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

In the matter of the application of

WELLS FARGO BANK, NATIONAL ASSOCIATION, U.S. BANK NATIONAL ASSOCIATION, THE BANK OF NEW YORK MELLON, THE BANK OF NEW YORK MELLON TRUST COMPANY, N.A., WILMINGTON TRUST, NATIONAL ASSOCIATION, HSBC BANK USA, N.A., AND DEUTSCHE BANK NATIONAL TRUST COMPANY (as Trustees, Indenture Trustees, Securities Administrators, Paying Agents, and/or Calculation Agents of Certain Residential Mortgage-Backed Securitization Trusts),

Petitioners,

For Judicial Instructions under CPLR Article 77 on the Administration and Distribution of a Settlement Payment,

Index No. 657387/2017

Hon. Marcy S. Friedman

OPENING MERITS BRIEF OF AMBAC ASSURANCE CORPORATION

TABLE OF CONTENTS

Ambac Assurance Corporation ("Ambac"),[1] the Certificate Insurer for certain classes of certificates issued by three trusts (GPMF 2006-AR2; GPMF 2006-AR3; and GPMF 2005-AR5) (the "Ambac Trusts") at issue in this proceeding, respectfully submits this opening memorandum of law concerning the distribution of payments under the Settlement Agreement.[2]

Preliminary Statement

The Settlement Agreement requires settlement payments to be treated as "Subsequent Recoveries" under the applicable PSAs. For two of the Ambac Trusts, GPMF 2006-AR2 and GPMF 2006-AR3 (the "2006 Trusts"), Ambac enjoys a priority right to receive "Subsequent Recoveries" before anyone else. This priority exists to reimburse Ambac for certain claim payments it has made under its insurance policies. Because these claim payments far exceed the Allocable Share for the relevant loan groups (Groups 2 and 3 in GPMF 2006-AR2 and Group 2 in GPMF 2006-AR3), Ambac is entitled to *the entire Allocable Share for these loan groups*.

In contrast, the PSA for the third Ambac Trust, GPMF 2005-AR5 (the "2005 Trust"), does not give Ambac the same priority to receive Subsequent Recoveries for which it bargained in the 2006 Trusts. For the 2005 Trust, Ambac relies upon its subrogation rights to stand in the shoes of the holders of insured certificates. In this capacity, Ambac contends that the Allocable Share for the 2005 Trust should be applied to write up the balances of *all classes* of certificates that were written down by Realized Losses in the reverse order in which the Realized Losses were applied. Only after these write-ups occur should the Allocable Share be distributed, with

[1] Ambac's January 29, 2018 filing was joined by the Segregated Account of Ambac Assurance Corporation (the "Segregated Account"), but the Segregated Account merged into Ambac on February 12, 2018, and thus no longer exists. Accordingly, this filing is made for Ambac alone.

[2] Capitalized terms not defined herein have the meanings given to such terms in the Petition for judicial instructions under Article 77 (NYSCEF No. 1) or the relevant Pooling and Servicing Agreements.

Ambac receiving through subrogation the payments that would otherwise be due to the holders of insured certificates.

I. Ambac's Role as Certificate Insurer

Ambac is the Certificate Insurer for the Class I-A-2 and II-A-2 certificates in GPMF 2006-AR2, the Class II-A-2 certificates in GPMF 2006-AR3, and the Class II-A-2 and III-A-2 certificates in GPMF 2005-AR5 (which classes are the "Insured Certificates"). As such, Ambac issued financial guaranty insurance policies (the "Policies") that protect holders of Insured Certificates in two ways. First, Ambac compensates holders for shortfalls in scheduled interest payments. Second, when the Insured Certificates are written down by Realized Losses, Ambac pays holders the amount of these Realized Losses.[3] As part of the bargain, the PSA gives Ambac both reimbursement and subrogation rights to recover its claim payments from the securitization trust.

