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BY HAND

January 22, 2013

The Honorable Doris Ling-Cohan, J.S.C.
IAS Part 36
Supreme Court of the State of New York, County of New York
60 Centre Street
New York, NY 10007

Re: *In the Matter of the Rehabilitation of Financial Guaranty Insurance Company*
Index No. 401265/2012, Motion Sequence No. 4

Dear Justice Ling-Cohan:

We submit this letter on behalf of Benjamin M. Lawsky, Superintendent of Financial Services of the State of New York, as court-appointed rehabilitator (the "**Rehabilitator**") of Financial Guaranty Insurance Company ("**FGIC**"), in response to Your Honor's request, at the status conference on January 15, 2013, for a short submission explaining the standard for judicial approval of the First Amended Plan of Rehabilitation for FGIC, dated December 12, 2012 (the "**Plan**").

As set forth in further detail below, pursuant to the New York Insurance Law (the "**NYIL**") and applicable New York case law, the Court must consider whether the Rehabilitator abused his discretion in approving and adopting the Plan. In reaching this conclusion, the Court should consider whether the Rehabilitator properly exercised his discretion to adopt a plan that removes the causes and conditions that made the Rehabilitation Proceeding necessary. Pursuant to this standard, the Court should defer to the Rehabilitator's judgment, unless the Court finds that the Rehabilitator acted arbitrarily or capriciously and abused his discretion. The Rehabilitator has shown that he exercised his discretion in a reasonable manner in developing and adopting the Plan; accordingly, the abuse of discretion standard strongly supports the notion that the Plan should be approved and, as provided for in the Plan, the Rehabilitation Proceeding should be terminated upon the Plan's effectiveness.

Standard Governing the Rehabilitator's Development and Adoption of the Plan

In the Order of Rehabilitation, this Court, pursuant to Section 7403(a) of the NYIL, directed the Rehabilitator to "take such steps toward the removal of the causes and conditions which have made [this Rehabilitation Proceeding] necessary as the Rehabilitator may deem *prudent and advisable*." Order of Rehabilitation ¶ 5 (emphasis added). Article 74 of the NYIL, which governs the rehabilitation of New York insurance companies, and applicable case law do not articulate a specific standard the

Rehabilitator must satisfy in formulating or seeking approval of a plan of rehabilitation pursuant to this authority. Accordingly, the Rehabilitator looked to the Order of Rehabilitation, New York case law addressing insurance company rehabilitation plans and the principles underlying Article 74, and determined that a plan of rehabilitation should maximize recoveries to FGIC's policyholders and other claimants in a way that begins distributions quickly and treats stakeholders *as a whole* fairly and equitably, while at the same time removing the causes and conditions that made the Rehabilitation Proceeding necessary. *See* Disclosure Statement for Plan of Rehabilitation for FGIC, dated September 27, 2012 (the "**Disclosure Statement**") § VII.F.

In adopting these guidelines, the Rehabilitator considered applicable case law and the fundamental principles underlying the NYIL. For example, in *In re National Surety Co.*, 268 N.Y.S. 88 (App. Div. 1st. Dep't 1933), *aff'd*, 191 N.E. 521 (N.Y. 1934), one of the only reported decisions by a New York court considering approval of a plan of rehabilitation, in affirming the approval of the *National Surety* plan, the First Department noted that "[t]he plan suggested seems feasible and to be for the benefit of all concerned, especially the creditors." *Id.* at 96.

In addition, the Rehabilitator considered the First Department's statement "that the paramount purpose of article 74 'is the preservation and enhancement of [the estate's] assets to the end that the interests of all its creditors, policyholders, stockholders and the public will be subserved.'" *Corcoran v. Frank B. Hall & Co., Inc.*, 545 N.Y.S.2d 278, 281 (App. Div. 1st Dep't 1989) (citing *Knickerbocker Agency, Inc. v. Holz*, 4 N.Y.2d 245, 253 (1958)); *see also Van Schaick v. Lincoln Dye Works*, 263 N.Y.S. 114, 115 (Sup. Ct., Albany County 1933) ("The Insurance Law provides for an orderly procedure in which all creditors are treated alike."). Consistent with this precedent, the Rehabilitator developed the Plan with the goal of ensuring that FGIC will have sufficient assets during the 40-year life of its insurance policies so that the claims of FGIC's policyholders may be paid on an equitable and ratable basis throughout that period.

