can invoke the Insolvency Clause to collect 100 cents on the dollar from reinsurers on a Permitted Claim even when it will only pay the policyholder 15% of the Permitted Claim in cash, the dynamic presents the risk that FGIC might permit a Claim and accelerate obligations in order to maximize and make an early collection of reinsurance even if it would otherwise make more economic sense not to accelerate the obligations. The Plan must address this risk by requiring FGIC to make such decisions on accelerating obligations without regard to the potential reinsurance recovery and must also provide that reinsurers receive their proportionate benefit from the acceleration.

FGIC would breach its obligations to reinsurers absent this Proposed Amendment. All reinsurance relationships incorporate, as a matter of law, the requirement that each party act with utmost good faith in relation to the other. The doctrine has been applied in the reinsurance context in New York since at least 1837. *See New York Bowery Fire Ins. Co. v. New York Fire Ins. Co.*, 17 Wend. 359 (N.Y. Sup. Ct 1837). The rationale for this obligation of utmost good faith is based on the economics of reinsurance, which would cease to exist if reinsurers were forced to duplicate actuarial and claims-handling efforts of ceding insurers. *See Unigard Sec. Ins. Co., Inc. v. N. River Ins. Co.*, 4 F.3d 1049, 1066 (2d Cir. 1993). Accordingly, a reinsurer is entitled to rely upon the utmost good faith of its cedent to handle claims in the best interest of both the ceding company *and* the reinsurer.

Several New York courts have equated the general duty of good faith with following all "proper and businesslike steps" in the claims settlement process. *See, e.g., American Marine Ins. Group v. Neptunia Ins. Co.*, 775 F. Supp. 703, 708 (S.D.N.Y. 1991), *aff'd* 961 F.2d 372 (2d Cir. 1992); *Insurance Co. of N. Am. v. U.S. Fire Ins. Co.*, 67 Misc. 2d 7, 10, 322 N.Y.S.2d 520, 523

(Sup. Ct. 1971), *aff'd,* 42 A.D. 2d 1056, 348 N.Y.S.2d 122 (1973). While a reinsurer has the obligation in certain circumstances to follow its cedent's decision to settle claims, the obligation is "subject to the ceding company's duty of utmost good faith, and the requirement that investigations be reasonable and businesslike". *Aetna Cas. & Sur. Co. v. Home Ins. Co*, 882 F. Supp. 1328, 1351 (S.D.N.Y. 1995). *See also Suter v. General Accident Ins. Co. of Am.*, 2006 U.S. Dist. Lexis 48209, at *84 (D. N.J. 2006) (reinsurer was relieved of liability to cedent on claim where cedent "did not make the kind of reasonable and businesslike investigation that the circumstances required").

A reinsurer is also not bound to pay its cedent's reinsurance claim when the claim was handled or the settlement allocated in order to maximize the cedent's reinsurance recovery. *See Allstate Ins. Co. v. Am. Home Ins. Co.*, 43 A.D.3d 113, 121-22, 837 N.Y.S.2d 138 (1st Dep't 2007) ("A reinsurer is not bound by the follow-the-fortunes doctrine where the reinsured's settlement allocation, at odds with its allocation of the loss with its insured, designed to minimize its loss, reflects an effort to maximize unreasonably the amount of collectible reinsurance.").

Accordingly, FGIC would breach its reinsurance agreements and jeopardize recovery for any Claim where it exercised its rights to accelerate underlying obligations for the purpose of increasing its reinsurance recovery. The Plan must be amended, therefore, to require that any acceleration shall have an economic benefit that does not include an increase in FGIC's reinsurance recovery. Furthermore, for the reasons set out in Point I above, reinsurers also have rights to their proportionate share of the benefit of any recoveries expected by the acceleration of the underlying obligations. Because FGIC controls the acceleration and can calculate its expected recoveries, it should not be permitted to arbitrage its reinsurance by collecting the full amount of reinsurance on a Permitted Claim and waiting until receipt of the expected recoveries

from the acceleration before crediting the reinsurer. The Plan must provide that amounts due from the reinsurer in respect of the Permitted Claim shall equal only the reinsured amount less the reinsurer's proportionate share of the expected recoveries with respect to the accelerated obligation.

POINT V

THE PLAN MUST PROVIDE THAT A REINSURER'S LIABILITY FOR COMMUTATION OF A FGIC POLICY IS LIMITED TO ITS SHARE OF THE COMMUTATION PAYMENT

In addition to recoveries from third parties, another way in which the Plan contemplates a reduction in FGIC's liability on Claims is in respect of commutations, *i.e.*, settlements of claims or potential claims. Section 4.8 of the Plan addresses "Alternative Resolution of Claims". It permits FGIC to enter into consensual arrangements "that result[] in the extinguishment or reduction of FGIC's liability, in respect of (i) all or part of any Policy, (ii) all or part of the underlying obligation or obligations insured by such Policy or (iii) the underlying Instrument, contract or arrangement, if any, giving rise to such Claim . . . ." Plan, § 4.8. As with recoveries, the Plan provision for Alternative Resolutions also does not recognize reinsurers' rights to benefit from the "extinguishment or reduction of FGIC's liability." For all of the reasons set out in Point I above, reinsurers have contractual and legal rights to have their reinsurance liability based only on the ultimate insured liability of FGIC.

Accordingly, the Plan must be amended to provide that when FGIC enters into an Alternative Resolution of a Claim or potential Claim it may only collect from reinsurer's their reinsured share of the value of the Alternative Resolution. If the commutation is with respect to a Claim that has been filed and previously allowed as a Permitted Claim, the reinsured amount of the Permitted Claim must be reduced to the amount of the commutation payment in the Alternative Resolution; in that situation, FGIC must pay the reinsurer in full in Cash as an

Administrative Expense Claim or through offset or recoupment any amount paid by the reinsurer in excess of the reinsured amount of the reduced Permitted Claim. In situations where the Alternative Resolution is entered into prior to the time that a Claim on the policy is filed, the Plan must provide for FGIC to enter a Permitted Claim in the amount of the commutation payment, and for the reinsurer's obligations to be based upon the value of such Permitted Claim (*i.e.*, the commutation payment).

POINT VI

THE PLAN, OR A CONTEMPORANEOUS COURT ORDER, MUST PROVIDE PROCEDURES FOR COMPLIANCE BY FGIC WITH ITS OBLIGATIONS UNDER THE INSOLVENCY CLAUSE

The Plan gives effect to the first part of the Insolvency Clause by requiring, "Each Reinsurer shall pay FGIC in full in Cash for such Reinsurer's reinsured portion of the entire amount of each Policy Claim . . . regardless of the amount paid in Cash by FGIC on account of such Policy Claim." Plan, § 3.6.[6/] The Plan does not, however, give effect to the remainder of the Insolvency Clause. Specifically, the Plan contains no provision requiring notice to reinsurers of the submission of Policy Claims that may be reinsured and no provision for reinsurers to investigate such Policy Claims and to interpose against such Policy Claims defenses that the reinsurer deems available to FGIC or the Rehabilitator. Article IV of the Plan addresses Claim Administration, including provisions for FGIC to object to Claims and for reconciliation of Disputed Claims. *See* Plan, § 4.6. But none of the Plan provisions give effect to reinsurers'

[6/] We assume that Section 3.6 contains a typographical error to the extent that it refers to reinsurers' obligation to make payments based on a "Policy Claim" rather than a "Permitted Policy Claim". Regardless of the issue of payment by FGIC (in cash or with DPOs), it is fundamental that a reinsurer's liability to FGIC is only triggered by FGIC's liability. Under the Plan, FGIC will not have liability in respect of a Claim until it is determined to be a Permitted Claim. Accordingly, the Plan should also be amended to change the references to "Policy Claim" in Section 3.6 to read as "Permitted Policy Claim".

rights to notice and to investigate Claims and interpose defenses; nor does any Plan provision address or limit the impact of commutations or alternative resolutions. These omissions from the Plan violate FGIC's contract obligations, and the Plan cannot be confirmed with an appropriate Proposed Amendment.

The Appellate Division in New York has recently affirmed that reinsurers have valid rights under the Insolvency Clause and that liquidation proceedings must provide for appropriate procedures allowing reinsurers to exercise those rights. *See In re Liquidation of Midland Ins. Co.*, 87 A.D.3d 487, 929 N.Y.S.2d 116 (1st Dept. 2011) (holding that liquidation court's claims procedure order provided appropriate protections). In *Midland*, the appellate court reasoned that "The [liquidation] court's January 15, 2008 order provides for 'a process in which [the reinsurers'] defenses can be adjudicated as part of the judicial approval process, involving a hearing before a referee equivalent to that provided where an objection is filed to the liquidator's disallowance of a claim.' Accordingly, the court set up a mechanism for a referee to hear and report to the court on the reinsurers' defenses." 87 A.D.3d at 490. In *Midland,* the liquidation court's Claims Procedure Order requires the liquidator to give reinsurers notice of claims that the liquidator is considering for allowance so that reinsurers can investigate the claims to determine if there are any viable defenses. The Claims Procedure Order sets out deadlines for reinsurers to provide notice of intent to interpose defenses and requires the liquidator to refer to a referee any policyholder claim to which a reinsurer has given notice of intent to interpose defenses. The *Midland* referee holds proceedings on the claim and the interposed defenses to hear and report on whether the claim should be allowed or disallowed in whole or in part. *See* Affirmation of Sean Thomas Keely ("Keely Aff."), Ex. A.

With respect to Insolvency Clause rights, the proposed FGIC Plan also differs from the

approved AAC Plan. In conjunction with the AAC Plan, the Segregated Account is required to operate pursuant to Rules Governing Ceded Reinsurance Contracts, which provide deadlines and procedures for the Rehabilitator to give reinsurers notice of submitted policyholder claims, for reinsurers to investigate those claims, and for the Rehabilitator or the reinsurer to interpose defenses to those claims before a final decision is made on whether to permit the claims. *See* Keely Aff., Ex. B. The AAC Rules Governing Ceded Reinsurance Contracts also require the Rehabilitator to give reinsurers notice of contemplated Alternative Resolutions and an opportunity to investigate them and interpose any defense to the potential policy claim prior to the consummation of any Alternative Resolution. *Id.* at 1.

As recognized in both the *Midland* and *AAC* cases, the Insolvency Clause involves a *quid pro quo*. The provision requiring payment of claims in cash in their full permitted amounts regardless of how much the insolvent reinsured pays in cash to a claimant fundamentally changes the reinsurance contract from one of indemnity to one of liability and fundamentally changes the dynamic of the relationship. In recognition of that, the New York Insurance Law expressly permits insurers to include in the Insolvency Clause in their reinsurance agreements the right of the reinsurer to investigate claims submitted to the insolvent reinsured and to interpose defenses to such claims that would be available to the insolvent reinsured or its rehabilitator. *See* N.Y. Ins. L. § 1308(a)(3). While the incentive of the rehabilitator might be to maximize the reinsurance asset and thus, perhaps, to forgo defenses to certain reinsured claims or to forgo defenses that would reduce the amount of certain reinsured claims, the Insolvency Clause gives reinsurers the ability to ensure that only valid claims are permitted in amounts that are justified by the facts.

The Insolvency Clause requires that there be adequate procedures for reinsurers to

exercise rights to investigate claims and interpose defenses. The New York liquidation court overseeing the estate of Midland recognized this when it required amendment of a claims procedure order because the original order did "not provide for a procedure to adjudicate any interposed defenses" or "specifically take into account a reinsurer's contractual right to notice, a right to associate and cooperate with the Liquidator, or a right to investigate claims." *Matter of Liquidation of Midland Ins. Co.*, 18 Misc.3d 1117(A) at *28 (N.Y. Sup. Ct. Jan. 14, 2008), *aff'd*, 87 A.D.3d 487 (1st Dep't 2011). The court held, "To interpose a defense therefore means that the defense may be raised and adjudicated, even if the Liquidator does not accept the defense in deciding whether or not to allow a claim." *Id.* at *23. A revised claims procedure order was entered to ensure that Midland and the Liquidator did not breach the Insolvency Clause in Midland's reinsurance contracts. *See* Keely Aff., Ex. A. Similarly, rules providing for exercise of reinsurers' Insolvency Clause rights were promulgated in the rehabilitation of the AAC Segregated Account "[i]n order to preserve the value of reinsurance . . . and in recognition of certain requirements imposed by the reinsurance contracts". *See* Keely Aff., Ex. B.

In contrast, the Plan provides for Reconciliation of Disputed Claims in Section 4.6, but does not mention reinsurers or provide for reinsurers to exercise their rights with respect to the investigation and defense of claims. Nor does the Plan provide for giving notice to reinsurers of claims when they are submitted and prior to a final determination on whether a claim should be designated a Permitted Claim. Thus, the Plan as currently structured would lead to FGIC and the Rehabilitator breaching the Insolvency Clause in the reinsurance agreements and thereby jeopardizes FGIC's reinsurance assets.

Accordingly, the Plan must be amended to incorporate procedures for reinsurers to exercise their Insolvency Clause rights or the effectiveness of the Plan must be conditioned on

entry of a companion claims procedure order giving effect to those rights. Such procedures could be incorporated into the Plan itself or in a contemporaneous order from the Court binding upon FGIC. They must give effect to reinsurers' rights to prompt notice of Claims (as well as prompt notice prior to any commutation and any acceleration by FGIC of underlying obligations), and rights to investigate and interpose defenses to Claims, commutations, or proposed acceleration of underlying obligations.