Ambac's core obligation under its Policies is to pay the "Deficiency Amount" on each Distribution Date (typically the 25th of each month). *See* GPMF 2006-AR2 Certificate Insurance Policy (Definitions of "Insured Amounts" and "Insured Payments") (Affidavit of Robert Tyrrell ("Tyrrell Aff.") Ex. 4). The Deficiency Amount is the sum of interest shortfalls for and Realized Losses allocable to the Insured Certificates on a given Distribution Date. *See id.* (definition of "Deficiency Amount"). To date, Ambac has paid more than $200 million in claim payments due to Realized Losses, but has received less than $500,000 in reimbursements for these trusts.

[3] In general terms, there are Realized Losses in a trust when a deficiency balance remains after liquidation of an underlying mortgage loan, *e.g.*, when foreclosure proceeds are less than the outstanding balance owed by the borrower. The PSA specifies how and when Realized Losses are allocated to particular classes of certificates. In general terms, Subsequent Recoveries are reversals of existing Realized Losses. In the ordinary course, there can be Subsequent Recoveries through additional collections.

II. Ambac is Entitled to the Full Allocable Shares for Insured Loan Groups in the 2006 Trusts

In the 2006 Trusts, Ambac should receive the entire Allocable Shares for the loan groups supporting the Insured Certificates because these PSAs specify that Subsequent Recoveries are paid ***first*** to Ambac to reimburse it for claim payments made due to Realized Losses. Here, Ambac's unreimbursed claim payments for Realized Losses far exceed the relevant Allocable Shares, so these entire Allocable Shares must be paid to Ambac.

The Settlement Agreement specifies that the Allocable Shares are to be treated as Subsequent Recoveries under the PSAs. Settlement Agreement § 3.06(a), NYSCEF Doc. No. 3 (the Allocable Shares are deposited into the "collection or distribution account pursuant to the terms of the Governing Agreements, for further distribution to Investors in accordance with the distribution provisions of the Governing Agreements . . . as though such Allocable Share was a 'subsequent recovery' . . ."). In the 2006 Trusts, PSA Sections 6.02(b) and (c) control the treatment of Subsequent Recoveries. At the outset, Subsequent Recoveries are deposited into the trust's Custodial Account, which is the relevant "collection" account within the meaning of the Settlement Agreement. GPMF 2006-AR2 PSA (Tyrrell Aff. Ex. 1) § 6.02(b) ("[I]n the event that the Servicer receives any Subsequent Recoveries, the Servicer shall deposit such funds into the Custodial Account . . . .").[4] Once deposited into the Custodial Account, these Subsequent Recoveries are "first used to pay any amounts owed to the Certificate Insurer as set for[th] in Section 6.02(c)." *Id.*[5]

---

[4] This submission cites to the PSA for GPMF 2006-AR2. The PSA for GPMF 2006-AR3 (Tyrrell Aff. Ex. 2) is materially identical in all relevant respects.

[5] The PSA authorizes the Servicer to make payments directly from the Custodial Account. *See* GPMF 2006-AR2 PSA § 4.02(a) ("The Servicer will, from time to time on demand of the Trustee, make or cause to be made such withdrawals or transfers from the Custodial Account as the Servicer has designated for such transfer or withdrawal pursuant to this Agreement.").

Section 6.02(c), in turn, determines the amount of Subsequent Recoveries that the Certificate Insurer receives "first" per Section 6.02(b):[6]

> Subsequent Recoveries will be allocated first to the Certificate Insurer for payment on any Reimbursement Amounts for such Distribution Date in respect of any Deficiency Amount described in clauses (a)(2) or (b)(y) of such definition, but only to the extent of the portion of Subsequent Recoveries that were paid by the Certificate Insurer for Realized Losses that were allocated to Class I-A-2 Certificates or II-A-2 Certificates, as applicable.

