Applicant to reimburse AMBAC Indemnity for any payments made by AMBAC Indemnity under the Indemnity Policies.

- 8. In order to secure its performance under the Agreement, Applicant generally will rehypothecate all collateral received in respect of loans of proceeds to Recipients to The Bank of New York as trustee (together with any successor trustee, the "Trustee") for the benefit of AMBAC Indemnity under a Master Trust Agreement. With respect to MICs in the form of collateralized investment contracts or Repos, however, the collateral pledged to secure the related loan of proceeds will be rehypothecated to the MIC Holder rather than to the Trustee.
- 9. Applicant may come within the definition of an investment company under section 3(a) of the 1940 Act to the extent that its loans to AMBAC and the other Recipients may be considered as investing or reinvesting in debt securities of AMBAC and the other Recipients. Applicant presently is relying on the exception from the 1940 Act provided by section 3(c)(1). It will be unable to continue to do so, however, at such time as the 100 owner limit contained therein is exceeded or if Applicant were to make a public offering of its securities.

Applicant's Legal Analysis

1. Generally, rule 3a–5 grants an exemption from all provisions of the 1940 Act, subject to certain conditions, to any finance subsidiary (as defined in the rule) of an eligible parent company so as to permit the finance subsidiary to offer debt securities or non-voting preferred stock in the United States. Rule 3a–5 also permits a finance subsidiary to loan the proceeds of its securities offerings to eligible companies controlled by the parent company.

2. Applicant's proposed activities will not meet the requirement of paragraph (a)(1) of rule 3a–5 that any debt securities of the finance company issued to or held by the public be unconditionally guaranteed by the parent company. In Applicant's case, all MICs will receive a guarantee in the form of an unconditional insurance policy to be issued by AMBAC Indemnity, unless the parent company guarantee required by rule 3a–5 is delivered instead.

3. Applicant submits that its planned operations raise two further issues under rule 3a–5. First, paragraph (b)(2)(i) of rule 3a–5 defines an eligible parent company as a company that, among other things, is not an investment company under section 3(a)

or that is excepted or exempted by order from the definition of investment company by section 3(b) or by the rules and regulations under section 3(a). Applicant states that there may be some uncertainty over AMBAC's status under section 3(a)(3) of the 1940 Act. Consequently, to the extent that AMBAC must rely on a section 3(c)(6) exception as an insurance holding company, AMBAC would not qualify as an eligible parent under rule 3a-5. Second, paragraph (b)(3)(i) of rule 3a-5 defines a "company controlled by the parent company" as a company that, among other things, is not an investment company under section 3(a) or that is excepted or exempted by order from the definition of investment company by section 3(b) or by the rules and regulations under section 3(a). AMBAC engages in certain activities (including certain investment activities) through wholly-owned subsidiaries that have no outstanding securities other than those owned directly or indirectly by AMBAC. Such subsidiaries would be eligible for exemption under rule 3a-3 under the 1940 Act, except that a section 3(c)(6) exempt entity is not an eligible parent of a rule 3a-3 exempt company. In addition, the Applicant might choose in the future to lend the proceeds of its MIC offerings to AMBAC Indemnity, which is a section 3(c)(3) exempt insurance company. Accordingly, Applicant requests exemptive relief from rule 3a-5(b)(3)(i) to permit it to lend the proceeds of its debt offerings to subsidiaries of AMBAC that would be exempt by virtue of rule 3a-3, but for AMBAC's status as their parent company, and to AMBAC Indemnity.

4. Section 6(c) of the 1940 Act provides, as here relevant, that the SEC, by order upon application, may conditionally or unconditionally exempt any person or persons from any provision of the 1940 Act or any rule thereunder, if such exemption is necessary and appropriate in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of the 1940 Act. Applicant submits that the exemptive relief requested meets those standards.

5. Applicant submits that the Indemnity Policy issued by AMBAC Indemnity covering the MICs serves the underlying objectives of the rule 3a–5 guarantee since the MIC Holders will be provided with benefits substantially similar to those provided by the guarantee requirement of rule 3a–5. There will at all times be an uninterrupted payment of funds to the MIC Holders. MIC Holders will also

benefit from safeguards that are not present in the guarantee of a non-regulated parent company, since AMBAC Indemnity is subject to a comprehensive scheme of regulation and supervision under the insurance laws of Wisconsin, its state of incorporation, as well as the insurance laws and regulations of other jurisdictions in which it does business.

6. Applicant further asserts that the receipt of an insurance policy from AMBAC Indemnity in lieu of an AMBAC guarantee increases the likelihood that the MIC Holders will be paid in full. This is because AMBAC's equity interest in AMBAC Indemnity is in excess of 99% of its assets, so that AMBAC's only significant source of funds with which to make payments is dividends on its AMBAC Indemnity stock. Furthermore, AMBAC Indemnity's triple-A rated claims paying ability has been assigned higher ratings than AMBAC's double-A rated senior debt by Moody's and S&P, reflecting an assessment by such rating agencies of the increased likelihood of payment in the case of AMBAC Indemnity. Based on the foregoing, Applicant requests exemptive relief from rule 3a-5(a)(1) to permit AMBAC Indemnity to issue insurance policies in lieu of the parent guarantees otherwise required.

7. Applicant's parent AMBAC may be considered a section 3(c)(6) exempt company, as noted above, because it is primarily engaged in a section 3(c)(3) business (insurance) through AMBAC Indemnity. Applicant contends that the types of businesses enumerated in section 3(c)(3) do not present the potential for investment company type activities with which the SEC was concerned when it limited the definition of parent company (such as AMBAC) and controlled company (such as AMBAC Indemnity) under rule 3a-5. Similarly, where AMBAC engages in certain activities through wholly-owned subsidiaries that would qualify for exemption under rule 3a-3, except for the fact that a section 3(c)(6) entity is not an eligible parent of a rule 3a-3 company, Applicant contends that there is no reason to impose the requirements of the 1940 Act on such subsidiaries. Accordingly, Applicant believes it is appropriate to grant relief from paragraphs (b)(2)(i) and (b)(3)(i) of rule 3a–5 to enable Applicant to lend the proceeds of its offerings to its parent company, AMBAC, and to the other Recipients.

8. Applicant believes that neither its structure nor its mode of operations resembles that of an investment company. Applicant asserts, therefore, that it is not the type of company