POINT VII

THE PLAN SHOULD BE AMENDED TO ADDRESS REINSURERS' RIGHTS OF RECOUPMENT AND OFFSET

New York law governing Delinquency Proceedings allows offset of debts and credits arising between the parties to a contract such as a reinsurance agreement (or to multiple such contracts), provided that the parties are "mutual", that is, acting as to each other in the same capacity (*e.g.*, neither is acting as a fiduciary or agent for third party); and that the obligations are "mutual", that is, each obligation arose at the same point in time in relation to commencement of the Delinquency Proceeding. Assured would have the right, as discussed below, to offset amounts owed under a reinsurance agreement against amounts owed to it by FGIC under the same agreement. Rights and defenses available to Assured under a single agreement as to which FGIC owes amounts resulting from breach or by operation of the same contract are properly characterized as being in the nature of recoupment. In addition, Assured has the rights of a secured claimant in regard to subrogation recoveries (such as the Jeffco warrants) already held by FGIC. Rather than leave the issues described above to *ad hoc* resolution by assertion of defenses by a reinsurer to a demand for payment, the Plan should include the Proposed Amendments.

As to obligations arising between mutual parties under a single agreement, a party from whom payment is demanded by a counterparty that also owes under the same contract may recoup a net balance owed to or from such party under the single agreement. The rights asserted by Assured in this Objection (such as rights to subrogation and salvage recoveries, to interpose defenses to payment of sums recovered from third parties and to defend against breaches of the standard of care owed by FGIC under reinsurance agreements) that arise under the same reinsurance agreements under which FGIC claims the right to payment of reinsurance due pursuant to the Insolvency Clause are capable of recoupment. Because these claims and defenses arise under the same agreement, an aggrieved reinsurer is entitled to "recoup" its loss obligations under the agreement. This was recognized by the *Pink* court, which referred to the collection of any salvage "to *recoup* losses on a specific risk under the reinsurance contracts". *Pink*, 28 N.E. 2d at 844 (emphasis added).

Courts have reasoned that recoupment is not an action against a debtor's property, because the debtor's rights in property (such as FGIC's rights to require turnover and to retain recoveries from Non-FGIC Payors) are subject to this equitable defense. *See, e.g., Bank of Marin v. England*, 385 U.S. 99, 101 (1966) ("[t]he trustee succeeds only to such rights as the bankrupt possessed; and the trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition"). Thus, the right of one counterparty to "recoup" based on the existence of claims resulting from the same transaction is an equitable right inherent in the other counterparty's property rights in the proceeds of the transaction. The moment the right of recoupment arises it equitably reduces or extinguishes (as between the parties) by operation of law, the amount of property due to the payee, but it may be asserted only as a defense in an action based on the contract giving rise to it. Thus, FGIC's

rights under any Plan to claim payment from its reinsurers, including from Assured, must be subject to appropriate terms protecting, through recoupment, offset, or allowance of an administrative or secured claim, reinsurers' rights to payment of subrogation recoveries due under the same reinsurance agreements.

Thus, if a cedent can claim from its reinsurer only a net amount, as calculated under the terms of the reinsurance agreement, a receiver for the cedent can claim no more. The doctrine of recoupment applies here to enforce the principle that the Rehabilitator cannot obtain greater payment rights or property rights to proceeds of subrogation, salvage and other recoveries under its agreements with Assured than are expressly provided for in those contracts.

As a general matter, the common law right to offset allows entities that owe each other money to apply their mutual debts against each other thereby avoiding the "absurdity of making A pay B when B owes A." *Studley v. Boylston Nat'l Bank of Boston,* 229 U.S. 523, 528, 335 S.Ct. 806, 808, 57 L.Ed. 1313 (1913). This right is long recognized in the common law and is preserved in insolvency proceedings, even though it effectively "prefers" the offsetting creditor. *See Bohack Corp. v. Borden, Inc.,* 599 F.2d 1160, 1165 (2d Cir. 1979) (setoff reasoned to be an extraordinary remedy, permitted in bankruptcy jurisprudence even though it effects a preference). In every state, including New York, *see* N.Y. Ins. Law § 7427, the law governing insolvency of insurers incorporates this common law by allowing, with certain exceptions, the set off of "mutual" debts and credits. *See also Kemper Reinsurance Co. v. Corcoran (In re Liquidation of Midland Ins. Co.),* 79 N.Y.2d 253; 590 N.E.2d 1186, 1190 (N.Y. 1992) ("The general rule, recognized by courts and commentators alike, holds that mutual debts [*sic*] and

credits between parties may be set off even though they arise from different transactions."). 7

Thus, if the Plan were to cause FGIC to breach the terms of one of its agreements with Assured, Assured could offset or recoup the damages caused by such breach from reinsurance payments owed to FGIC under the same or other reinsurance agreements, as the case may be. Rather than leave FGIC to breach its contracts and reinsurers to exercise their remedies in disputed proceedings, the Plan should be amended to recognize expressly reinsurers' rights to offset, as well as to recoup, balances under reinsurance agreements.

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7 Offset can be distinguished from recoupment in that recoupment applies where the parties' obligations to each other arise from the same transaction or related series of transactions, and is not available when the debts between the parties arise from unrelated events or transactions. The ability of a reinsurer to "recoup" amounts due to it from the cedent under the reinsurance agreement broadens the relief available to reinsurer under a reinsurance agreement, in the event of the cedent's insolvency, because it is an equitable defense, and like a compulsory counterclaim, is not limited by statute. The defense of recoupment may be asserted even if the obligations to be netted arose at different times in relation to the Delinquency Proceeding (for example, one arising before the Delinquency Proceeding was begun and the other after) provided that the obligations to be recouped relate to the same parties and same transaction.

CONCLUSION

For the reasons set forth above, the Plan as currently proposed would breach FGIC's obligations under its reinsurance agreements and jeopardize potentially significant reinsurance assets, and thus cannot be confirmed on this basis. Accordingly, the Court should require revision of the Plan to include the Proposed Amendments set forth herein.

Absent such amendments, the Court should deny the Rehabilitator's application for approval of the Plan.

New York, New York
November 19, 2012

Respectfully Submitted,

By: _____

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Rehabilitation of	:	Index No. 401265/2012
FINANCIAL GUARANTY INSURANCE COMPANY,	:	I.A.S. No. 36
	:	Hon. Doris Ling-Cohan
	:	Motion Seq. 004

AFFIDAVIT OF PHILIP R. KASTELLEC

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

Philip R. Kastellec, having been duly sworn, does hereby depose and say as follows:

1. I am an attorney admitted in New York and am Deputy General Counsel to Assured Guaranty Corp.

2. I submit this affidavit in opposition to the application by Benjamin F. Lawsky, Superintendent of Financial Services of the State of New York, as rehabilitator (the "Rehabilitator") of Financial Guaranty Insurance Company ("FGIC"), for approval of the Plan of Rehabilitation (the "Plan") filed with this Court on September 27, 2012 as Exhibit B to the Affirmation of Gary T. Holtzer ("Holtzer Aff.").

3. I base the statements made in this affidavit based on the records of Assured Guaranty Corp., Assured Guaranty Re Ltd. ("AGRe") and Assured Guaranty Re Overseas Ltd. ("AGRO")

(referred to herein, collectively, as "Assured"), and on my knowledge of such records and information gathered for me in my capacity as Deputy General Counsel of Assured Guaranty Corp.

4. FGIC and Assured are parties to reinsurance agreements covering a combined gross par outstanding amount of several billion dollars in ceded liabilities.

5. According to Assured's records, FGIC ceded outstanding par as of March 31, 2012 of the following amounts: (1) $1,740,320,106 to AGRe, (2) $406,653,070 to AGC, and (3) $1,728 ,418 to AGRO. These amounts differ from the amounts reported in the Disclosure Statement in Support of the Plan, which is annexed as Exhibit D to the Holtzer Affirmation.

6. Each of the reinsurance agreements between FGIC and Assured contains provisions governing the parties' respective rights, duties and obligations in respect of subrogation, salvage and other recoveries and claims handling. Each of the reinsurance agreements also contains a clause addressing the parties' rights and obligations in the event of the insolvency of FGIC. The 2004 Facultative Reinsurance Agreement (Agreement No. 60002), to which FGIC and Assured Guaranty Re International, Ltd. are parties (the "2004 Facultative Agreement"), is one of the agreements between the parties. A true copy of the 2004 Facultative Agreement is attached hereto as Exhibit A.

PHILIP R. KASTELLEC

Sworn to before me
This 19th day of November, 2012

Notary Public

SPENCER L. LEUENBERGER
Notary Public, State of New York
No.01LE6247272
Qualified in New York County
Commission Expires August 22, 2015

EXHIBIT A

FACULTATIVE REINSURANCE AGREEMENT
(hereinafter referred to as the "Agreement")

between

FINANCIAL GUARANTY INSURANCE COMPANY
however named and operating in the United States of America
and each other applicable jurisdiction
(hereinafter referred to as the "Company")

and

ASSURED GUARANTY RE INTERNATIONAL LTD.
(hereinafter referred to as the "Reinsurer")

Wherever the word "Company" is used in this Agreement, such term shall be held to include any and all assumed names of the Company under which it operates or may operate in the United States of America and each other applicable jurisdiction provided that notice be given to the Reinsurer of any such assumed name as soon as practicable, with full particulars as to any effect on this Agreement.

In consideration of the mutual covenants and upon the terms and conditions set forth in this Agreement, Financial Guaranty Insurance Company, as the reinsured, Assured Guaranty Re International Ltd., as the reinsurer, hereby agree as follows:

ARTICLE I

BUSINESS COVERED

The Company hereby cedes as reinsurance to the Reinsurer, and the Reinsurer hereby accepts as reinsurance, and agrees to indemnify the Company for, the Reinsurer's percentage or other applicable share (the "Reinsurer's Share") of Losses, as defined herein, with respect to each Policy, as defined herein (each a "Covered Policy" and collectively the "Covered Policies") as specified in a Reinsurance Memorandum substantially in the form of Exhibit A annexed to this Agreement, or in such other form as the parties may approve (a "Reinsurance Memorandum").

The Reinsurer shall have the right, in its sole discretion, to reject or accept any individual risk presented to the Reinsurer by the Company pursuant to a duly completed Reinsurance Memorandum. Subject to the second succeeding paragraph, the Reinsurer shall not be bound hereunder on any individual risk unless it first has given its approval by providing

the Company with a copy of the Reinsurance Memorandum for that particular risk signed by or on behalf of the Reinsurer. The Reinsurer shall either return the signed Reinsurance Memorandum or notify the Company of its decision not to assume a particular risk as soon as practicable. Execution of a Reinsurance Memorandum by or on behalf of the Reinsurer shall be conclusive evidence of the Reinsurer's acceptance of a particular risk, and the Reinsurer shall be bound to provide coverage under this Agreement in accordance with the terms and conditions of the Company's policy, insurance contract, surety bond, financial guarantee or reinsurance agreement covering such risk, whether directly written by the Company or assumed by the Company through a reinsurance or other agreement, including reinsurance agreements covering risks ceded to the Company by a Company affiliate (the "Policy" or "Policies") and shall be subject in all respects to all the general and specific stipulations, clauses, waivers, extensions, modifications, alterations, cancellations, interpretations and endorsements of any of the Policies, as modified by any particular terms and conditions of coverage with respect to such risk specified in the Reinsurance Memorandum pertaining to that risk. The Reinsurer's liability shall attach as of the effective date of the Policy, unless the Reinsurance Memorandum provides for a different date.

The Reinsurer's Share of the risks insured by the Company under Policies covered by this Agreement shall be separate and apart from the shares of any other reinsurers or retrocessionaires assuming such risks. The Reinsurer's obligations pursuant to this Agreement shall not be joint or considered co-insurance with any other reinsurer or retrocessionaire and in no event shall the Reinsurer's liabilities and obligations pursuant to this Agreement be reduced or otherwise limited by any other reinsurance.

Notwithstanding the foregoing provisions of this Article I, the parties hereto acknowledge that the Company may, from time to time, request (either orally or in writing) that the Reinsurer commit to provide reinsurance under this Agreement in respect of the risk or risks referred to in such request. Any such request by the Company shall include as much of the information called for by the form of Reinsurance Memorandum as shall then be reasonably available to the Company, but may provide ranges in respect of amounts of coverage requested, premium rates and (if applicable) commissions payable, and good faith estimates of other relevant information. Upon receipt of any such request, the Reinsurer shall either furnish the Company with a written commitment, which shall refer to this Agreement and identify the risk or risks to be reinsured by the Reinsurer pursuant hereto, state that the Reinsurer commits to reinsure such risk or risks pursuant to this Agreement, and specify any additional terms or conditions to the Reinsurer's commitment, or notify the Company of its decision not to reinsure such risk as soon as practicable. Once the Reinsurer has provided the Company with a written commitment to reinsure a particular risk hereunder, the Reinsurer shall be bound to provide coverage under this Agreement in accordance with the terms and conditions of this Agreement and the terms and conditions of the underlying Policy covering the risk, as and when issued by the Company, as modified by any particular terms or conditions of coverage with respect to such risk as may be specified in the Reinsurer's written commitment. In such event, the Company agrees to prepare, as promptly as reasonably practicable, consistent

with its usual business practices, a Reinsurance Memorandum pertaining to the risk so reinsured, setting out all of the information required by the Reinsurance Memorandum, and the Company and the Reinsurer shall execute such Reinsurance Memorandum to memorialize the details concerning the risk so reinsured hereunder; provided, however, that the failure by the Company to so prepare or the Reinsurer to execute a Reinsurance Memorandum in respect of any risk which the Reinsurer has committed to reinsure in accordance with the foregoing provisions of this paragraph shall not relieve the Reinsurer from its liability in respect of said risk under this Agreement and the applicable Policy. In such event, the applicable written commitment shall be considered a Reinsurance Memorandum for all purposes of this Agreement.