Id. § 6.02(c). The relevant language can be broken down into two subparts.[7]

1. "*Subsequent Recoveries will be allocated first to the Certificate Insurer for payment on any Reimbursement Amounts for such Distribution Date*"

Subsequent Recoveries are earmarked to pay Ambac for any "Reimbursement Amount[s]," which the Policy defines as "the sum of (i) all Insured Payments paid by the Certificate Insurer, but for which the Certificate Insurer has not been reimbursed prior to such Distribution Date pursuant to Section 6.01 of the Agreement, plus (ii) interest accrued thereon . . . ." GPMF 2006-AR2 Certificate Insurance Policy (Tyrrell Aff. Ex. 4). Starting with component (i), Ambac has made the following Insured Payments (*i.e.*, claim payments) as of the August 27, 2018 Distribution Date:

GPMF 2006-AR2 Class I-A-2	$31,819,699.12
GPMF 2006-AR2 Class II-A-2	$13,152,044.70
GPMF 2006-AR3 Class II-A-2	$105,315,659.00

[6] To the extent Subsequent Recoveries exceed the sum Ambac receives on a priority basis under Section 6.02(c), the excess remains in the Custodial Account until the monthly transfer of the balance of the Custodial Account to the Distribution Account for payment to holders through the waterfall. *See* PSA §§ 4.02(d); 4.04(c). Here, there will be no such excess for the 2006 Trusts.

[7] The final clause of Section 6.02(c) ("but only to the extent of the portion of Subsequent Recoveries that were paid by the Certificate Insurer for Realized Losses that were allocated to Class I-A-2 Certificates or II-A-2 Certificates, as applicable") means that the only Subsequent Recoveries made available to Ambac are those associated with Realized Losses allocated to the Insured Certificates, as opposed to Subsequent Recoveries relating to other loan groups. Accordingly, Ambac makes no claim to Subsequent Recoveries associated with uninsured loan groups, and thus takes no position on the proper distribution of the Allocable Shares for Groups 3 and 4 of GPMF 2006-AR2 or Groups 1, 3, or 4 of GPMF 2006-AR3.

(Affidavit ¶¶ 4-5, 9). It is necessary to subtract from these Insured Payments any reimbursement Ambac already received, but these amounts are *de minimis*: $204,499.77 for GPMF 2006-AR2 and $139,859.46 for GPMF 2006-AR3. (Affidavit ¶¶ 6, 9).

Component (ii) of the Reimbursement Amount is the interest accrued on unreimbursed Insured Payments, which amounts to $4,437,788.89, $1,730,401.70, and $17,659,732.30 respectively. (Affidavit ¶¶ 7-9). Accordingly, the Reimbursement Amounts for the 2006 Trusts as of August 27, 2018, which represents the maximum that Ambac can receive first from Subsequent Recoveries, are as follows:[8]

GPMF 2006-AR2 Class I-A-2	$36,257,488.01
GPMF 2006-AR2 Class II-A-2	$14,882,446.07
GPMF 2006-AR3 Class II-A-2	$122,975,391.33

2. “*in respect of any Deficiency Amount described in clauses (a)(2) or (b)(y) of such definition*”

This second clause of Section 6.02(c) has the effect of limiting payment of Reimbursement Amounts to those attributable to claim payments Ambac made *due to Realized Losses*, as opposed to claim payments made due to interest shortfalls. This provision refers to Reimbursement Amounts “in respect of” two specified clauses of the definition of “Deficiency Amount,” which is a definition used to calculate Ambac’s claim payments. Because clause (b)(y) of this definition is inapplicable here,[9] the relevant language is that of clause (a)(2):

> the amount, if any, of any Realized Losses allocable to [Insured Certificates] on such Distribution Date (after giving effect to all distributions to be made thereon on such Distribution Date other than pursuant to the Certificate Insurance Policy).

GPMF 2006-AR2 PSA Article I (Definition of “Deficiency Amount”).

[8] Affidavit ¶¶ 7-9.

[9] Clause (b)(y) applies for the “Final Distribution Date.” PSA Article I (Definition of “Deficiency Amount”). Because the final Distribution Date has not occurred, clause (b)(y) does not apply.