Standard Governing the Court's Review

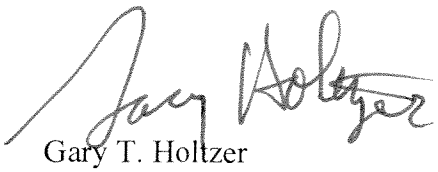
New York case law is clear that the Court's review is based upon the deferential abuse of discretion standard. As the Third Department stated, "[t]he courts will generally defer to the rehabilitator's business judgment and disapprove the rehabilitator's actions only when they are shown to be arbitrary, capricious or an abuse of discretion." *Callon Petroleum Co. v. Superintendent of Ins.*, 863 N.Y.S. 2d 92, 93-4 (App. Div. 3d Dep't 2008) *citing Mills v. Florida Asset Fin. Corp.*, 818 N.Y.S.2d 333, 334 (App. Div. 3d Dep't 2006); *see also Matter of Dinallo v. DiNapoli*, 877 N.E.2d 643 (N.Y. 2007) (noting that, as to the Superintendent's role as court-appointed receiver on behalf of distressed insurers, "the Legislature, by statutory enactment, bestowed upon the Superintendent broad fiduciary powers to manage the affairs of distressed domestic insurers and to marshal and disburse their assets."); *Mills*, 818 N.Y.S.2d at 334 ("The Legislature has granted [the rehabilitator] plenary powers and broad discretion to manage, as a fiduciary, the affairs of an insolvent insurer."); *In re New York Title & Mortgage Co.*, 9

N.Y.S.2d 994, 1001 (Sup. Ct., N.Y. County 1939) ("The judgment of the Superintendent of Insurance, an administrative officer of the state . . . is entitled to great weight and is not lightly to be set aside."). Thus, "a party contesting the rehabilitator's actions bears the burden of showing arbitrary conduct by the rehabilitator." *Callon Petroleum*, 863 N.Y.S.2d at 94.

The deference accorded the Rehabilitator in the NYIL makes sense given the unique and independent role played by the Rehabilitator in the rehabilitation process. While particular policyholders are likely to be driven by their own (often differing) interests in objecting to a plan, the Rehabilitator is the only party that has no financial or other interest in the outcome and is obligated to consider the best interests of policyholders as a whole. Thus, where, as here, the Rehabilitator has exercised his discretion in a reasonable manner in proposing the Plan, the NYIL and case law cited above accord great deference to the Rehabilitator's judgment.

The Rehabilitator has shown that the Plan, including each of the challenged provisions, falls squarely within his broad authority, pursuant to Section 7403(a) of the NYIL, to remove the causes and conditions that made the Rehabilitation Proceeding necessary. The Rehabilitator is exercising his authority to achieve the objective of placing the insurer in a position, post-receivership, to maximize recoveries for policyholders overall for the next 40 years. This broad authority includes limiting the future enforcement of specific contract provisions where that is necessary to prevent injury to policyholders as a whole. Accordingly, the Rehabilitator has not abused his discretion by determining that the Plan accomplishes the goal of treating policyholders as a whole in a fair and equitable manner, while at the same time removing the causes and conditions that made the Rehabilitation Proceeding necessary, so that the Rehabilitation Proceeding can be terminated in accordance with Section 7403(d) of the NYIL on the effective date of the Plan as provided for therein. Plan § 7.6. The Rehabilitator's exercise of discretion should, therefore, be accorded deference and the Plan should be approved.

Respectfully submitted,



Gary T. Holtzer

Enclosures

cc: Richard W. Slack (by email)
All counsel of record (by email w/ encls.)