In the event of a refinancing (whether by refunding or otherwise) of the obligations insured under a Policy (the "Refinanced Obligations") by the issuance of new obligations that are insured by the Company (the "Refinancing Obligations"), including any Refinancing Obligations issued to prevent, mitigate or satisfy a claim under the Policy or a Loss hereunder, at the Company's election exercisable within thirty (30) days after the issuance of the Refinancing Obligations, the Reinsurer shall automatically assume under this Agreement the same Reinsurer's Share of the Refinancing Obligations as the Reinsurer assumed of the Refinanced Obligations. Any Policy issued by the Company in respect of the Refinancing Obligations as to which the Company makes such election shall be deemed to be a Policy hereunder and subject to the Reinsurance Memorandum applicable to the Policy covering the Refinanced Obligations.

ARTICLE II

TERM; AMENDMENT

A. This Agreement shall commence as of 12:01 a.m., Eastern Time, December 23, 2004, and shall remain in full force and effect until this Agreement is terminated by the mutual written consent of the Company and the Reinsurer or by the Company as provided in Article XIX hereof.

B. This Agreement may only be amended by written agreement of the Company and the Reinsurer. Any such amendment shall conform to the requirements of Section 6906(a) of the New York Insurance Law.

ARTICLE III

TERRITORY

This Agreement applies to Losses arising out of any Policy written or reinsured by the Company in any jurisdiction.

ARTICLE IV

LOSSES AND LOSS ADJUSTMENT EXPENSES

A. The Reinsurer shall pay to the Company the Reinsurer's Share of any Losses (as defined below) under or in connection with the Covered Policies. For all purposes of this Agreement, unless the context expressly requires otherwise, the word "Loss" (including for the avoidance of doubt the word "Losses") shall mean and include (i) such amounts as are actually paid by the Company in settlement or satisfaction of claims under or in respect of Covered Policies or in settlement or satisfaction of any litigation or other proceedings seeking payment of such claims, including judgments or other awards arising therefrom (including prejudgment interest when added to a judgment), and (ii) any and all Allocated Loss Adjustment Expenses (as defined below). In the event of insolvency of the Company, "Loss" shall mean and include such amount of Loss as the Company actually would have been required to pay, and payment by the Reinsurer shall be made to the liquidator, receiver, conservator or other statutory successor of the Company in accordance with the provisions of Article XVI of this Agreement. If the settlement or satisfaction of a Loss involves the issuance of Refinancing Obligations that are insured by the Company, the Reinsurer shall be deemed to have assumed (without further action on the part of the Company or the Reinsurer) the same proportionate share of the Refinancing Obligations as the Reinsurer had assumed of the Refinanced Obligations as though the Refinancing Obligations were issued on the same date in the same underwriting year as the Refinanced Obligations. "Loss" shall not include punitive or bad faith damages or other extracontractual liability asserted against Company, its officers, directors, employees or agents.

B. The term "Allocated Loss Adjustment Expenses" shall include but not be limited to: (i) expenses and costs incurred or sustained in connection with mitigation, investigation, adjustment, settlement, workout, defense and litigation of claims and suits, satisfaction of judgments and other awards, resistance to or negotiations concerning a Loss or potential Loss; (ii) legal and other expenses and costs incurred or sustained in connection with (A) coverage questions regarding any potential claim or Loss, and legal actions, including declaratory judgment actions, relating thereto, (B) Loss prevention, mitigation or investigation in respect of any Covered Policies as to which the Company has posted a loss reserve, (C) the investigation or workout of a Loss or potential Loss, or (D) the protection, perfection and exercise of any subrogation or salvage or reimbursement rights or security interests relating to any Covered Policies, (iii) all interest on judgments other than prejudgment interest when added to a judgment, and (iv) legal and other expenses and costs incurred or sustained to obtain recoveries, salvages or other reimbursements, or to secure the reversal or reduction of a verdict, judgment or award. Allocated Loss Adjustment Expenses shall not include the expenses and the pro rata share of the salaries of the officers or employees of the Company or its affiliates.

C. The Company shall have complete and sole control of and direction of all activities, efforts and decisions relating to Covered Policies and the risks ceded under this Agreement, including but not limited to all activities, efforts and decisions to:

1. Mitigate, investigate, negotiate, settle or defend a Loss or potential Loss;

2. Prevent, mitigate or investigate a probable Loss or potential Loss under Covered Policies as to which the Company has posted a loss reserve;

3. Investigate and work out a Loss or potential Loss; and

4. Protect, perfect and exercise any Recovery (as defined in the following paragraph) or security interests or other rights relating to any Covered Policy and may take any action as it may deem advisable with respect thereto.

All Loss settlements by the Company, all Recovery settlements and all settlements with an issuer or obligor (an "Issuer") with respect to obligations insured under a Policy (including deficiencies resulting therefrom) shall be final, conclusive and unconditionally binding upon the Reinsurer, and the Reinsurer agrees to pay or allow, as the case may be, the Reinsurer's Share of each such settlement in accordance with this Agreement. For purposes of this Agreement, "Recovery" shall mean any amount actually received by the Company in reimbursement of any Loss covered by the Reinsurer under this Agreement, whether by subrogation, salvage, reimbursement or other recovery from the Issuer or otherwise. The Company shall credit the Reinsurer with a percentage of any Recovery received or recovered by the Company, such percentage to equal the Reinsurer's Share of the Loss to which the Recovery relates. If any Recovery in a form other than cash when received or recovered by the Company, the cash value of such Recovery shall be credited to the Reinsurer when such recovery or salvage is converted to cash by the Company. The cash value of such Recovery shall be the cash value as of the date of conversion to cash by the Company. This provision shall remain in effect until all Recoveries have been obtained, in the Company's sole discretion.

E. It shall be the responsibility of the Company to investigate and manage claims and suits involving the Covered Policies to their final determination.

F. Notwithstanding the foregoing, in the event that the Reinsurer's obligation with respect to Losses to be covered by the Reinsurer under any Policy is subject to a limitation, then the calculation of Losses paid under such Policy shall be without regard to Allocated Loss Adjustment Expenses or any prejudgment interest when added to a judgment in respect of such Loss.

ARTICLE V

REINSURANCE FOLLOWS ORIGINAL POLICIES

A. Except to the extent otherwise specified as to any particular Covered Policy or Policies in the related Reinsurance Memorandum or as otherwise agreed between the Company and the Reinsurer in writing, all reinsurance under this Agreement shall be subject in all respects to the same rates, terms, conditions, waivers and interpretations, and to the same modifications, cancellations and alterations as the respective Covered Policies of the Company to which such reinsurance relates, the true intent of this Agreement being that the Reinsurer shall, in every case to which this Agreement applies, and in the proportion or manner specified in the related Reinsurance Memorandum, follow the fortunes of the Company; provided, however, that this Article shall not be construed to expand the liability of the Reinsurer beyond what is specifically assumed under this Agreement.

B. The Reinsurer shall be bound by the judgment of the Company as to the obligation(s) and liability(ies) of the Company under any original insurance or reinsurance. The Reinsurer acknowledges the Company's obligations to make payment under its Policies are unconditional, irrevocable and non-cancellable by the Company for any reason and that the Company has waived, and agreed not to assert, any and all rights (whether by counterclaim, set-off or otherwise) and defenses (including, without limitation, any defense of fraud or any defense based on misrepresentation, breach of warranty, or non-disclosure of information by any person) whether acquired by subrogation, assignment or otherwise to the extent such rights and defenses may be available to the Company to avoid payment of its obligations under any Policy in accordance with the express provisions of any Policy.

C. Nothing herein shall in any manner create any obligations or establish any rights against the Reinsurer in favor of any third party or any person not party to this Agreement.

D. Except to the extent otherwise specified as to any particular Covered Policy or Policies in the related Reinsurance Memorandum or as otherwise agreed between the Company and the Reinsurer in writing, if the Company returns premium to the owner of a Covered Policy on account of the cancellation of or reduction of risk under such Policy the Reinsurer shall reimburse the Company for the Reinsurer's applicable share of the unearned premium reserve related to the portion of the premium returned by the Company with respect to such Covered Policy (net of ceding commissions, if applicable).

ARTICLE VI

PREMIUMS AND COMMISSIONS

The Company shall pay to the Reinsurer the Reinsurer's Share of the amount of all premiums and fees in lieu of premium actually received by the Company with respect to each Covered Policy (the "Reinsurance Premium"), after deducting (if and to the extent so agreed or provided) any ceding commission allowed by the Reinsurer, all as more particularly set forth in the Reinsurance Memorandum relating to the particular Covered Policy. For illustration only, and without limiting the foregoing, the Company shall retain with respect to a Covered Policy, and shall not pay to the Reinsurer any portion of, (i) fees which would otherwise be payable to the Company irrespective of the issuance of a Policy; (ii) fees representing payment for Company employee services of an extraordinary nature occasioned by the unusual features of a Covered Policy or (iii) fees representing reimbursement of, or anticipated future payment of, out-of-pocket expenses. Except to the extent otherwise specified as to any particular Covered Policy in the related Reinsurance Memorandum, or as separately agreed between the Company and the Reinsurer in writing, the Reinsurance Premium shall be payable in arrears within thirty (30) days after the end of the month during which the Company receives the Reinsurance Memorandum signed by the Reinsurer. Any subsequent premium installments received by the Company in respect of such Covered Policy shall be payable in arrears, included in the calculation, and paid as provided in, Article VII.

ARTICLE VII

REPORTS AND REMITTANCES

A. Within thirty (30) days after the end of each month, the Company shall furnish the Reinsurer with a report (the "Monthly Report"), in a mutually acceptable form, which shall contain a report of the Reinsurer's Share of the Reinsurance Premium due with respect to the applicable month pursuant to Article VI. Such Reinsurance Premium shall be due and payable within forty-five (45) days after the end of the month to which the Reinsurance Premium relates.

B. Within thirty (30) days following the end of each quarter, the Company shall furnish the Reinsurer a quarterly statement (the "Quarterly Statement") showing (i) unearned premium reserves, (ii) Losses paid (broken out to show all applicable categories of Loss), segregated by underwriting year (i.e., year of Policy issuance), (iii) applicable loss reserves, (iv) contingency reserves and (v) such additional information as may be required by the Reinsurer for completion of its statutory annual statements or to comply with any Rating Agency (as such term is defined in Article XIX) requirements. Within fifteen (15) days following the receipt of such Quarterly Statement, the Reinsurer shall pay the Reinsurer's share of Losses paid by the Company during the quarter, less amounts paid by the Reinsurer pursuant to Clause C below and not refunded by the Company. Within forty five (45) days following the end of each quarter, the Company shall pay the

Reinsurer the Reinsurer's portion of subrogation, salvage and other Recoveries actually received by the Company with respect to Covered Policies during the quarter.

C. Should payment due from the Reinsurer exceed five-hundred thousand dollars ($500,000) as respects any one Loss, the Company may give the Reinsurer notice of payment made or its intention to make payment on a certain date. If the Company has paid the Loss, payment shall be due from the Reinsurer immediately, but shall be paid in no event later than two (2) Business Days after receipt of the notice to dispatch such payment. If the Company intends to pay the Loss by a certain date and has submitted a satisfactory proof of Loss or similar document, payment shall be due from the Reinsurer twenty-four (24) hours prior to that date, provided the Reinsurer shall have a period of two (2) Business Days after receipt of said notice to dispatch the payment. Should the Company not make such payment on the date specified, and the Company does not anticipate making such payment within ten (10) days thereafter, the payment shall be refunded to the Reinsurer. Amounts specifically remitted by the Reinsurer as set forth herein shall be credited to its next quarterly account. If the Reinsurer shall dispute the amount owing as set forth in the Quarterly Report, the Reinsurer nevertheless shall pay the amount in dispute to the Company as provided in this paragraph pending resolution of the dispute as provided in this Agreement. For purposes of this Agreement, "Business Day" means any day other than a day on which banks in the State of New York or in Bermuda are permitted or required to be closed.

ARTICLE VIII

OFFSET

The Company and the Reinsurer may offset any balance or amount, whether on account of premiums, premium adjustments, commissions, claims, Losses, salvage, or otherwise, due from one party to the other under this Agreement or any Reinsurance Memorandum or any other reinsurance agreement between the parties. The party asserting the right of offset may exercise such right at any time whether the balance(s) due are on account of premiums or Losses or otherwise. In the event of the insolvency of a party hereto, offsets shall only be allowed in accordance with applicable law, including Section 7427 of the New York Insurance Law.

ARTICLE IX

INDEMNIFICATION; ERRORS AND OMISSIONS

A. Any recitals in this Agreement of the terms and provisions of any original insurance or reinsurance are merely descriptive. The Reinsurer is reinsuring, to the amount herein provided, the obligations of the Company under any original insurance or reinsurance. The Company shall be the sole judge as to (i) what shall constitute a claim or Loss covered under any original insurance or reinsurance of the Company; (ii) the

Company's liability thereunder; and (iii) the amount or amounts which it shall be proper for the Company to pay thereunder.