Clause (a)(2) of this definition refers to only one component of Ambac's claim payments – payments for Realized Losses allocated to Insured Certificates. It does not refer to the second component of Ambac's claim payments – interest shortfalls – which are referenced in clause (a)(1). Accordingly, this part of Section 6.02(c) limits the payment of Ambac's Reimbursement Amounts from the Subsequent Recoveries to the claim payments made due to the allocation of Realized Losses to the Insured Certificates. Here, that limitation has little impact because nearly all of Ambac's claim payments were due to Realized Losses, amounting to the following:[10]

GPMF 2006-AR2 Class I-A-2	$31,811,625.30
GPMF 2006-AR2 Class II-A-2	$13,145,679.21
GPMF 2006-AR3 Class II-A-2	$105,315,659.00

* * *

Reading these provisions together, Ambac is entitled to receive ***first***, before anyone else, an amount from Subsequent Recoveries that equals the component of its Reimbursement Amounts representing any claim payments Ambac made for Realized Losses that were allocated to the Insured Certificates. Because that amount far exceeds the Allocable Shares for the related loan groups, Ambac is entitled to receive the entire Allocable Shares associated with the relevant loan group supporting the Insured Certificates, as set forth in the following table.[11]

Certificates	**Claim Payments due to Realized Losses**	**Allocable Share[12]**
2006-AR2 I-A-2	$31,811,625.30	$7,105,781.67
2006-AR2 II-A-2	$13,145,679.21	$2,823,270.99
2006-AR3 II-A-2	$105,315,659.00	$21,385,826.33

[10] Affidavit ¶¶ 4-5, 9.

[11] Because the full amount of the Allocable Shares must be paid to Ambac, there is no write up of any certificate balances. *See* PSA § 6.02(b) (providing that only if further Subsequent Recoveries remain after payment to Ambac are "the amount of such remaining Subsequent Recoveries" applied to increase the Current Principal Amount of certificates). Because no write up occurs, the Court need not decide the proper mechanics of such write up as it relates to the 2006 Trusts.

[12] Dec. 19 Expert Allocation, NYSCEF No. 178.

III. All Certificates in the 2005 Trust Should Be Written Up First, Before the Settlement Payment is Distributed

Unlike the 2006 Trusts, the 2005 Trust does not give Ambac priority rights to Subsequent Recoveries. Here, Ambac relies on its subrogation rights, which entitle it to receive the Subsequent Recoveries that would otherwise be paid to holders of Insured Certificates. GPMF 2005-AR5 PSA (Tyrrell Aff. Ex. 3) § 4.10(d) ("[T]o the extent the Certificate Insurer pays any Insured Amount, either directly or indirectly . . . to the Holder of a Insured Certificate, the Certificate Insurer will be entitled to be subrogated to any rights of such Holder to receive the amounts for which such Insured Amount was paid . . . .").[13] Ambac's claim payments in the 2005 Trust far exceed the Allocable Shares for the relevant loan groups, so Ambac effectively stands in the shoes of the holders of Insured Certificates. Affidavit ¶¶ 10-12.

Two issues raised in the Petition are relevant to the 2005 Trust: (1) whether all certificates should be written up by the Settlement Payment (Petition ¶¶ 45-48); and (2) whether the Write-Up First Method or Pay First Method should be used (Petition ¶¶ 21-40). The Settlement Agreement answers both of these questions: *all classes* of certificates previously written down by Realized Losses should be written up, and this write-up must occur *first*, before distributions are made.[14]

[13] Ambac's Certificate Guaranty Insurance Policy (Policy Number AB0936BE) further provides that Ambac's insurance "payments of principal or interest shall be made only upon presentation of an instrument of assignment in form and substance satisfactory to Ambac, transferring to Ambac all rights under such Insured Obligations to receive the principal of and interest on the Insured Obligation. Ambac shall be subrogated to all the Holders' rights to payment on the Insured Obligations to the extent of the insurance disbursements so made." (Tyrrell Aff. Ex. 6); *see also id.* Endorsement p. 4 (providing that the "terms and provisions of the [GPMF 2005-AR5 PSA] constitute the instrument of assignment").