B. The Reinsurer shall be bound by the judgment of the Company as to the obligation(s) and liability(ies) of the Company under any original insurance or reinsurance subject to the terms and conditions of this Agreement.

C. Inadvertent delays, errors or omissions made in connection with this Agreement shall not relieve either party from any liability which would have attached had such delay, error or omission not occurred, provided always that such delay, error or omission shall be rectified promptly after discovery by the Company's home office.

ARTICLE X

CURRENCY

A. Whenever the word "Dollars" or "dollars" or the "$" sign appears in this Agreement, they shall be construed to mean United States Dollars and all transactions and reports pursuant to this Agreement shall be in United States Dollars except as otherwise provided herein.

B. Premiums and Loss payments in a currency other than the currency stated shall be converted at the rate of exchange adopted by the Company (such rate of exchange being available on nationally recognized currency exchanges) at the time of conversion of the currency, and such rate of exchange shall be conclusive and binding on the Reinsurer.

C. Premiums (including installment premiums) paid to the Company in other than United States Dollars shall be paid by the Company to the Reinsurer in United States Dollars at the rates of exchange at which the Company converted such currency to Dollars.

D. Losses or other amounts paid by the Company in other than United States Dollars shall, at the option of the Company, be paid by the Reinsurer in United States Dollars or in the applicable foreign currency or in United States Dollars-at the same rates of exchange at which the Company converted Dollars to such foreign currency.

ARTICLE XI

ACCESS TO RECORDS

To the extent not prohibited or restricted by any applicable law, the Reinsurer or its duly authorized representative shall have access to the books and records of the Company at all reasonable times for the purpose of obtaining information concerning this Agreement or the subject matter hereof. In addition, the Company or its authorized representatives

shall have access to the books and records of the Reinsurer, at all reasonable times for the purpose of obtaining information concerning this Agreement or the subject matter hereof.

The Reinsurer shall provide the Company with its annual and, to the extent available, quarterly or semi-annual financial statements (in English) promptly after such statements become available for distribution to the public and, if requested by the Reinsurer, the Company shall provide the Reinsurer with its annual and, to the extent available, quarterly or semi-annual financial statements (in English) promptly after such statements become available for distribution to the public.

ARTICLE XII

TAXES

In consideration of the terms under which this Agreement is issued, the Company undertakes not to claim any deduction of the premium hereon when making tax returns, other than Income or Profits Tax returns, to any state or territory of the United States of America or to the District of Columbia.

ARTICLE XIII

FEDERAL EXCISE TAX

(Applicable to any Reinsurer, excepting Underwriters at Lloyd's London and other Reinsurers exempt from Federal Excise Tax, who is domiciled outside the United States of America.)

A. The Reinsurer hereby agrees to allow for the purpose of paying the Federal Excise Tax the applicable percentage (currently 1%) of the premium payable hereon (as imposed under Section 4371 of the Internal Revenue Code) to the extent such premium is subject to the Federal Excise Tax.

B. In the event of any return of premium becoming due hereunder, the Reinsurer shall deduct the applicable percentage from the return premium payable hereon and the Company or its agent shall take steps to recover the tax from the United States Government.

ARTICLE XIV

STATUTORY FINANCIAL STATEMENT CREDIT

The Reinsurer shall take all steps necessary to comply with all applicable laws and regulations so as to permit the Company to obtain full financial statement credit for the reinsurance provided by this Agreement in all applicable jurisdictions, including without limitation compliance with Section 6906 of the New York Insurance Law. It is

understood and agreed that any term or condition required by any such laws or regulations to be included in this Agreement for the Company to receive financial statement credit for the reinsurance provided by this Agreement shall be deemed to be incorporated in this Agreement.

A. DEPOSIT

Where required by applicable law in order for the Company to take financial credit for the reinsurance provided by this Agreement, the Company shall be entitled to withhold from the Reinsurer as security for the payment of the Reinsurer's obligations, an amount herein called the "Deposit." The Deposit shall equal the Reinsurer's Share of (i) Losses paid by the Company but not yet recovered from the Reinsurer and (ii) the Company's contingency reserves, unearned premium reserves and loss reserves relating to Covered Policies, as determined by the Company on the basis of the requirements of applicable law. The Company shall be entitled to use the Deposit to pay any amounts due to the Company hereunder from the Reinsurer, including, without limitation, payment or reimbursement of Losses, loss reserves, unearned premiums, unearned premium reserves and premiums returned to insureds in respect of any Covered Policy. The Deposit shall be evaluated and adjusted quarterly.

At any time after default or anticipatory default by the Reinsurer in payments owing to the Company under this Agreement (and the expiration of any applicable cure period), the Company may appropriate so much of the Deposit as may be required to eliminate the default.

The Company may at its discretion, in lieu of taking any part of the Deposit, require payment of any sum in default, and it shall be no defense to any such claim that the Company might have had recourse to the Deposit.

Upon termination of this Agreement, if the Company reassumes any cessions hereunder from the Reinsurer, it shall credit the Reinsurer with the balance of the accumulated Deposit as of such reassumption date. If the cessions in force are allowed to run to their normal expiry, the Deposit shall be adjusted quarterly.

At its option, the Reinsurer may substitute a Letter of Credit or a Trust Account (defined below) for the Deposit, provided that such substitution complies with applicable law. Should such substitution be made, notwithstanding any other provisions of this Agreement, the Letter of Credit or Trust Account may be drawn upon by the Company at any time to fund the Deposit or for any amounts due from the Reinsurer under this Agreement to the extent permitted by applicable law and the following provisions.

The Company and the Reinsurer agree that the Deposit, Letter of Credit or Trust Account will be in such form and held in such manner so as to allow the Company to take financial credit for the reinsurance provided by this Agreement and also allow, if

possible, the Reinsurer to treat the Deposit, the Letter of Credit or assets in the Trust Account as an admitted asset in accordance with applicable law.

B. LETTER OF CREDIT:

If the Reinsurer elects to substitute a Letter of Credit for the Deposit, the following provisions shall apply to the Reinsurer:

The Reinsurer hereby agrees that it will apply for, and secure delivery to the Company of, a clean, unconditional, irrevocable letter of credit (a "Letter of Credit"), payable in dollars, to be issued on or before the commencement date of this Agreement and thereafter on or before December 31 of each year in which Covered Policies remain outstanding, which Letter of Credit will be issued or confirmed by a bank and shall be in a form that complies with all applicable requirements of regulatory authorities having jurisdiction over the Company, in such amount, and at such time, as is required by Clause A above. If the issuing or confirming bank shall cease to meet such requirements during the term of the Letter of Credit, the Reinsurer shall replace such Letter of Credit with one complying with the provisions of this subsection upon the earlier of the stated expiration, next extension or renewal date, or modification or amendment of the Letter of Credit. Such Letter of Credit shall provide for automatic extension of the Letter of Credit without amendment for one year from the date of expiration of said Letter or any future expiration date unless thirty (30) days prior to any expiration the issuing bank shall notify the Company by registered mail that the issuing bank elects not to consider the Letter of Credit renewed for any additional period.

The Reinsurer hereby grants to the Company, and any of its successors in interest (including, without limitation, any liquidator, receiver, conservator or other statutory successor of the Company), control over the authority to draw at any time on any Letter of Credit delivered by such Reinsurer pursuant to this Article, notwithstanding any other provisions herein. Without limiting the generality of the foregoing, the Company is expressly authorized to draw the full amount of the Letter of Credit provided hereunder by the Reinsurer upon the occurrence of an Insolvency Event (as hereinafter defined) or event which, with the giving of notice or the passage of time or both, would constitute an Insolvency Event with respect to the Reinsurer or in the event that such Letter of Credit is within ten (10) days of expiring and has not been replaced by a Letter of Credit with an extended term of one year and otherwise meeting the conditions hereof. The Company shall hold the proceeds of any draw on a Letter of Credit provided by the Reinsurer pursuant to this Article in a segregated bank account in the name of the Company and shall be entitled to use such proceeds (including any investment earnings) to pay any amounts due to the Company hereunder from the Reinsurer, including, without limitation, payment or reimbursement of Losses, loss reserves, unearned premiums, unearned premium reserves and premiums returned to insureds in respect of any Covered Policy. At such time as the Company determines that the Reinsurer shall have no further actual or contingent liability to it hereunder or in respect of the Policies reinsured hereunder, any remaining amounts on deposit in such account and attributable to draws on the Letter of

Credit provided by the Reinsurer shall be returned to the Reinsurer or applied in accordance with applicable law. Any and all payments hereunder shall be made and applied without diminution because of any Insolvency Event with respect to the Company or the Reinsurer, as the case may be.

The designated banks shall have no responsibility whatsoever in connection with the propriety of draws on any Letter of Credit made by the Company or the disposition of funds drawn, except to see that any such draws are made only upon the order of authorized representatives of the Company.

C. COLLATERAL TRUST ACCOUNT

If the Reinsurer elects to substitute a Trust Account for the Deposit, the following provisions shall apply to the Reinsurer:

(a) The Reinsurer shall deposit assets in a trust account (a "Trust Account") in such amount, and at such time, as is required by Clause A above. The Reinsurer shall enter into a trust agreement with the Company and a bank acceptable to the Company which is a member of the United States Federal Reserve System or is a New York State chartered bank (the "Trustee") for the purpose of establishing the Trust Account for the exclusive benefit and use of the Company. The Trust Account shall consist solely of cash (United States legal tender), certificates of deposit (issued by a United States bank and payable in United States legal tender), and investments of the types specified in subsections (1), (2), (3), (8) and (10) of Section 1404(a) of the New York Insurance Law, as amended from time to time, or any successor provision of law, provided that such investments are issued by an institution that is not the parent, subsidiary, or affiliate of either the Reinsurer or the Company. The trust agreement shall comply with the requirements of Title 11, Part 126 of the New York Code of Rules and Regulations (Insurance Regulation No. 114).

Prior to depositing assets with the Trustee, the Reinsurer shall execute assignments, endorsements in blank, or transfer legal title to the Trustee of all shares, obligations or other assets requiring assignments so that the Company, or the Trustee upon the direction of the Company, may whenever necessary negotiate any such assets without consent or signature from the Reinsurer or any other entity. The assets deposited in the Trust Account shall be valued, for the purpose of determining the extent thereof, according to their current fair market value on the date as of which such valuation is to be made. All settlements of account between the Company and the Reinsurer shall be made in cash or its equivalent.

The Reinsurer may, from time to time, while there is no deficiency in the Trust Account, request the Company to withdraw from the Trust Account all or any part of the assets contained therein, and the Company shall deliver same to the Reinsurer or to its order, if it first replaces the withdrawn assets with other qualified assets of equal value approved by the Company so that at all times the market value of the Trust Account is not

less than the amount required to be on deposit. The Company shall not unreasonably or arbitrarily withhold its approval. The Reinsurer shall have the full and unqualified right to vote and execute consents with respect to any shares of voting stock deposited.

(c) The Company, and any of its successors in interest (including, without limitation, any liquidator, receiver, conservator or other statutory successor of the Company), may withdraw assets from the Trust Account at any time and from time to time, notwithstanding any other provisions herein. The Company shall be entitled to use the amounts on deposit (including any investment earnings) (i) to pay any amounts due to the Company hereunder from the Reinsurer, including, without limitation, payment or reimbursement of Losses, loss reserves, unearned premiums, unearned premium reserves and premiums returned to insureds in respect of any Covered Policy, or (ii) to fund an account with the Company in an amount equal to the deduction, for reinsurance ceded, from the Company's liabilities for Covered Policies (such amount shall include, but shall not be limited to, amounts for Loss reserves, contingency reserves and unearned premium reserves), or (iii) to return to the Reinsurer any amounts in excess of 102% of the amount required to be on deposit so long as an Insolvency Event or an event which, with the giving of notice or the passage of time or both, would constitute an Insolvency Event with respect to such Reinsurer has not occurred, or (iv) at such time as the Company determines that the Reinsurer shall have no further actual or contingent liability to it hereunder or in respect of the Policies reinsured hereunder, any remaining amounts on deposit in the Trust Account shall be returned to the Reinsurer or applied in accordance with applicable law. Any and all payments hereunder shall be made and applied without diminution because of any Insolvency Event with respect to the Company or any Reinsurer, as the case may be.

(d) The designated bank shall have no responsibility whatsoever in connection with the propriety of withdrawals from the Trust Account, or the disposition of funds withdrawn, except to see that withdrawals are made only upon the order of authorized representatives of the Company.

ARTICLE XV

NOTICE OF LOSS AND LOSS SETTLEMENTS

The Company shall give notice to the Reinsurer, as soon as reasonably practicable, of any occurrence which results in, or is likely in the Company's sole opinion to result in, a claim for Loss settlement, and the Company shall keep the Reinsurer advised of all subsequent material developments relating thereto. Failure to provide such notice shall not relieve the Reinsurer of any of its obligations hereunder.

The Reinsurer agrees to abide by the Loss settlements of the Company, such settlements to be construed as satisfactory proof of Loss.

ARTICLE XVI

INSOLVENCY OF THE COMPANY

A. In the event of insolvency and the appointment of a conservator, liquidator, or statutory successor of the Company, the portion of any risk or obligation assumed by the Reinsurer shall be payable to the Company or its conservator, liquidator, or statutory successor on the basis of the liability of the Company under the Policies, without diminution because of that insolvency, or because the conservator, liquidator, or statutory successor has failed to pay all or a portion of any claims.

B. Payments by the Reinsurer as above set forth shall be made directly to the Company or to its conservator, liquidator, or statutory successor.

C. In the event of the insolvency of the Company, the liquidator, receiver, conservator or statutory successor of the Company shall give written notice to the Reinsurer of the pendency of a claim against the insolvent Company on the Policy or Policies reinsured within a reasonable time after such claim is filed in the insolvency proceeding and during the pendency of such claim any Reinsurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defense or defenses which it may deem available to the Company or its liquidator, receiver, conservator or statutory successor. The expense thus incurred by the Reinsurer shall be chargeable subject to court approval against the insolvent Company as part of the expense of liquidation to the extent of the share of the benefit which may accrue to the Company solely as a result of the defense undertaken by the Reinsurer.

ARTICLE XVII

ARBITRATION

A. Except as provided in Article XVIII, any dispute, claim or other matter in question between the Company and the Reinsurer arising out of, or relating to, the formation, interpretation, performance or breach of this Agreement, whether such dispute arises before or after termination of this Agreement, shall be settled by arbitration. Arbitration shall be initiated by the delivery of a written notice of demand for arbitration by one party to the other within a reasonable time after the dispute has arisen.

B. Each party shall appoint an individual as arbitrator and the two so appointed shall then appoint a third arbitrator. If either party refuses or neglects to appoint an arbitrator within sixty (60) days, the other party may appoint the second arbitrator. If the two arbitrators do not agree on a third arbitrator within sixty (60) days of their appointment, each of the arbitrators shall nominate three individuals. Each arbitrator shall then decline two of the nominations presented by the other arbitrator. The third arbitrator shall then be chosen from the remaining two nominations by drawing lots. The arbitrators shall be active or former officers of insurance or reinsurance companies or

Lloyd's Underwriters; the arbitrators shall not have a personal or financial interest in the result of the arbitration.

C. The arbitration hearings shall be held in New York, New York, or such other place as may be mutually agreed. Each party shall submit its case to the arbitrators within sixty (60) days of the selection of the third arbitrator or within such longer period as may be agreed by the arbitrators. The arbitrators shall not be obliged to follow judicial formalities or the rules of evidence except to the extent required by governing law, that is, the state law of the situs of the arbitration as herein agreed; they shall make their decisions according to the practice of the reinsurance business. The decision rendered by a majority of the arbitrators shall be final and binding on both parties. Such decision shall be a condition precedent to any right of legal action arising out of the arbitrated dispute which either party may have against the other. Judgment upon the award rendered may be entered in any court having jurisdiction thereof.

D. Each party shall pay the fee and expenses of its own arbitrator and one-half of the fee and expenses of the third arbitrator. All other expenses of the arbitration shall be equally divided between the parties.

E. Except as provided above, arbitration shall be based, insofar as applicable, upon either the arbitration procedures of ARIAS US or the Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes as the parties may agree or in the absence of any agreement, as the Company shall elect.

ARTICLE XVIII

SERVICE OF SUIT

(This Article shall apply only to a Reinsurer domiciled outside of the United States and/or unauthorized in any state, territory or district of the United States having jurisdiction over the Company.)

A. Notwithstanding the provisions of Article XVII, it is agreed that (i) in the event of the failure of the Reinsurer to pay any amount not disputed to be due under this Agreement or to perform any other agreement, covenant or obligation not disputed to be owing under this Agreement, (ii) in the event it is necessary for the Company to seek a stay of action brought in any jurisdiction to enforce the provisions of Article XVII or (iii) in the event of the failure of the Reinsurer to pay any amount determined to be due under this Agreement after arbitration, judgment confirming the arbitration award or the resolution of any appeals therefrom (or the time for taking such appeals having expired) or to perform any other agreement, covenant or obligation determined to be owing under this Agreement after arbitration as contemplated by Article XVII hereof, the Reinsurer irrevocably submits to the nonexclusive jurisdiction of any Federal or New York State court sitting in New York City over any suit, action or proceeding arising out of or relating to this Agreement. The Reinsurer irrevocably waives, to the fullest extent

permitted by law, any objection which it may now or hereafter have to the laying of the venue of any such suit, action or proceeding brought in such court and any claim that any suit, action or proceeding brought in such a court has been brought in an inconvenient forum. The Reinsurer agrees that a final judgment, not subject to any further appeal, in any such suit, action or proceeding brought in such a court shall be conclusive and binding upon it and will be given effect in the country of domicile of the Reinsurer to the fullest extent permitted by applicable law and may be enforced in any Federal or New York State court sitting in New York City (or any other courts to the jurisdiction of which the Reinsurer is or may be subject) by a suit upon such judgment, provided that service of process is effected upon it as specified in this Article as otherwise permitted by law. Nothing herein shall be deemed to limit or waive the Reinsurer's right to remove a suit, action or proceeding to Federal court or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States.

In any suit instituted against the Reinsurer upon this Agreement in accordance with the provisions of this Article, the Reinsurer will abide by the final decision of such court or of any appellate court in the event of an appeal.

B. Service of process in any such suit against the Reinsurer may be made upon LeBoeuf, Lamb, Greene & MacRae, LLP, 125 West 55th Street, New York, New York 10019 (the "Firm").

C. The above-named Firm is authorized and directed to accept service of process on behalf of the Reinsurer in any such suit and/or upon the request of the Company to give a written undertaking to the Company that it shall enter a general appearance on the Reinsurer's behalf in the event such a suit shall be instituted.

D. Further, as required by and pursuant to any statute of any state, territory or district of the United States which makes provision therefor, the Reinsurer hereby designates the Superintendent, Commissioner or Director of Insurance or other officer specified for that purpose in the statute, or his successor or successors in office, as their true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the Company or any beneficiary hereunder arising out of this Agreement, and hereby designates the above-named as the person to whom the said officer is authorized to mail such process or a true copy thereof.

E. The Reinsurer irrevocably waives, to the fullest extent permitted by law, all claims of error by reason of any such service and agrees that such service shall be deemed in every respect effective service of process upon the Reinsurer in any such suit, action or proceeding and shall, to the fullest extent permitted by law, be taken and held to be valid and personal service upon, and personal delivery to, the Reinsurer.

ARTICLE XIX

SPECIAL CANCELLATION

A. The Company shall have the right, in its sole discretion, to immediately terminate this Agreement and all Reinsurance Memoranda executed hereunder by giving the Reinsurer notice of termination upon the occurrence of any of the following events (each a "Special Cancellation Event"):

1. An Insolvency Event (as defined in C. below) shall have occurred with respect to the Reinsurer; or

2. The surplus to policyholders (as defined by the laws of the State of New York) of the Reinsurer falls below the greater of (i) seventy-five million dollars ($75,000,000) or (ii) the amount required by Section 6906 of the New York Insurance Law; or

3. The capital of the Reinsurer decreases in any fiscal year by an amount equal to or greater than 25% of the Reinsurer's capital as of the end of its immediately preceding fiscal year, such capital to be determined under the laws of its domicile jurisdiction; or

4. The Reinsurer (a) fails to pay any amount payable by it under this Agreement or any other reinsurance agreement or treaty between it and the Company when due, which failure shall not have been cured within one Business Day after written notice of such failure from the Company to the Reinsurer, or (b) fails to comply with any of the terms and conditions of this Agreement (other than a failure of the nature referred to in Clauses A.1, A.2, A.3, A.4(a), A.5, A.6, A.7, A.8, A.9, A.10 A.11, A.12, A.13 or A.14 of this Article), which failure under this Clause A.4(b) is not cured within ten (10) days of the Company's giving the Reinsurer written notice thereof; or

5. The Reinsurer stops writing financial guaranty reinsurance, and provides public notice thereof, in any medium or manner; or

6. If as of the effective date of this Agreement the obligations of the Reinsurer are directly or indirectly supported by a guaranty, capital maintenance agreement, deed of mutual guaranty or any other support agreement or arrangement from any affiliate or affiliates of the Reinsurer, such support agreement or arrangement ceases for whatever reason to be in full force and effect; or

7. There has occurred a Change in Control (as defined in D. below) of the Reinsurer; or

8. The Company or the Reinsurer is required to comply with Rating Agency provisions or requirements which reduce the credit for reinsurance given by any such Rating Agency to the Company in respect of the reinsurance provided by the Reinsurer under this Agreement (other than due to a Rating Agency action applicable generally to reinsurers described in A.9), as compared to such credit as of the effective date hereof; or

9. The Company or the Reinsurer is required to comply with Rating Agency provisions or requirements applicable generally to reinsurers which reduce the credit for reinsurance given by any such Rating Agency to the Company in respect of the reinsurance provided by the Reinsurer under this Agreement, as compared to such credit as of the effective date hereof and the Reinsurer has not, within ninety (90) days, provided collateral or other security sufficient to restore the Rating Agency credit that the Company received prior to said Rating Agency action; or

10. Any insurance regulator having appropriate jurisdiction directs the Company to cancel the Reinsurer's participation in this Agreement; or

11. The performance in whole or in part of this Agreement by the Company or the Reinsurer becomes prohibited or rendered impossible by any law, regulation or Rating Agency requirement; or

12. If at any time after the effective date of this Agreement, either (i) the Reinsurer's insurer financial strength rating or financial enhancement rating assigned by Standard & Poor's Ratings Services ("S&P") or the insurance financial strength rating assigned by Moody's Investors Service, Inc. ("Moody's") (S&P and Moody's are sometimes herein referred to individually as a "Rating Agency" and collectively as the "Rating Agencies") either is withdrawn or is reduced to one or more letter categories below the rating assigned to such Reinsurer by such Rating Agency as of the effective date of this Agreement, or (ii) the Reinsurer, for whatever reason, shall no longer be rated by each Rating Agency that rated the Reinsurer as of the effective date of this Agreement (for purposes of illustration only, and without limiting the generality of the foregoing, the following shall be deemed a reduction in the Reinsurer's letter category rating: the change from any "Triple A" rating category to any "Double-A" rating category, from any "Double-A" rating category to any "Single-A" rating category, or from any "Single-A" rating category to any lower rating category, as well as any equivalent or larger reduction).

Upon the occurrence of a Special Cancellation Event, the Company shall have the right (the "Reassumption Right"), at its option, to reassume all or any portion of the liability previously ceded to the Reinsurer under this Agreement in respect of all of the Covered

Policies (in the case of a partial reassumption, the same percentage for each Covered Policy), such reassumption to become effective on the date specified in such notice, or, if no date is specified, immediately upon the giving of such notice (such effective date being referred to herein as the "Notice Date"). The Company's Reassumption Right may be exercised at any time or from time to time for as long as the event referred to in A. above shall be continuing. Notwithstanding anything to the contrary contained herein, in exercising its Reassumption Right, the Company shall not be obligated to reassume any liability hereunder if such reassumption would result in the violation of any single risk limit applicable to the Company, whether imposed by law, regulation, Rating Agency or internal Company limit. The ratings of the Reinsurer referred to in paragraph A.12 above shall include published ratings or non-public ratings provided by the Rating Agencies, including as a result of guaranties or other facilities provided to, or collateral provided by, the Reinsurer or any affiliated company.

B. Upon any reassumption of liability by the Company pursuant to the provisions of Paragraph A. of this Article, the Reinsurer shall automatically and without any further action on the part of the Company be unconditionally obligated to pay to the Company the Reinsurer's Share (or applicable portion thereof) of any loss reserves maintained by the Company and any unearned premiums ceded by the Company, with respect to the Policies for which the Company shall have reassumed liability, within five (5) business days after the Notice Date. Notwithstanding anything herein to the contrary, this Agreement shall continue in full force and effect, and the Reinsurer shall remain obligated for the Reinsurer's Share, with respect to any liabilities or obligations under or in connection with Covered Policies for which the Company has not reassumed the liability of the Reinsurer, as well as for the Reinsurer's Share of any Losses (including Allocated Loss Adjustment Expenses) unpaid by the Reinsurer prior to such reassumption. In the event that the Company elects to reassume all liability previously ceded to the Reinsurer under this Agreement, then, upon payment by the Reinsurer to the Company of all amounts payable pursuant to this Paragraph B. or otherwise pursuant hereto, this Agreement shall terminate, except for the provisions of Article XVII, XVIII, XX, XXIII and XXIV hereof, which shall continue in full force and effect.

C. As used in this Agreement, the term "Insolvency Event" means, in respect of the Company or the Reinsurer, as the case may be, that (1) an involuntary bankruptcy, insolvency or similar proceeding shall be commenced or an involuntary petition shall be filed in a court of competent jurisdiction seeking (a) relief in respect of such entity or of all or substantially all of its property or assets under any applicable bankruptcy, insolvency, receivership or similar law, (b) the appointment of a receiver, trustee, custodian, sequestrator, conservator or similar official with respect to such entity or all or substantially all of its property or assets, or (c) the winding-up, liquidation or dissolution of such entity, and any such proceeding or petition shall continue undismissed for a period of 30 or more consecutive days or an order or decree approving or ordering any of the foregoing shall be entered, or (2) such entity shall (a) voluntarily commence any proceeding or file any petition seeking relief (or take any similar or analogous action) under any applicable bankruptcy, insolvency, receivership or similar law, (b) consent to

the institution of, or fail to contest in a timely and appropriate manner, any proceeding or the filing of any petition described in clause (1) above, (c) apply for or consent to the appointment of a receiver, trustee, custodian, sequestrator, conservator or similar official for such entity or for all or substantially all of its property or assets, (d) file an answer admitting the material allegations of a petition filed against it in any such proceeding, (e) make a general assignment for the benefit of its creditors, or (f) become unable, admit in writing its inability, or fail generally to pay its debts or contractual obligations as they become due.