[14] As explained above, it is not necessary for the Court to reach these issues for the 2006 Trusts because the entirety of the Allocable Shares for the relevant loan groups should be paid directly to Ambac.

A. All Certificates that Were Written Down by Realized Losses Should Be Written Up

The Settlement Agreement requires writing up *all* certificates that were previously written down by Realized Losses, including the Insured Certificates:

> After the distribution of the Allocable Share to a Settlement Trust pursuant to Subsection 3.06(a), the Accepting Trustee for such Settlement Trust will apply . . . the amount of the Allocable Share for that Settlement Trust in the reverse order of previously allocated losses, to increase the balance of *each class of securities* (other than any class of REMIC residual interests) to which such losses have been previously allocated . . . .

Settlement Agreement § 3.06(b) (emphasis added). The only classes exempt from the write up are the REMIC residual interests. All other classes, including the Insured Certificates, are to be written up by the amount of the Settlement Payment "by not more than the amount of such losses previously allocated to that class of securities . . . ." *Id.*[15]

B. The Write-Up First Method Should Be Used

Additionally, the Settlement Agreement requires that certificates be written up *before* distributions are made to holders, *i.e.*, the Write-Up First Method. The Settlement Agreement provides for an iterative process for the Settlement Payment to flow to the ultimate recipients. First, the Settlement Payment "shall be deposited into the related Trust's collection or distribution account." Settlement Agreement § 3.06(a). Then, the Settlement Payment is distributed "in accordance with the distribution provisions of the Governing Agreements . . . as though such Allocable Share was a 'subsequent recovery . . . .'" *Id.* Section 3.06(b) addresses the timing of the write-up. Write-up occurs "[a]fter the distribution of the Allocable Share *to a Settlement Trust* pursuant to Subsection 3.06(a) . . . ." Settlement Agreement § 3.06(b) (emphasis added). Therefore, write-up occurs after deposit of the Settlement Payment into each

[15] In the case of the Insured Certificates, Ambac becomes the owner for all purposes of any written-up balances via its subrogation rights.

trust's distribution account (*i.e.*, distribution to a "Settlement Trust"), but before distribution to the holders.

Were write-up intended to occur after both payment to the Trust and distribution to holders, Section 3.06(b) would have provided that the write-up occurs after the distribution of the Allocable Share *to investors*. But instead, the Settlement Agreement specifies that the write-up occurs after payment *to the Trust*, which occurs before distribution to the ultimate recipients. *See Goldstein v. AccuScan, Inc.*, 2 N.Y.3d 811, 812 (2004) ("[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms.").

CONCLUSION

For the foregoing reasons, the Court should instruct Wells Fargo, as Trustee, to pay the entire Allocable Shares for loan group II of GPMF 2006-AR3 and loan groups I and II of GPMF 2006-AR2 directly to Ambac. The Court also should instruct Wells Fargo to distribute the Allocable Shares for loan groups II and III of GPMF 2005-AR5 using the Write-Up First Method, and to write up all certificates that were written down for Realized Losses by the amount of the Allocable Shares, in the reverse order that Realized Losses were allocated as required by the Settlement Agreement, and then to pay to Ambac, as subrogee of the holders of the GPMF 2005-AR5 Insured Certificates, the portion of the Allocable Shares that would otherwise be payable to such holders.

Date: September 14, 2018

By:

/s/ Henry J. Ricardo

PATTERSON BELKNAP WEBB & TYLER LLP
Henry J. Ricardo
1133 Avenue of the Americas
New York, NY 10036-6710
Tel: (212) 336-2000
Fax: (212) 336-2222
hjricardo@pbwt.com

Attorneys for Ambac Assurance Corporation