D. As used in this Agreement, a "Change in Control" will be deemed to occur when an individual person, corporation or other entity acquires directly or indirectly more than twenty-five percent (25%) of the voting securities of the Reinsurer or obtains the power to vote (directly or through proxies) more than twenty-five percent (25%) of the voting securities of the Reinsurer, except if such individual person, corporation or other entity is under common control with the Reinsurer. The Reinsurer shall be required to notify the Company in writing (by certified letter) of any Change in Control or proposed Change of Control within 15 business days after the Reinsurer becomes aware of such Change in Control or proposed Change of Control.

ARTICLE XX

CONFIDENTIALITY

The Reinsurer agrees that it will cause its affiliates, employees, legal counsel, auditors and other agents to, (a) keep confidential and not disclose the Information (as defined below) to any other person (other than the Reinsurer's employees, legal counsel, auditors and other agents, including employees of affiliates of the Reinsurer who perform administrative services for the Reinsurer pursuant to a service agreement with the Reinsurer, in each case with a need to know), except (i) to the extent required by law, regulation or judicial order or as requested by the Reinsurer's regulators, (ii) as to information generally available to the public other than as the result of disclosure by the Reinsurer or any such other person, (iii) information furnished by the Reinsurer to the Rating Agencies, provided that the Reinsurer advises such Rating Agencies that such information is confidential in nature, or (iv) as may be necessary in connection with any retrocession, subject to receipt of a written confidentiality agreement from the proposed retrocessionaire that contains provisions substantially similar to those set forth in this Article, and (b) not to use the Information for any purpose other than evaluating whether to provide reinsurance hereunder. The term "Information" shall mean all the following, whether provided by the Company, its employees, affiliates or representatives, whether in oral, written, digital or other form, and whether provided before or after the effective date of this Agreement, information concerning the Company or its business, this Agreement, the Covered Policies, any other Policies and the related terms and conditions thereof, as well as all underlying transactions relating thereto and all certificates, notices, agreements and any other communications of any sort relating to the foregoing, together with all documents, materials and other information provided by the Company, its employees,

affiliates or representatives in connection with this Agreement or the foregoing items or matters, including any and all financial, technical (including underwriting and credit evaluation techniques, procedures, practices and methodologies), commercial or other information, and any notes, communications, analyses, compilations, studies, memoranda or other documents prepared or derived by the Reinsurer or others which contain or reflect all or any part of such documents, materials and other information.

If any Information is subject to a confidentiality agreement between the Company and a third party, the Company shall notify the Reinsurer thereof and, by accepting such Information, the Reinsurer shall be deemed to have agreed to comply with the terms and conditions thereof. At the request of the Company, the Reinsurer shall confirm such agreement in writing.

ARTICLE XXI

RESERVES

Except to the extent otherwise specified as to any particular Policy or Policies in the related Reinsurance Memorandum or as otherwise agreed between the Company and the Reinsurer in writing, the Reinsurer shall maintain its applicable share of the Loss reserves unearned premium reserves and contingency reserves, or any other reserves as are required to be established and maintained by the Company with respect to the Policies reinsured hereunder under applicable law.

ARTICLE XXII

FINANCIAL STATEMENT CREDIT

The Reinsurer, upon the request and at the discretion of the Company, shall provide the Company evidence that the Reinsurer has taken all steps necessary to ensure that the Company obtains full financial statement credit according to statutory requirements in all applicable United States jurisdictions for the reinsurance ceded to the Reinsurer hereunder, including the posting of security and the maintenance of aggregate risk limits, if required. Any term or condition required by such law or regulation to be included in this Agreement for the Company to receive financial credit for the reinsurance provided hereunder shall be deemed incorporated in this Agreement by this reference; this shall include any applicable terms or provisions of the New York Insurance Law, California Insurance Code, Illinois Municipal Bond Insurance Regulations and Florida Statutes.

ARTICLE XXIII

GOVERNING LAW

This Agreement shall be governed by, and construed and interpreted in accordance with, the laws of the State of New York applicable to agreements made and to be performed entirely therein without reference to such State's principles of conflicts of law to the extent that the application of the laws of another jurisdiction would be required thereby. If any term or provision of this Agreement shall be held void, illegal or unenforceable, the validity of the remaining portions or provisions shall not be affected thereby.

ARTICLE XXIV

ADDRESSES FOR NOTICES AND REMITTANCES

All reports, payments, remittances, notices, letters, financial statements or any other communications between the parties to this Agreement shall be addressed as follows:

To the Company:

Financial Guaranty Insurance Company
125 Park Avenue
New York, New York 10017
Attn: Donna Blank – Senior Vice President

To the Reinsurer:

Assured Guaranty Re International Ltd.
30 Woodbourne Avenue
Hamilton HM 08
Bermuda
Attn: Chief Risk Officer

provided, however, that in the event a party notifies the other party in writing of a change in address, all such communications shall thereafter be directed to the address indicated in such notice.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed in duplicate by their duly authorized representatives:

FINANCIAL GUARANTY INSURANCE COMPANY	ASSURED GUARANTY RE INTERNATIONAL LTD.
By: _____	By: _____
Name: DONNA BLANK	Name: Dianne Samson
Title: SVP	Title: President
Date: 12/23/04	Date: 12/23/04

REINSURANCE MEMORANDUM
for an
INDIVIDUAL RISK CESSION
under the
FACULTATIVE REINSURANCE AGREEMENT (the "Agreement")
between
FINANCIAL GUARANTY INSURANCE COMPANY (the "Reinsured")
and
_____ (the "Reinsurer")

The cession evidenced by this memorandum is subject to all the terms and conditions contained in Agreement No. 60002, dated as of December 23, 2004, covering Reinsurance Memoranda between the parties as described therein.

Issuer: _____

Issue: _____

Revenue Source: _____

Revenue Stream No.: _____

Structured (S) or Municipal (M): _____

Country: _____

Issue Currency (if not U.S. Dollars): _____

Interest rate (F/V): _____

Final Maturity: _____

Covered Policy(ies): _____

Covered Policy Effective Date(s): _____

Ratings: S&P: _____ Moody's: _____ FGIC: _____

Reinsurer's Share of Risk:

Reinsurer's Share % (if applicable): _____

Par Ceded: $_____ Part/Excess (choose one) of $_____

[Exposure Ceded: $_____ Part/Excess (choose one) of $_____]

Specific Maturities Ceded to Reinsurer (if other than proportionate share of entire issue): _____

First Loss (Y/N); Limit of Liability: _____

Excess of Loss (Y/N); Attachment Point: _____

Reinsurer's Share of Loss Adjustment Expenses (if different from Reinsurer's Share % above): _____ [Describe]

Gross debt service: _____

Ceded debt service: _____

Premium Payment Terms: Up-front / Installment / Other

If Other, Describe: _____

Gross Premium Ceded: Rate: _____%

Amount: $_____

Other: _____ [Describe]

Ceding Commission: Rate: _____%

Amount: $_____

Net Premium Ceded: _____

Effective Date of Reinsurance: _____

Documents Attached Hereto (if not previously provided to or waived by the Reinsurer):

Exhibit A-1:	FGIC Policy and Endorsements
Exhibit A-2:	Official Statement / Prospectus
Exhibit A-3	Debt Service Schedule
[Exhibit A-4	Issuer/FGIC Confidentiality Agreement]

Submitted by:	Accepted by:
FINANCIAL GUARANTY INSURANCE COMPANY	ASSURED GUARANTY RE INTERNATIONAL LTD.
By: _____	By: _____
Name: _____	Name: _____
Title: _____	Title: _____
Date: _____	Date: _____

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Rehabilitation of	:	Index No. 401265/2012
	:	I.A.S. No. 36
FINANCIAL GUARANTY INSURANCE COMPANY,	:	Hon. Doris Ling-Cohan
	:	Motion Seq. 004

AFFIRMATION OF SEAN THOMAS KEELY

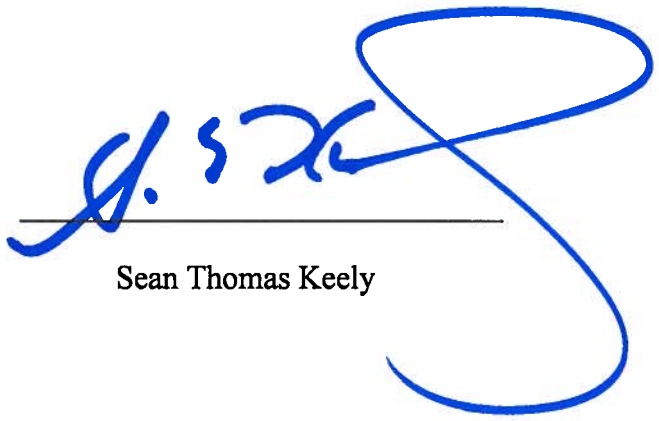
SEAN THOMAS KEELY, an attorney duly admitted to practice in the courts of this State, affirms under penalty of perjury, pursuant to section 2106 of the New York Civil Practice Law and Rules as follows:

1. I am a partner with the firm of Hogan Lovells US LLP, counsel to Assured Guaranty Corp. ("AGC"), Assured Guaranty Re Ltd. ("AGRe") and Assured Guaranty Re Overseas Ltd. ("AGRO") (collectively, "Assured"), with respect to this rehabilitation proceeding. I submit this affirmation in support of Assured's objection to the Plan of Rehabilitation of Financial Guaranty Insurance Company filed on September 27, 2012 by Benjamin Lawsky, Superintendent of the Department of Insurance of the New York Department of Financial Services, as rehabilitator of FGIC.

2. Attached hereto as Exhibit A is a true and correct copy of an order dated May 31, 2009 and entered on June 2, 2009 in *In the Matter of the Liquidation of Midland Insurance Company*, Index No. 41294/86, in the Supreme Court of the State of New York, County of New York.

3. Attached hereto as Exhibit B is a true and correct copy of the Rules Governing Ceded Reinsurance Contracts Following June 4, 2012 Interim Cash Payment Order, dated August 28, 2012, issued by the Rehabilitator and the Special Deputy Commissioner of the Segregated Account of Ambac Assurance Corporation (the "Ambac Ceded Reinsurance Rules"). The Ambac Ceded Reinsurance Rules were issued in connection with the proceeding styled *In the Matter of the Rehabilitation of the Segregated Account of Ambac Assurance Corporation*, Case No. 10 CV 1576, in the Circuit Court for the State of Wisconsin, Dane County. A copy of the Ambac Ceded Reinsurance Rules is also available at http://ambacpolicyholders.com/storage/courtfilings/08282012/Rules%20Governing%20Ceded%20Reinsurance%20Contracts%208-28-12.pdf.

New York, New York
November 19, 2012



Sean Thomas Keely

EXHIBIT A

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK, IAS PART 7

In the Matter of

the Liquidation of

Midland Insurance Company

Index No. 41294/86

ORDER

Present:
HON. MICHAEL D. STALLMAN, J.

1. On April 3, 1986, Midland Insurance Company, a New York authorized stock casualty insurer, was declared insolvent and placed into liquidation ("Midland") under the receivership of the Superintendent of Insurance ("Superintendent") of the State of New York as liquidator of Midland ("Liquidator"). Pursuant to Insurance Law Section 7434, payments to be distributed from the Midland estate are made on allowed claims. By order dated January 30, 1997 ("January 1997 Order"), Justice Beverly Cohen approved a procedure for the allowance of claims.

2. Pursuant to a Decision and Order dated January 14, 2008 (the "Decision"), this Court held that "[t]o give effect to the contractual interposition rights" of Midland's reinsurers, the allowance procedures, in effect pursuant to the January 1997 Order, should be modified. The Decision held that those modifications should. (1) "permit reinsurers to assert defenses available to Midland or to the Liquidator to any claim allowed by the Liquidator that is either partially or wholly reinsured," and (2) "establish a process in which those defenses can be adjudicated as part of the judicial approval process, involving a hearing before a referee equivalent to that provided where an objection is filed to the Liquidator's disallowance of a claim." The Decision found that new procedures should "take into account a reinsurer's contractual right to notice, a right to associate and cooperate with the Liquidator, and/or a right to investigate claims."

FILED
JUN - 2 2009
COUNTY CLERK'S OFFICE NEW YORK

3. The Decision also required the Liquidator to "solicit input from reinsurers, major policy holders, and the guaranty associations and any other interested parties about proposed changes," and "report to the Court within 120 days with proposed changes." The 120-day period was extended for 75 days, with the advice and agreement of the reinsurers, major policyholders and the guaranty associations (collectively, the "Interested Parties").[1]

4. Since July 2008, the Liquidator and certain of the Interested Parties have apprised the Court of their progress in working with the Liquidator to prepare drafts of this proposed Order over the course of several telephone conference calls. The Interested Parties have provided their input and suggested revisions to the Liquidator's draft of this proposed Order. The Liquidator incorporated many of those revisions into its proposed Order. The submission of this proposed Order is without prejudice to any right to appeal.

5. In accordance with the Decision, and in addition to its draft of this proposed Order, the Liquidator submitted an affirmation which affirms that its draft of this proposed Order and the Liquidator's revised claims procedures for Midland ("Midland Claims Procedures") were circulated to the Interested Parties, that the Liquidator solicited and received input from the Interested Parties, and that some of that input was incorporated into its drafts of this proposed Order and the Midland Claims Procedures.

NOW THEREFORE,
The Court finds that,
~~IT IS HEREBY ORDERED THAT:~~

1. The Liquidator has complied with the Decision by modifying his claims allowance procedures and creating the Revised Allowance Procedures described below in Paragraph 3. Accordingly, it is ORDERED that:

[1] This extension was predicated upon the Liquidator providing notice of such extension on the web-site of the New York Liquidation Bureau ("Bureau"). Such Notice was posted on the Bureau's web-site on June 6, 2008. Thereafter, the 75-day period was subsequently extended several times, again, predicated on notice provided by the Liquidator on the Bureau's web-site until such time that this proposed Order was submitted.

2. The Revised Allowance Procedures apply to claims of both Major Policyholders and non-Major Policyholders, as those terms are defined in Midland Claims Procedures. The Liquidator has the right to amend the Midland Claims Procedures so long as any amendments are consistent with the Revised Allowance Procedures contained in this Order.

3. The Revised Allowance Procedures provide, in pertinent part, as follows:

(a) The Liquidator shall, on a periodic basis, prepare a list of any claims that the Liquidator is considering for allowance and that are either partially or wholly reinsured. The Liquidator shall mail a notice setting forth the listed claims ("Pre-Allowance Notice") to all reinsurers entitled to notice pursuant to one or more reinsurance contracts issued by such reinsurers ("Reinsurers"). If the identities of some or all reinsurers that potentially reinsure a particular claim are not known, as in the case of certain non-Major Policyholder claims, a general notice setting forth the applicable rights of the reinsurers shall be mailed to all reinsurers that have not commuted or otherwise compromised such claim with the Liquidator.

(b) If the Liquidator determines that a claim should be allowed, the Liquidator shall mail the claimant a Notice of Determination ("NOD"). The NOD shall advise each such claimant that the claim will be allowed by the Liquidator in the amount set forth therein subject to potential objections and court approval. The NOD shall not be mailed until at least sixty (60) days after the Liquidator's mailing of the Pre-Allowance Notice.

(c) A copy of the NOD shall be mailed to the Reinsurers and also to the applicable State Guaranty Association ("SGA") (or, if not known, to the Midland Coordinating Committee (the "Coordinating Committee") of the National Conference of Insurance Guaranty Funds ("NCIGF")). If the claim does not

involve any reinsurance protection and/or SGA involvement, the NOD shall not be mailed to any Reinsurers, any SGA, or the NCIGF.

(d) If the claimant disputes the amount of the allowance, then the claimant may object to the NOD by serving a written objection on the Liquidator ("Objection"). The Objection must be received by the Liquidator within sixty (60) days of the date of the NOD. The Liquidator shall, within ten (10) business days of the date of the Liquidator's receipt of the Objection, send a copy of the same to any Reinsurer and to any SGA that the Liquidator knows has any involvement with the claimant's claim (or, if not known, to the Coordinating Committee).

(e) If the claimant does not mail to the Liquidator a notice of acceptance of the NOD within sixty (60) days of the date of the NOD, then the claimant shall be deemed to have accepted the allowance. Within ten (10) business days of the date that the Liquidator has knowledge that the allowance has been accepted or deemed accepted, the Liquidator shall advise the Reinsurers and any affected SGA (or, if not known, to the Coordinating Committee) by mail that the claimant has accepted the allowance.

(f) To the extent that a Reinsurer has a contractual right to interpose defenses that it in good faith believes are available to Midland or the Liquidator, such Reinsurer, in connection with the allowance, may interpose such defenses on behalf of Midland or the Liquidator. If such Reinsurer elects to exercise such right, it shall mail a "Notice of Intent to Interpose Defenses" to the Liquidator and the claimant within ninety (90) days of the date of the NOD. The Liquidator shall mail a copy of the Reinsurer's Notice of Intent to Interpose Defenses to any applicable SGA (or, if not known, to the Coordinating Committee), within ten (10) business days

of its receipt, and a copy to the claimant if it is received by the Liquidator prior to receipt of any Objection from the claimant. In such cases, the claimant shall mail a copy of its Objection to such Reinsurer contemporaneously with its mailing of the Objection to the Liquidator. Within thirty (30) days of receipt of the Reinsurer's Notice of Intent to Interpose Defenses, the claimant may dispute the amount of the allowance in the NOD as inadequate even where the claimant had previously accepted or been deemed to have accepted the NOD.

(g) If one or more Reinsurers timely files a Notice of Intent to Interpose Defenses, then the objection of the Reinsurer or Reinsurers shall be heard by a referee, as set forth in subparagraph (i) below.

(h) If the claimant accepts or is deemed to have accepted the claim allowance, and no Reinsurer serves a Notice of Intent to Interpose Defenses, then the claimant is not required to take any further action. The Liquidator will submit an *ex-parte* motion to this Court no sooner than ninety-one (91) days after the date of the NOD, seeking an order approving the allowance in the amount set forth on the NOD. If the allowance is approved by the Court, then the claimant will be entitled to share *pro rata* with claimants of the same class in the distribution of assets, if any, to be made by the Liquidator pursuant to New York Insurance Law Article 74.

(i) The Liquidator will refer each claim for which there is a timely objection by a claimant or timely Notice of Intent to Interpose Defenses filed by one or more Reinsurers to the referee appointed by order of this Court to hear and report on whether the claim should be allowed or disallowed, in whole or in part, including timely objections or defenses raised by any party. Where more than one

Reinsurer has exercised its contractual right to interpose defenses to the same claim, there will be a single consolidated proceeding before the referee.

(j) The Liquidator will notify by mail each claimant, Reinsurer, and any applicable SGA (or, if not known, to the Coordinating Committee), of the time and place of the hearing before a referee.

(k) An SGA shall have a right to notice of and to participate as a party in any judicial or other proceeding, including any proceeding before a referee, concerning: (i) a claim by the SGA, or (ii) a claim by a policyholder or other claimant under a policy where (A) the SGA has paid a claim under such policy and the claim by the SGA has not been finally allowed and approved by the Court; or (B) a claim has been asserted against the SGA under such policy and the SGA has notified the Liquidator that such claim may result in a claim by the SGA against the Liquidator.

(l) If by no later than thirty (30) days before the Liquidator mails the NOD to the Reinsurer(s), the Liquidator has not provided a Reinsurer with all documents properly requested by such Reinsurer pursuant to a right to any access records clause or similar provision in its reinsurance contract, such Reinsurer shall be entitled to an extension of time to mail a Notice of Intent to Interpose Defenses, but in no event shall such extension of time be more than an additional forty-five (45) days. After service of the NOD, Reinsurers shall be entitled to reasonable access to the Liquidator's claim file as needed. Such access shall be provided within ten (10) business days of the Reinsurer's request for access, provided, however, that all documents previously copied for and provided to the Reinsurer or its agent shall not again be made available.

(m) Service or mailing as used anywhere herein refers to first-class mail to the last known address of the party to be served. If the parties agree in writing that service or mailing may be accomplished by means of electronic or facsimile transmission in lieu of mailing, and a copy of such proof of this authorized substitute for mailing is retained for purposes of presenting to the Court, if necessary, such substitute service shall be accepted.

n) If the Liquidator fails to timely meet any of the time periods set for mailing notices pertaining to an allowance to any party, it shall not affect the validity of the allowance but shall only entitle the party that did not receive timely notice to postpone the approval process until such date as that party's notice rights have been fully protected.

Dated: May 31, 2009
New York, New York

ENTER:

J.S.C.

FILED

JUN - 2 2009

NEW YORK
COUNTY CLERK'S OFFICE

EXHIBIT B

RULES GOVERNING CEDED REINSURANCE CONTRACTS FOLLOWING JUNE 4, 2012 INTERIM CASH PAYMENT ORDER

August 28, 2012

Issued by
The Rehabilitator and the Special Deputy Commissioner
of the Segregated Account of Ambac Assurance Corporation

On March 24, 2010, the Circuit Court for Dane County, Wisconsin (the "Rehabilitation Court") entered a rehabilitation order (the "Rehabilitation Order"), granting the petition of the Commissioner of Insurance of the State of Wisconsin to place the Segregated Account of Ambac Assurance Corporation (the "Segregated Account") into rehabilitation and to appoint the Commissioner as the Rehabilitator for the Segregated Account (the "Rehabilitator"). On June 4, 2012, the Rehabilitation Court entered an order approving a motion by the Rehabilitator to commence making Interim Distributions on Permitted Policy Claims (the "Interim Cash Payment Order"). In order to facilitate an efficient and orderly process for the submission of Policy Claims to the Segregated Account and the evaluation, processing, and payment of Policy Claims by the Segregated Account pursuant to the Interim Cash Payment Order, the Rehabilitator promulgated the Rules Governing the Submission, Processing and Partial Payment of Policy Claims in Accordance with June 4, 2012 Interim Cash Payment Order, as filed with the Rehabilitation Court and effective on August 1, 2012 (as amended, modified or supplemented from time to time pursuant to the terms thereof, the "Policy Claim Rules").[1]

In order to preserve the value of reinsurance in respect of certain policies allocated to the Segregated Account and in recognition of certain requirements imposed by the reinsurance contracts to which AAC is a party as a ceding company (the "Ceded Reinsurance Contracts"), the Rehabilitator hereby issues the following rules, procedures and guidelines (as may be amended, modified or supplemented from time to time pursuant to the terms hereof, the "Rules") to the Management Services Provider, AAC and each entity providing reinsurance in respect of policies allocated to the Segregated Account. These Rules are being filed with the Rehabilitation Court simultaneously with their posting online at www.ambacpolicyholders.com. They shall thereupon be effective.

These rules replace and supersede the Guidelines under Plan of Rehabilitation (Ceded Reinsurance) dated as of March 17, 2011.

1. As Management Services Provider, AAC will continue to handle the processing of Policy Claims pursuant to the Policy Claim Rules.

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[1] Capitalized terms used herein and not defined herein shall have the meanings ascribed thereto in the Policy Claim Rules.

2. Pursuant to the Policy Claim Rules, the Segregated Account will pay Policy Claims once per month on the 20th of the month (or if such day is not a Business Day, on the next Business Day) (i.e., the Payment Date) if certain requirements are satisfied. Determinations as to which Policy Claims will be paid on the Payment Date in a given month will be made by the 15th day (or if such day is not a Business Day, on the next Business Day) of such month (i.e., the Determination Date).

3. No Pending Policy Claim shall be eligible to be considered a Permitted Policy Claim on a given Payment Date unless the Proof of Policy Claim Form and other required documentation was received by the Management Services Provider on or prior to 5:00 p.m. on the last Business Day of the month preceding the month in which such Payment Date occurs.

4. The Management Services Provider, on behalf of the Rehabilitator, shall notify reinsurers of Pending Policy Claims relating to Policies for which they provide reinsurance by sending reinsurers copies of Proof of Policy Claim Forms relating to such Policies, and any supporting documentation delivered with such Proof of Policy Claim Forms, promptly following its receipt thereof. The Management Services Provider shall use reasonable best efforts to so deliver each such Proof of Policy Claim Form (and supporting documentation, if any) within one Business Day of its validation of the underlying Policy Claim and, in any event (and whether or not such Policy Claim has been validated), by the later of (a) the last Business Day of the month in which it was received and (b) the Business Day next following the date on which it was received. Notwithstanding the foregoing and without prejudice to any rights to further information or inspection of any reinsurer under its applicable Ceded Reinsurance Contract, with respect to any Policy Claims submitted during the Moratorium Period, the Management Services Provider shall be required only to deliver Proof of Policy Claim Forms (and supporting documentation, if any) re-submitted to it pursuant to Section 1.04 of the Policy Claim Rules. The Management Services Provider shall deliver such Proof of Policy Claim Forms (and supporting documentation, if any) via email unless a reinsurer requests another method of delivery.

5. In connection with the delivery to a reinsurer of a Proof of Policy Claim Form containing details of a Pending Policy Claim submitted during the Moratorium Period, the Management Services Provider shall, in (or appended to) the bordereau submitted to the reinsurer pursuant to the Ceded Reinsurance Contract relating to the month in which such Policy Claim is Permitted or Disallowed, as the case may be, identify to such reinsurer such Pending Policy Claim as having been previously submitted during the Moratorium Period and provide such reinsurer with a reconciliation of the amounts (if any) billed to, and paid by, such reinsurer in respect of such Policy Claim during the Moratorium Period as against the amounts to be billed to, and paid by, such reinsurer (if any) in respect of such Policy Claim as re-submitted pursuant to Section 1.04 of the Policy Claim Rules. Without prejudice to the terms of any applicable Ceded Reinsurance Contract, each of the Management Services Provider and a reinsurer will, following delivery of a bordereau containing details of a reinsured Policy Claim reconciliation, use reasonable efforts to cooperate to resolve any discrepancies in respect of such Policy Claim reconciliation.

6. Reinsurers shall be permitted to investigate such Pending Policy Claims and interpose defenses as permitted by the applicable Ceded Reinsurance Contracts and in accordance with the procedures described in these Rules.

7. If, having been notified of a Pending Policy Claim as provided in paragraph 4 above, a reinsurer notifies the Management Services Provider, in the manner provided in paragraph 11 below, on or prior to 5:00 p.m. on the 10th day of the month (or if such day is not a Business Day, on the next Business Day) following the month in which such Policy Claim was submitted in accordance with Section 1.02 of the Policy Claim Rules, that such reinsurer intends to interpose a defense in respect of such Policy Claim, then the following rules shall apply:

(a) The reinsurer and the Management Services Provider shall as soon as reasonably practicable discuss the merits of such defense and share with one another all relevant information related to such defense and the subject Policy Claim, subject to appropriate confidentiality undertakings. The reinsurer shall explain with reasonable particularity the basis for such defense and provide all supporting documents necessary for the Management Services Provider and Rehabilitator to understand and assess the defense.

(b) If, at any time following the reinsurer's provision of notice that it intends to interpose any defense to a Pending Policy Claim, the reinsurer agrees with the Rehabilitator and Management Services Provider that no such defense should be asserted (or continue to be asserted) in response to the subject Policy Claim, then the Management Services Provider and the Rehabilitator may determine the subject Policy Claim to be a Permitted Policy Claim in accordance with the Policy Claim Rules.

(c) If, at any time following the reinsurer's provision of notice that it intends to interpose any defense to a Pending Policy Claim, the Rehabilitator and the Management Services Provider agree that such defense should be asserted (or continue to be asserted) in response to the subject Policy Claim (or a portion thereof, if applicable), the Management Services Provider or the Rehabilitator shall determine that such Policy Claim (or portion thereof, as applicable), is a Disputed Claim in accordance with Section 1.09 of the Policy Claim Rules. The Rehabilitator or Management Services Provider shall prepare an Objection to such Disputed Claim on the basis of such defense, and shall provide such reinsurer with a copy of such Objection promptly following the provision of such Objection to the relevant Holder pursuant to Section 1.09 of the Policy Claim Rules. The Rehabilitator or Management Services Provider shall provide such reinsurer with a copy of any response of such Holder to such Objection promptly following its receipt thereof.

(d) If, at any time following the reinsurer's provision of notice that it intends to interpose any defense to a Pending Policy Claim, the Management Services Provider or the Rehabilitator intend to decline to assert the defense raised by the reinsurer, the Management Services Provider or the Rehabilitator shall so notify the reinsurer and the reinsurer may, within ten (10) Business Days of the date of such notification, direct the Rehabilitator and the Management Services Provider in writing to determine that the subject Policy Claim (or portion thereof, as applicable) is a Disputed Claim in accordance with Section 1.09 of the Policy Claim Rules. The Rehabilitator or Management Services Provider and the reinsurer (each acting reasonably) shall cooperate to prepare an Objection to such Disputed Claim on the basis of such defense, and the Rehabilitator or the Management Services Provider shall provide such reinsurer with a copy of such

Objection promptly following the provision of such Objection to the relevant Holder pursuant to Section 1.09 of the Policy Claim Rules. The Rehabilitator or Management Services Provider shall provide such reinsurer with a copy of any response of such Holder to such Objection promptly following its receipt thereof.

(e) The failure by the reinsurer to direct the Rehabilitator and the Management Services Provider in writing to determine that the subject Policy Claim (or portion thereof, as applicable) is a Disputed Claim prior to the close of business on the tenth (10^{th}) Business Day after the date of notification from the Management Services Provider or the Rehabilitator that it declines to assert the defense raised by the reinsurer pursuant to paragraph 7(d) (i) shall permit the Management Services Provider and the Rehabilitator to make such determinations in their sole discretion with respect to the subject Policy Claim, including, without limitation, any determination that the subject Policy Claim (or any portion thereof) is a Permitted Policy Claim, and (ii) shall constitute a waiver by such reinsurer of its rights under the insolvency clause of any applicable Ceded Reinsurance Contract to further interpose any defense available to AAC, the Segregated Account or the Rehabilitator with respect to, such Policy Claim. Such waiver shall not apply to any other right to (i) inspect records or to (ii) raise any other defense available to the reinsurer under its applicable Ceded Reinsurance Contract or at law.

(f) Following an Objection to the subject Policy Claim and subsequent response to such Objection by the relevant Holder, if the Management Services Provider or the Rehabilitator intend to decline (or continue to decline) to assert the defense raised by the reinsurer and so notify the reinsurer, the reinsurer may, within 10 Business Days of the date on which the reinsurer received such notification from the Rehabilitator or the Management Services Provider, direct the Rehabilitator and the Management Services Provider in writing to determine that such Disputed Claim (or the portion that is not disputed by the Rehabilitator or the Management Services Provider) is fully or partially a Disallowed Claim in accordance with Section 1.09 of the Policy Claim Rules. In any subsequent proceeding before the Rehabilitation Court brought by the Holder of such Policy Claim pursuant to Section 1.09 of the Policy Claim Rules, the reinsurer shall be permitted to interpose any defense to the subject Policy Claim (or portion thereof) in connection with such adjudication of the subject Policy Claim by the Rehabilitation Court. The Rehabilitator may support such defense to the subject Policy Claim, or may oppose such defense in support of the payment of the subject Policy Claim. If the Rehabilitator supports such defense to the subject Policy Claim (or portion thereof, as applicable) on the basis of the defense raised by the reinsurer pursuant to this paragraph 7(f), the reinsurer shall be permitted the opportunity, at its own expense, to associate with the Rehabilitator in the defense against the subject Policy Claim in any proceeding before the Rehabilitation Court. If the Rehabilitator opposes such defense in support of the payment of the subject Policy Claim (or portion thereof, as applicable), the reinsurer shall have sole responsibility for asserting the defense to payment of the subject Policy Claim in any proceeding before the Rehabilitation Court.

(g) The failure by the reinsurer to direct the Rehabilitator in writing to determine that such Disputed Claim is fully or partially a Disallowed Claim prior to the close of business on the tenth (10^{th}) Business Day after the date of notification from the

Management Services Provider or the Rehabilitator that it declines to assert or continue to assert the defense raised by the reinsurer pursuant to paragraph 7(f) (i) shall permit the Management Services Provider and the Rehabilitator to make such determinations in their sole discretion with respect to the subject Policy Claim, including, without limitation, any determination that the subject Policy Claim (or any portion thereof) is a Permitted Policy Claim, and (ii) shall constitute a waiver by such reinsurer of its rights under the insolvency clause of any applicable Ceded Reinsurance Contract to further interpose any defense available to AAC, the Segregated Account or the Rehabilitator with respect to, such Policy Claim. Such waiver shall not apply to any other right to (i) inspect records or to (ii) raise any other defense available to the reinsurer under its applicable Ceded Reinsurance Contract or at law.

(h) With respect to such Policy Claim, the reinsurer will be prohibited from raising the same defense in any subsequent collection action brought by the Rehabilitator, Management Services Provider or AAC against the reinsurer for nonpayment of reinsurance in respect of such Policy Claim.

8. If a reinsurer is notified of a Pending Policy Claim as provided in paragraph 4 hereof, then any failure by such reinsurer to notify the Management Services Provider that it intends to interpose any defense to a Pending Policy Claim by 5:00 p.m. on the 10th day (or if such day is not a Business Day, on the next Business Day) following the month in which such Policy Claim was submitted (i) shall permit the Management Services Provider and the Rehabilitator to make such determinations in their sole discretion with respect to the subject Policy Claim, including, without limitation, any determination that the subject Policy Claim (or any portion thereof) is a Permitted Policy Claim, and (ii) shall constitute a waiver by such reinsurer of its rights under the insolvency clause of any applicable Ceded Reinsurance Contract to further investigate, or to interpose any defense available to AAC, the Segregated Account or the Rehabilitator with respect to, such Policy Claim. Such waiver shall not apply to any other right to (i) inspect records or to (ii) raise any other defense available to the reinsurer under its applicable Ceded Reinsurance Contract or at law.

9. If the Rehabilitator intends to implement any Alternative Resolution of a Policy Claim or potential Policy Claim relating to a Policy for which there is in-force reinsurance, and such Alternative Resolution would involve a possible liability on the part of any reinsurer, then the following rules shall apply:

(a) The Rehabilitator or the Management Services Provider (on behalf of the Rehabilitator) shall provide written notice to such reinsurer that it is considering such Alternative Resolution at least 15 days prior to the implementation thereof (the "Alternative Resolution Notice").

(b) The reinsurer shall be permitted to investigate such Policy Claim or potential Policy Claim and shall be provided with all relevant information relating to the proposed Alternative Resolution, subject to appropriate confidentiality undertakings. If the applicable Ceded Reinsurance Contract(s) include a right to interpose defenses, the reinsurer shall have the opportunity to interpose defenses in accordance with the procedures set forth in these Rules.

(c) If a reinsurer notifies the Rehabilitator and the Management Services Provider, in the manner provided in paragraph 11 below, within 10 days of the date of the Alternative Resolution Notice that such reinsurer intends to interpose a defense in respect of such Policy Claim or potential Policy Claim or Alternative Resolution thereof, then the Rehabilitator and the Management Services Provider shall negotiate promptly with the reinsurer to reach a resolution of its objections to the Alternative Resolution of such Policy Claim. If a timely resolution is not reached, the dispute shall be submitted to the Rehabilitation Court for resolution.

(d) Any failure by a reinsurer to notify the Rehabilitator and the Management Services Provider within 10 days of the date of the Alternative Resolution Notice that it intends to interpose a defense to a Policy Claim or potential Policy Claim with respect to which the Rehabilitator intends to implement an Alternative Resolution shall constitute a waiver by such reinsurer of its rights under the insolvency clause of any applicable Ceded Reinsurance Contract to further investigate, or to interpose a defense available to AAC, the Segregated Account or the Rehabilitator with respect to the Alternative Resolution thereof. Such waiver shall not apply to any other right to inspect records or to raise defenses available to the reinsurer under the applicable Ceded Reinsurance Contract or law.

10. These Rules shall control with respect to any inconsistent provisions of the Plan of Rehabilitation that provide or impose rules, procedures, guidelines and/or obligations for, or on, any party with respect to the rights and obligations of the parties under the terms of any Ceded Reinsurance Contract. In the event of any direct conflict between the terms of these Rules, on the one hand, and applicable law or the terms of any Ceded Reinsurance Contract, on the other hand, applicable law or the terms of such Ceded Reinsurance Contract, as applicable, shall govern. The failure on the part of a Person to adhere strictly to these Rules shall not excuse another Person from performing the obligations required to be performed by it under a Ceded Reinsurance Contract so long as such failure would not be expected to materially harm or prejudice the Person by whom such adherence is sought. These Rules may be supplemented, modified or withdrawn by the Rehabilitator at any time or from time to time in the Rehabilitator's sole discretion after 15 Business Days have elapsed since the delivery of notice by the Rehabilitator or the Management Services Provider of such supplement, modification or withdrawal to affected reinsurers, and during such period of 15 Business Days each reinsurer shall have the opportunity to comment on any such supplement, modification or withdrawal.

11. All notices provided under these Rules shall be effective if delivered in writing by email to (a) in the case of a reinsurer, such authorized representatives of such reinsurer as shall be specified in writing to the Management Services Provider from time to time, and (b) in the case of the Rehabilitator or the Management Services Provider, Reinsurance_Communication@ambac.com or to such other authorized representatives of the Management Services Provider as the Management Services Provider shall specify in writing to reinsurers from time to time. Additionally, notifications of intent to interpose a defense provided by reinsurers pursuant to paragraphs 7 or 9 hereof shall be in the form attached hereto as Exhibit A and shall also be emailed to claimsprocessing@ambac.com.

12. Unless notified to the contrary by no later than July 31, 2012, the Management Services Provider and the Rehabilitator shall be entitled to rely upon the contact information previously provided to the Management Services Provider by each reinsurer for the email address(es) of its authorized representative(s) who are to receive notices as described in paragraph 11 above.

13. All dates, times and day counts referred to in these Rules shall be understood to refer to such dates, times and day counts in New York.

Exhibit A

Form of Notification of Intent to Interpose Defense

Date: [_____]

Ambac Assurance Corporation,
as Management Services Provider of
the Segregated Account of Ambac Assurance Corporation
One State Street Plaza
New York, NY 10004

Attention: Claims Processing
Email: claimsprocessing@ambac.com
Facsimile: (212) 208-3404

With copies to:

- Reinsurance_Communication@ambac.com
- Manager, Securities Settlements

  Email: OpsGroup@Ambac.com

  Facsimile: (212) 208-3507
- General Counsel

  Facsimile: (212) 208-3384

Reference Policy Number: [_____]

The undersigned is in receipt of a Proof of Policy Claim Form dated _____ with respect to the above-referenced Policy, a copy of which is attached hereto. The undersigned hereby notifies Ambac Assurance Corporation, as Management Services Provider for the Segregated Account of Ambac Assurance Corporation, that the undersigned intends to interpose a defense in respect of the Claim identified in such Proof of Policy Claim Form for the following reason(s):

> *[Explain with particularity the basis for such defense and provide all supporting documents necessary for the Management Services Provider and Rehabilitator to understand and assess the objection.]*

[ ]

By_____
Name:
Title: