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

ABN AMRO BANK N.V.; BARCLAYS BANK PLC; BNP PARIBAS; CALYON; CANADIAN IMPERIAL BANK OF COMMERCE; CITIBANK, N.A.; HSBC BANK USA, N.A.; JPMORGAN CHASE BANK, N.A.; KBC INVESTMENTS CAYMAN ISLANDS V LTD.; MERRILL LYNCH INTERNATIONAL; BANK OF AMERICA, N.A.; MORGAN STANLEY CAPITAL SERVICES INC.; NATIXIS; NATIXIS FINANCIAL PRODUCTS INC.; COÖPERATIVE CENTRALE RAIFFEISEN-BOERENLEENBANK B.A., NEW YORK BRANCH; ROYAL BANK OF CANADA; THE ROYAL BANK OF SCOTLAND PLC; SMBC CAPITAL MARKETS LIMITED; SOCIÉTÉ GÉNÉRALE; UBS AG, LONDON BRANCH; and WACHOVIA BANK, N.A.,

Petitioners,

- against -

ERIC DINALLO, in his capacity as Superintendent of the New York State Insurance Department, the NEW YORK STATE INSURANCE DEPARTMENT, MBIA INC., MBIA INSURANCE CORPORATION, and MBIA INSURANCE CORP. OF ILLINOIS,

Respondents.

Index No. 601846/09

Hon. Barbara R. Kapnick

MBIA'S SUR-REPLY MEMORANDUM OF LAW
IN FURTHER OPPOSITION TO ARTICLE 78 PETITION

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Highly Confidential

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MBIA respectfully submits this sur-reply memorandum of law in further opposition to the Petition[1] and in response to the Banks' reply and memorandum of law in further support of their verified petition, dated March 11, 2011 ("Banks' Reply").[2]

Submitted herewith in opposition to the Petition are:

A. the affidavits of:

(i) Joseph W. Brown, MBIA Inc.'s CEO, who refutes the Banks' mischaracterizations of certain of his public statements; and

(ii) C. Edward Chaplin, MBIA's President and MBIA Insurance's CFO, who refutes certain incorrect assertions by the Banks, corrects certain information in the record and otherwise supplements his November 24, 2009 affidavit;

and

B. the expert affidavits of:

(i) Professor Tom Baker, a leading expert on insurance regulation, who demonstrates that the Superintendent had the clear authority and discretion to approve the Transformation, for which there is extensive precedent, and that the former Superintendents hired by the Banks offer, at most, after-the-fact opinions that they would have exercised their discretion differently, which is insufficient to satisfy the standard for sustaining the Banks' Article 78 Petition;

(ii) Jane Boisseau, a leading insurance law specialist and the lead attorney for MBIA in connection with the Transformation, who refutes the Banks' erroneous

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[1] Except as otherwise defined herein, capitalized terms used herein are the same as those used in MBIA's memorandum of law in opposition to Article 78 petition, dated November 24, 2009 ("MBIA Opp."). MBIA, as used herein, refers collectively to the MBIA Respondents. Also submitted herewith as Appendix A is a chart summarizing the evidence rebutting each of the arguments asserted by the Banks' purported experts.

[2] Submitted herewith in further opposition to the Petition is the Affidavit of Geoffrey P. Miller, sworn to November 15, 2011 ("Miller Aff."); the Affidavit of Edward W. Buttner, sworn to November 16, 2011 ("Buttner Aff."); the Affidavit of Tom Baker, sworn to November 15, 2011 ("Baker Aff."); the Affidavit of Jane Boisseau, sworn to November 15, 2011 ("Boisseau Aff."); the Affidavit of Louis G. Dudney, sworn to November 16, 2011 ("Dudney Aff."); the Affidavit of James K. Finkel, sworn to November 16, 2011 ("Finkel Aff."); the Affidavit of Robert H. Edelstein, sworn to November 15, 2011 ("Edelstein Aff."); the Affidavit of C. Edward Chaplin, sworn to November 16, 2011 ("Chaplin Sur-Reply Aff."); and the Affidavit of Joseph W. Brown, sworn to November 16, 2011 ("Brown Aff."). The Banks submitted a 93 page, 197 paragraph, "Reply" (Banks' Reply 17-109), which contains numerous inaccuracies, misstatements, and factual allegations not raised previously in the Banks' Petition. To the extent a response is necessary, MBIA hereby denies all allegations contained in paragraphs 1 through 197 of the Banks' Reply, and states that the documents and testimony cited therein speak for themselves.

contentions concerning the NYID's approval process, based on her twenty-five years of experience dealing with the NYID;

(iii) Edward W. Buttner IV, a CPA and specialist in insurance company accounting and reporting, who refutes certain of the Banks' erroneous contentions concerning MBIA Insurance's accounting practices;

(iv) Louis G. Dudney, a CPA, CFF and Principal at the financial analysis AlixPartners firm and an expert on solvency and related issues, who demonstrates that MBIA Insurance was solvent after the Transformation, that the NYID's conclusions concerning MBIA Insurance's solvency were reasonable and that the affidavits of the Banks' experts, Ronald F. Greenspan and René M. Stulz, are rife with flawed assumptions, methodological errors and erroneous conclusions;

(v) Professor Robert H. Edelstein, a leading expert in macroeconomic financial analysis, who demonstrates that the macroeconomic outlook underlying MBIA's application for approval of the Transformation was reasonable as of the date of the Transformation;

(vi) James K. Finkel, a leading expert on structured finance products with the Duff & Phelps financial analysis firm, who demonstrates that MBIA's methodologies and assumptions for modeling ranges of expected performance of and projected losses on the structured finance products it insured were reasonable, sophisticated and appropriate at the time of the Transformation, that the NYID's review of that modeling was reasonable and appropriate, and that the opinions of the Banks' loss projection experts, Messrs. Greenspan and Stulz and BlackRock Solutions ("BlackRock"), are unfounded, misleading and unrealistic; and

(vii) Professor Geoffrey P. Miller, a leading expert on insurance and banking regulation, who demonstrates that the NYID's review of MBIA Insurance's financial condition was appropriate and consistent with best practices, that (contrary to the Banks' positions) the existence of the financial crisis supported the NYID's approval and that the Banks' contention that the NYID impermissibly took into account objectives other than protecting policyholders is unfounded, misleading and ignores that, according to their own testimony, the Banks' own former Superintendents themselves took into account public policy objectives in addition to the protection of policyholders.

PRELIMINARY STATEMENT

When they commenced this proceeding in June 2009 challenging the approval of MBIA's February 2009 Transformation by the NYID, the Banks marched into Court proclaiming that MBIA Insurance was on the verge of an imminent catastrophe. With alarmist rhetoric, the Banks claimed -- contrary to the findings of the agency charged by the Legislature to oversee the insurance industry and to make such findings -- that the Transformation had rendered MBIA Insurance insolvent. In fact, in carrying out and approving the Transformation, MBIA and the NYID sought to ensure that all of MBIA's policyholders, including the Banks and other structured-finance policyholders and municipal finance policyholders, would remain insured by well-capitalized insurance companies capable of paying claims as they come due.[3] It is now nearly three years since the Transformation. MBIA has been and remains solvent, has paid all claims to all policyholders as they have come due, and continues to do so. And, during those same three years, the NYID, which has continued to oversee and monitor MBIA, has made no contrary finding, because no such contrary finding has been or is warranted. In addition, PricewaterhouseCoopers LLP ("PwC"), MBIA's outside auditor, has issued two unqualified audit opinions on MBIA's GAAP and statutory financial statements for 2009 and 2010, notwithstanding the Banks' claims that MBIA was insolvent both before and after Transformation and that it continues to be insolvent.

Nonetheless, the remaining seven of the eighteen original Banks in this case persist in asking this Court to overturn the NYID's express approval of the Transformation, asserting that the approval was contrary to law, arbitrary and capricious, and that the Transformation left

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[3] The purpose of the Transformation was to facilitate, during an ongoing financial crisis, the unfreezing of the public finance markets by establishing a separate insurance company capable of writing new municipal finance insurance. (MBIA Opp. 1; Miller Aff. ¶ 59(a); Baker Aff. ¶¶ 70-71; Boisseau Aff. ¶¶ 16, 54, 86-87; Brown Aff. ¶¶ 5-6; Affidavit of C. Edward Chaplin, sworn to November 24, 2009 ("Chaplin Aff.") ¶ 39.)

MBIA Insurance insolvent and unable to meet its claims as they come due. However, the Banks have no legitimate basis for the relief they seek, and the NYID's approval should be upheld. That determination should be upheld under any standard, but it especially should be upheld under the extremely limited scope of judicial review of the NYID's approval under CPLR Article 78. Under Article 78, the NYID's determination -- made pursuant to its statutory authority -- may be overturned only if the Banks demonstrate that the NYID exceeded its jurisdiction or that its decision was arbitrary and capricious or lacked a rational basis. Here, the Banks have not made and cannot make such a showing. At bottom, the Banks' Petition amounts to a challenge to the NYID's approval of the Transformation -- and, in effect, to everything else the NYID has or has not done with respect to MBIA during the past three years -- based on nothing more than that they disagree with the NYID.

The simple fact is: over two years after commencing this Article 78 proceeding, and after taking unprecedented Article 78 discovery from MBIA and the NYID, including the production of millions of pages of documents and the depositions of MBIA's senior management and NYID employees, the Banks still are unable to identify any basis in law or fact that would warrant overturning the NYID's approval of the Transformation. The Banks' arguments come down to: alleged violations of procedural or other requirements that appear nowhere in the Insurance Law or anywhere else; language from e-mails and deposition testimony obtained during discovery that the Banks take out of context and distort; case law wholly inapplicable to the facts at issue here; unjustified and unsupported denigration of the NYID's expertise and capacity to perform the duties delegated to it by the Legislature; unjustified and unsupported denigration of the scope of the NYID's pre-approval review of the Transformation; misleading and patently inaccurate

expert reports concerning MBIA's loss modeling methodology and financial condition; and false innuendo concerning the motivations behind the NYID's approval of the Transformation.

None of the Banks' purported evidence supports their claims. Among other things, the Banks have submitted affidavits from four former Superintendents of the NYID criticizing the NYID's approval. When read in full, their opinions are little more than conclusory and irrelevant assertions that they "would have done it differently" than Superintendent Dinallo. But even that is contradicted by their own actions. At depositions, MBIA demonstrated that while the former Superintendents criticize Superintendent Dinallo for approving the Transformation because it would help unfreeze the public finance markets -- which they claim is not a permissible purpose under the Insurance Law -- they themselves approved transactions for comparable public interest reasons during their own tenures in office. Likewise, the Banks have submitted opinions from financial experts purporting to evaluate MBIA's financial condition but, in doing so, they improperly rely on alternate assumptions carefully selected -- *ex post facto* -- by the Banks to suit their position in this proceeding. However, even if the positions of the Banks' experts were reasonable, and they are not, the mere fact that Superintendent Dinallo could have approached the Transformation differently provides no legal grounds on which to attack his reasonable exercise of authority and discretion in approving the Transformation. Indeed, as the former Superintendents themselves correctly confirmed, the NYID's decisions concerning issues within its expertise, and concerning statutes that it has been charged by the Legislature with implementing, are entitled to great deference.

In an attempt to cast their Petition as something other than a simple disagreement with the NYID's findings, the Banks advance several arguments, each of which is meritless. First, the Banks argue that the NYID's review and approval of the Transformation did not meet the

requirements of the Insurance Law, so as to render the approval in violation of the law. (Banks' Reply 10-13.) The Banks contend that the Insurance Law required that: the NYID hire a third-party financial valuation firm to evaluate MBIA Insurance's financial condition as of the Transformation (*id.* at 47-50); the earned surplus required to pay the Dividend be measured as of the date of the Board of Directors' conditional resolution authorizing the Dividend rather than the date it was paid (*id.* at 10-11); the transactions comprising the Transformation be executed sequentially rather than simultaneously (*id.* at 116-117); the NYID apply the statutory requirements for dividends under Section 4105 to the Share Redemption, which is expressly governed by an entirely separate provision, Section 1411(d) (*id.* at 97-99, 118-124); the NYID reject the Reinsurance Transaction because MBIA Insurance purportedly had insufficient surplus (*id.* at 188); the NYID include in its Approval Letter all factual and legal support for its determination that would otherwise be found in the administrative record (*id.* at 136-139); the NYID afford policyholders prior notice and an opportunity to be heard (*id.* at 21, 34-35); and the Superintendent consider only certain policy aims when rendering his determinations. (*Id.* at 161-64.) None of these purported requirements has *any* basis in the Insurance Law whatsoever, and, indeed, neither the Banks nor their experts plausibly identify any violation of a single provision of the Insurance Law. As explained by University of Pennsylvania Law Professor Tom Baker, a leading expert on insurance law and regulation, the procedures employed by the NYID in reviewing the Transformation and the NYID's decision to approve Transformation were both properly within the authority and discretion of Superintendent Dinallo. (Baker Aff. ¶¶ 13, 16, 18-26.) Far from articulating a legitimate legal basis for challenging the approval of the Transformation, the Banks and their experts simply disagree with the NYID's application of its discretion.

Second, contrary to the carefully reasoned findings of the NYID following its review, the Banks contend that the terms of the Transformation were not fair, equitable, and reasonable to structured-finance policyholders, so as to render the Approval arbitrary and capricious. (Banks' Reply 131-35.) This argument is flatly contradicted by the NYID's findings that, among other things, post-Transformation, MBIA Insurance would continue to maintain "sufficient resources to meet policyholders' claims as they come due" (RX 1 (NYID Press Release).) Indeed, the NYID's determination is confirmed not just by PWC's audits, but also by the analysis of Louis G. Dudney, a leading solvency expert with extensive experience with monoline insurers, showing that MBIA Insurance was solvent following the Transformation. (Dudney Aff. 8-9, 47-49.)

Moreover, the Banks' argument depends entirely on the fallacious claim advanced by the Banks that policyholders are treated "fairly" only if they are treated identically. Thus, for example, the Banks and their experts point to their lack of access to "future earnings" of the public-finance business as demonstrating that structured-finance policyholders were not treated equitably. However, policyholders have no entitlement to future or even past earnings of an insurance company -- indeed, the Insurance Law provides explicitly for dividend payments by insurance companies -- and there is nothing in the Banks' insurance policies providing otherwise. As the Banks' own experts themselves testified, the question is not whether policyholders are treated "identically," but rather whether their insurers are left with sufficient assets to pay claims when due, which is precisely what the NYID reasonably and correctly determined with respect to MBIA Insurance -- *i.e.*, that it would remain solvent and have sufficient claims-paying resources. As Professor Baker shows, there is ample precedent, in New York and elsewhere, for liability-based restructurings, such as the Transformation, where insurance regulators, including the

NYID, "have approved the separation of insurance businesses to allow an insurance company to reenter or reinvigorate an insurance market, even in cases where some policyholders were treated differently than others, so long as the company makes adequate provisions for all of its policyholders." (Baker Aff. ¶ 16.)

Third, the Banks argue that the NYID's findings of fact as to MBIA Insurance's financial condition were inadequate, rendering the approval arbitrary and capricious. (Banks' Reply 136-39.) There is no basis under the Insurance Law or otherwise to support the Banks' argument. The Approval Letter itself contains the findings of fact underlying the NYID's approval of the Transformation. Moreover, courts look to the administrative record in determining whether a rational basis existed for the determination of an agency. Here, the record contains thousands of pages detailing the NYID's analysis, process and evaluation of the Application, as well as the communications between the NYID and MBIA regarding the Transformation. It is indisputable that the record clearly sets out the NYID's findings of fact underlying its determination and demonstrates that the determination was supported by a rational basis.

Fourth, the Banks contend that the process by which the NYID reviewed the Transformation Application was inadequate, rendering the approval arbitrary and capricious. (Banks' Reply 144-60.) In fact, as NYU Law Professor Geoffrey Miller, the Director of NYU Law School's Center for Financial Institutions and an expert with 25 years of experience in banking and insurance regulation, confirms, the procedures utilized by the NYID in its review of MBIA's financial condition were appropriate and consistent with financial institution regulation best practices. (Miller Aff. ¶¶ 65-69.) Nevertheless, by distorting and mischaracterizing evidence, the Banks denigrate the NYID as lacking sufficient resources and expertise to conduct the review, denigrate the quality and scale of the review conducted by the NYID and attack the

sufficiency of the NYID's review of MBIA's loss modeling. The Banks make these arguments despite the fact -- as the Banks knew when they purchased their policies -- that the Legislature delegated to the NYID itself the responsibility to regulate insurers like MBIA, and to review and approve exactly the types of transactions at issue in this proceeding, which the NYID has done for over twenty years. (Boisseau Aff. ¶ 80.) Moreover, the Banks' claims that the NYID's review was "misled" are belied by the record and by the established standards for such reviews by agencies, including the NYID.

The Banks' attacks on the NYID's process rest entirely on red-herring issues. For instance, the Banks criticize the sufficiency of particular aspects of MBIA's loss modeling methodology, such as the use of so-called "large loan overrides," the adequacy of MBIA's loss projections, the propriety of the discount rate MBIA used in setting its loss reserves, and the sufficiency of the NYID's review of MBIA's methodology, such as the reasonableness of approving the Transformation based on data and analysis from several months prior to the NYID's approval of the Transformation. The Banks do so, notwithstanding that their own expert, Mr. Paltrowitz, testified at deposition that: (1) his firm, BlackRock, uses similar large loan analyses and overrides; (2) a regulator's reliance in February 2009 on an analysis of illiquid assets, like those at issue here, from the fall of 2008 would not be unreasonable; and (3) loss projections may turn out to be wrong, but may nevertheless be reasonable. Indeed, as James K. Finkel, a structured-finance expert with over 24 years of experience in the creation of and trading and investment in a wide variety of structured finance products, confirms, the modeling methodologies and assumptions MBIA employed in projecting losses on such products were

sophisticated, acceptable, up-to-date, and reasonable for the context in which they were used.[4] (Finkel Aff. ¶ 18.)

The Transformation was an effort in the public interest to ensure the availability of insurance in order to unfreeze the public finance markets. It was accomplished without a dime of taxpayer funds. It was reviewed for more than a year by dedicated professionals and approved by Superintendent Dinallo in the utmost good faith. Contrary to the Banks' egregiously false claims, no one "looted" anything or was enriched by it. By contrast, the banking industry several years ago was bailed out with billions of dollars in taxpayer funds, after meetings over one weekend, to rescue it from the very financial crisis it played a major role in creating. The Banks should not be heard to complain about what the NYID did here, and their Petition should be dismissed in its entirety.

ARGUMENT

I. THE NYID'S APPROVAL OF THE TRANSFORMATION IS ENTITLED TO DEFERENCE

Judicial review of an agency determination, such as the NYID's approval of the Transformation, is deferential and extremely limited. Under CPLR § 7803, this Court may disturb the NYID's approval of the Transformation only if the NYID acted "in excess of jurisdiction" or its approval was "made in violation of lawful procedure," was "affected by an error of law," or was "arbitrary and capricious or an abuse of discretion." The NYID's approval of the Transformation was none of these things. To the contrary, in reviewing and approving the Transformation, the NYID carefully and correctly applied the applicable provisions of the

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4 Likewise, Edward W. Buttner IV, a certified public accountant with specialized knowledge and expertise in accounting, auditing, and reporting matters as they pertain to insurance companies, insurance regulators, and other insurance-related entities, concludes, among other things, that MBIA Insurance's calculation of the discount rate used to set its loss reserves as of December 31, 2008 complied with the Insurance Law and statutory accounting principles prescribed by the NYID. (Buttner Aff. ¶ 13.)

Insurance Law, followed its established procedures in reviewing MBIA's Transformation Application and relied upon experienced professionals and applicable industry standards.

The Banks and their experts have had two and one-half years to review the NYID's approval of the Transformation and they have come up with no valid basis for challenging it. From the beginning of this proceeding, the Banks' attack on that approval has been premised on misstatements of the facts and law, cherry-picked statements from NYID and MBIA employees taken out of context, and baseless rhetoric. This is designed to try to shield from the Court the indisputable truth: the Banks are asking this Court to overturn the NYID's approval of the Transformation -- which was entirely appropriate and correct -- based on nothing more than their disagreement with that determination.

That, of course, cannot justify disturbing the NYID's determination; even a court's disagreement with an agency's determination is not sufficient basis for disturbing it. *See* cases cited at MBIA Opp. at 6-9; *see also Plaza Mgmt. Co. v. City Rent Agency*, 48 A.D.2d 129, 131, 368 N.Y.S.2d 178, 180 (1st Dep't 1975) ("The judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body. . . .Whether or not we (or Special Term) would have acted differently or defined the broad terms involved in a different manner, is of no moment.") (internal quotation marks omitted).

The Banks assert that the NYID is entitled to "no deference" here because, they claim, the NYID's approval of the Transformation "turns on questions of 'pure statutory reading and analysis.'" (Banks' Reply at 10, 110.) This is patently wrong. As the Banks' own cases make clear, where, as here, an agency has been charged with implementing a specialized body of law, the agency "is presumed to have developed an expertise that requires [courts] to accept its interpretation of that law if not unreasonable." *Teachers Ins. & Annuity Ass'n of Am. v. City of*

N.Y., 82 N.Y.2d 35, 41-42, 603 N.Y.S.2d 399, 401-02 (1993) (deferring to agency's interpretation of phrase "special historical or aesthetic interest"). It is only where the question is one of "pure legal interpretation" that no such deference to the agency is owed. *Id.* Here, by contrast, the Banks are seeking to overturn not the NYID's "pure legal interpretation" of the Insurance Law, but its *application* of such Insurance Law standards as "earned surplus," "reasonable and equitable," and "fair and equitable."[5]

Thus, where -- as unquestionably is the case here -- "'the interpretation of a statute or its application involves knowledge and understanding of underlying operational practices or entails an evaluation of factual data and inferences to be drawn therefrom, the courts regularly defer to the governmental agency charged with the responsibility for administration of the statute.'" *In re Claim of Gruber*, 89 N.Y.2d 225, 231, 652 N.Y.S.2d 589, 593 (1996) (quoting *Kurcsics v. Merchants Mut. Ins. Co.*, 49 N.Y.2d 451, 459, 426 N.Y.S.2d 454, 458 (1980)); *see also Toys 'R' Us v. Silva,* 89 N.Y.2d 411, 418-19, 654 N.Y.S.2d 100, 104 (1996) ("[I]n questions relating to its expertise, the [agency]'s interpretation of the statute's terms must be given great weight and judicial deference, so long as the interpretation is neither irrational, unreasonable nor inconsistent with the governing statute.") (internal quotation marks omitted).

Moreover, Insurance Law § 201 gives the Superintendent broad power -- *i.e.*, the "rights, powers, and duties, in connection with the business of insurance in this state, expressed or reasonably implied by [the Insurance Law] or any other applicable law of this state." There thus can be no question but that decisions of how best to implement, interpret and apply the Insurance Law fall squarely within the purview of the NYID's specialized expertise and are entitled to

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[5] The Banks rely upon authority that, unlike here, does concern only questions of pure statutory interpretation. *See, e.g., Polan v. State Ins. Dep't*, 3 N.Y.3d 54, 58, 781 N.Y.S.2d 482, 484 (2004) (explaining that administrative agency was not entitled to deference where the court interpreted the plain language of Section 4224 of the Insurance Law).

great deference. *See* cases cited at MBIA Opp. 5-7, 16-17; *see also LMK Psychological Servs., P.C. v. State Farm Mut. Auto. Ins. Co.*, 12 N.Y.3d 217, 223, 879 N.Y.S.2d 14, 14 (2009) (Superintendent's calculation of attorneys' fees was entitled to deference because it was not irrational, unreasonable, nor counter to the wording of Insurance Law § 5106(a)); *Mercy Hosp. of Watertown v. N.Y. State Dep't of Soc. Servs.*, 79 N.Y.2d 197, 204, 581 N.Y.S.2d 628, 632 (1992) (affirming agency determination, on the ground that "the Legislature has delegated administrative duties in broad terms, leaving the agency to determine what specific standards and procedures are most suitable to accomplish the legislative goals"); *Appelbaum v. Deutsch*, 66 N.Y.2d 975, 978, 499 N.Y.S.2d 373, 374 (1985) (where agency is "responsible for administering and enforcing [a statute]," its interpretation must "be given great weight and judicial deference, so long as the interpretation is neither irrational, unreasonable, nor inconsistent with the governing statute") (internal quotation marks omitted); *Breen v. Cunard Lines S.S. Co.*, 33 N.Y.2d 508, 511, 355 N.Y.S.2d 333, 335 (1974).

Moreover, courts refuse to overturn agency determinations where -- again, as unquestionably is the case here -- the petitioner submits merely contrary or competing evidence to challenge the sufficiency of the agency's process or the basis on which the agency determination was made. *See Mercy Hosp.*, 79 N.Y.2d at 204, 581 N.Y.S.2d at 632 (agency's "decision to employ statistical sampling in conducting audits" fell well within its broad legislative grant of authority"); *Procaccino v. Stewart*, 25 N.Y.2d 301, 306, 304 N.Y.S.2d 433, 435 (1969) (Superintendent's determination not arbitrary and capricious where it was based on "reasonable cost projections," even if "cost projections were . . . too conservative and too low").

As shown further below, all of the NYID's determinations here -- including its approval of the Transformation and its determinations of how and when to calculate "earned surplus"

under Insurance Law § 4105(a), of whether the Share Redemption was "reasonable and equitable" under section 1411(d), and of whether the Reinsurance Agreement was fair and equitable -- are the quintessential kind of determinations that are not "purely statutory interpretation" and are within the authority and expertise of the NYID. The Banks do not, because they cannot, point to a single instance in which the NYID undertook a "purely legal statutory interpretation." All of the NYID's determinations therefore are entitled to deference in this proceeding.

II. THE NYID'S APPROVAL OF THE TRANSFORMATION COMPLIED FULLY WITH THE INSURANCE LAW

Under any standard, the NYID's approval of the Transformation complied fully with the Insurance Law. *See* MBIA Opp. 14-17; NYID Opp. 16-32. There is no question that this is true, particularly given the deference due to that determination.

A. The Banks' Attacks On The Legality Of The Dividend Are Meritless.

Under Insurance Law § 4105(a), insurers may not "declare or distribute any dividend to shareholders except out of earned surplus." As the NYID correctly confirmed in its Approval Letter, MBIA Insurance had more than sufficient earned surplus to declare and distribute the Dividend to MBIA Inc. (RX 2 (R00971-80 [Approval Letter]) at 976); Baker Aff. ¶¶ 60-69; Buttner Aff. ¶¶ 20, 102, 116-17; Chaplin Aff. ¶ 89.) The Banks nonetheless claim that the Dividend declared and distributed by MBIA Insurance to MBIA Inc. was illegal. (Banks' Reply 114-18.) The Banks are wrong.

1. MBIA Insurance's earned surplus was correctly measured as of the date the dividend was paid.

The Banks contend that MBIA Insurance's earned surplus was insufficient to pay the Dividend, because they claim earned surplus should have been measured on the date the Board of Directors of MBIA Insurance conditionally approved the proposed dividend (December 16,

2008), rather than on the date of the Transformation. (Banks' Reply 114-15.) The banks are wrong. This argument rises and falls on the Banks' erroneous assertion that MBIA, not yet having executed the Reinsurance Transaction, lacked sufficient earned surplus to consummate the Transformation. (*Id.* at 115.) This argument is absurd, and evidences the Banks' implicit acceptance of a simple fact: consistent with the NYID's findings, the Transformation, executed on February 18, 2009, complied fully with all applicable aspects of the Insurance Law, including, but not limited to, Section 4105(a).

In fact, the Dividend was declared and distributed on the date it was paid, February 18, 2009 -- the day after the Transformation was approved, the day the Transformation occurred, and the day MBIA Insurance's earned surplus increased as a result of the Transformation. On December 16, 2008, MBIA Insurance did not declare and distribute a dividend. Rather, on that date, its Board of Directors provided only a contingent approval, authorizing the dividend "at such time and on such terms as may be approved by a Designated Officer, subject to receipt of any applicable regulatory approvals." (RX 3 (R00629-32) at 631.) Indeed, the resolution the Board passed expressly conditioned the Dividend and the Transformation as a whole on "receipt of approval from the Illinois Division of Insurance and the New York State Insurance Department" -- events that could only occur in the future. (*Id.* at 630.) Accordingly, there is no basis to measure MBIA Insurance's earned surplus when it was conditionally authorized by the Board to occur at some time in the future; nothing was declared or distributed on the date of that conditional authorization.[6]

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[6] The case law relied on by the Banks for the uncontroversial proposition that "a company must comply with financial dividend restrictions when declaring *and* paying a dividend" (Banks' Reply 114) (emphasis in original), is entirely inapposite. In those instances, unlike here, the dividends actually had been declared and distributed at the time in question. *See Liebman v. Auto Strop Co.*, 241 N.Y. 427, 433 (1926) (involving minority stockholder's challenge to majority stockholder's decision to declare and distribute dividend); *Randall v. Bailey*, 23 N.Y.S.2d 173, 176-79 (Sup. Ct. New York County 1940) (involving suit in bankruptcy court to recover dividends declared and paid), *aff'd*, 262 A.D. 844 (1st Dep't 1941), *aff'd*, 288 N.Y. 280 (1942).

Even if the Banks were correct that the Board of Directors' conditional resolution did constitute the Dividend's declaration and distribution, and they plainly are not, MBIA Insurance still would have had sufficient earned surplus for the Dividend. On December 16, 2008, the Board of Directors also resolved to conditionally authorize the Transformation transaction that increased earned surplus -- namely, the Reinsurance Transaction. (RX 3 (R00629-32) at 630-31.) Thus, if the Dividend is deemed to have been "declared and distributed" when the Board resolved to conditionally authorize it, so too must the Reinsurance Transaction be deemed to have been made -- and earned surplus sufficiently increased (MBIA Opp. 14-15) -- on that date. Accordingly, even under the Banks' erroneous contention, the Dividend fully complied with the Insurance Law.

2. MBIA Insurance had sufficient earned surplus <u>on February 17, 2009 to distribute the dividend.</u>

The Banks also contend that MBIA Insurance still lacked sufficient earned surplus on February 17, 2009 to satisfy Section 4105(a) because, they claim, the Reinsurance Transaction, which released sufficient earned surplus to declare and distribute the Dividend, supposedly occurred after the Dividend. The Banks' argument is based entirely on the erroneous contention that the Transformation transactions occurred sequentially, not simultaneously, and that -- notwithstanding statutory accounting (*i.e.*, the accounting required by the Insurance Law) to the contrary -- the Reinsurance Transaction could not "create" earned surplus. (Banks' Reply 95 ¶ 166 n.156, 99 ¶¶ 174, 116.) Again, the Banks are wrong.

Contrary to the Banks' artificial contention that the Transformation was sequenced, the record could not be clearer that the interdependent transactions comprising the Transformation were carried out -- and were viewed as being carried out -- simultaneously, not sequentially. For example, when asked whether it would be fair to say all the "Transformation Transactions

occurred simultaneously when the [NYID] approved them on February 17," Deputy Superintendent Moriarty responded: "[t]hat was our understanding, yes." (RX 4 (Moriarty Dep.) 419:10-20.) Regarding whether the Approval Letter accurately described the order in which the Transformation occurred, Mr. Moriarty testified that "[t]he transactions, as far as I know, were not performed in any specific order but were done simultaneously as part of the transformation application."[7] (*Id.* at 93:17-94:02; *see also id.* at 245:10-14.)

In fact, the Transformation *was* a "package deal" -- none of the transactions comprising it would have taken place without all of the others. MBIA Insurance approved the transactions subject to regulatory approval of the entire Transformation. The Transformation was presented by MBIA to the NYID as a package deal. The NYID approved each of the transactions comprising it at the same time and made clear it considered and approved it as a package deal. And, of course, the Transformation was carried out as a package.

Further, as explained by MBIA's expert witnesses, Professor Baker and Ms. Boisseau, the Reinsurance Transaction removed approximately $3.48 billion in policy liabilities from the balance sheet of MBIA Insurance, and reserves to support these liabilities were transferred to the reinsurer, MBIA Illinois. (Baker Aff. ¶¶ 62-63; Boisseau Aff. ¶ 58.) The release of these liabilities and the payment of a ceding commission to MBIA Insurance from MBIA Illinois resulted in a substantial increase in MBIA Insurance's earned surplus. (*Id.*) Thus, the Transformation itself -- through the Reinsurance Transaction -- released sufficient earned surplus

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[7] The Banks mischaracterize deposition testimony of MBIA's Treasurer, Mr. Pastore, claiming that he "acknowledged" that the Transformation occurred sequentially. (Banks' Reply 117.) In fact, Mr. Pastore testified correctly and clearly: "I don't think of it as transaction A, B, C. I think of it as a transformation transaction, and I believe it was approved on that basis. It was not approved as one independent transaction from another. I don't think you could have one without the other. It was one transaction." (RX 5 (Pastore Dep.) 75:23-76:06.) In the testimony to which the Banks refer, Mr. Pastore explained that he was referring to MBIA's movement of funds associated with each component of the Transformation, not the booking of funds which occurred simultaneously. (RX 5 (Pastore Dep.) 74:12-79:21.)

for MBIA Insurance to declare and distribute the Dividend. (Buttner Aff. ¶¶ 20, 115-17, 119-20, 123, 135; Baker Aff. ¶¶ 60-69.) Indeed, such reinsurance transactions between affiliated insurers are common, and they often result in an increase in earned surplus in one of the companies. In fact, during 2009 and 2010, there were nearly 2,000 property/casualty insurers that either assumed and/or ceded premiums to affiliated reinsurers, many of which resulted in an increase in an insurer's earned surplus. (Buttner Aff. ¶ 122.)

The Banks also maintain that the Insurance Law required MBIA to sequence the components of the Transformation. (*See* Banks' Reply 35, 95-96, 99, 116-17; *see also* Corcoran Aff. ¶ 18; Stewart Aff. ¶ 33.) Nothing supports that argument. For example, the Banks cite to Section 4105(a) (Banks' Reply 116), but the plain, unambiguous language of that section has no such requirement.[8] Accordingly, the NYID's interpretation and application of Section 4105 must be accorded the deference it is due.

The Banks also rely on former Superintendent Stewart for the proposition that Section 4105(a) "requires that earned surplus exist ***before*** a dividend is distributed." (*Id.* (citing Stewart Aff. ¶¶ 13-28, 33) (emphasis in original).) However, at deposition, Mr. Stewart could cite *no* provision of the Insurance Law to support this claim and, indeed, testified that he was not aware of any Insurance Law provision prohibiting the creation of earned surplus as part of a transaction. In any event, Mr. Stewart admitted that he was not opining as to the legal

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[8] The Banks cite to portions of the Chaplin and Moriarty depositions concerning whether the reinsurance component of Transformation could have been approved as a stand-alone transaction to support their argument that the Transformation was sequenced. (Banks' Reply 116.) Neither deponent, however, ever stated that, in the event that the NYID had requested the Transformation be sequenced, which it did not, MBIA Insurance was prohibited from entering into a reinsurance transaction with MBIA Illinois prior to executing a share redemption or a dividend. (*See* RX 6 (Chaplin Dep.) 427:11-428:14; RX 4 (Moriarty Dep.) 95:7-96:2.) Further, it was never contemplated by MBIA or the NYID that any of the Transformation transactions would be effected on their own without the others. (Boisseau Aff. ¶ 70.)

requirements of Section 4105 or any other provision of the Insurance Law. (RX 7 (Stewart Dep.) 158:25-59:9; *see also* RX 8 (Muhl Dep.) 90:4-14.)

Moreover, Section 4105(a) "authorizes the Superintendent to make a 'finding that the insurer *will retain* sufficient surplus to support its obligations and writings.'" (*See* Baker Aff. ¶ 65 (emphasis added).) Professor Baker also makes it clear that this clause contradicts the Banks' contention that the Superintendent cannot base his finding on surplus released through a related transaction. (*See* Baker Aff. ¶ 65 ("The use of the future tense -- 'will retain' -- points to the future, after the transaction is complete, and indicates that the Superintendent has the authority to make 'his finding' based on surplus created during a set of related transactions.").)

The Banks argue that the simultaneity of the Transformation is an "after-the-fact theory." (Banks' Reply 116.) The Banks are wrong. As the facts demonstrate, the NYID and MBIA always viewed the Transformation as interdependent component transactions that were designed to occur simultaneously and were, in fact, carried out simultaneously. (Boisseau Aff. ¶ 67; *see also* RX 4 (Moriarty Dep.) 93:23-94:2, 121:14-18.) Indeed, as early as February 22, 2008, when MBIA first met with the NYID to discuss a potential restructuring of MBIA's business, MBIA told the NYID that the "various components of the restructuring were interdependent and should be viewed as occurring simultaneously," and "NYID representatives present at the meeting indicated that the transaction worked as a simultaneous transaction." This view of the simultaneity of the components underlying the Transformation never changed and, in fact, was confirmed during subsequent conversations between MBIA's legal counsel and the NYID's legal counsel. (Boisseau Aff. ¶¶ 68-70.)

In addition, the Banks cite to terms used by both MBIA and the NYID when describing the Transformation, such as "series of transactions," "step" and "once," as supposed evidence

that the components underlying the Transformation did not occur simultaneously. (Banks' Reply 35, 95, 116-17; *see also* Corcoran Aff. ¶ 18; Stewart Aff. ¶¶ 30-31.) The Banks use such words entirely out of context. The Transformation was comprised of complex financial components, and the documents quoted by the Banks were created to describe the Transformation's component parts or "steps" as a convenient way to isolate the specific transactions that comprised the restructuring as a whole. (Boisseau Aff. ¶ 71.) The words cited by the Banks were "not intended to *specify* any set chronological sequencing of the components of the Transformation. This understanding was explicitly shared by MBIA, Dewey, and the NYID." (*Id.* at ¶ 71.) This is typical in complex transactions where, as here, there are a number of components. (Buttner Aff. ¶¶ 20, 116-17.)

Finally, in a last-ditch attempt to invalidate the Dividend, the Banks wrongly cite to an approval letter for a separate and unrelated transaction requested by MBIA and approved by the NYID more than a year after the approval of the Transformation. (RX 9; Banks' Reply 118.) The Banks misconstrue the approval letter for that other transaction to argue that MBIA Insurance's increase in earned surplus as a result of the Reinsurance Transaction was an "accounting anomaly" because it was "not the product of historic profits" and thus was not sufficient to support the Dividend. (Banks' Reply 110.)

However, that separate and unrelated transaction concerned a reset of MBIA Illinois's earned surplus, and has nothing to do with the issues here. The NYID clearly had the authority to approve MBIA Illinois's request to reset its earned surplus (Ins. Law § 4108(a); RX 10 (NAIC Statements of Statutory Accounting Principles 55-57), and the Banks do not -- because they cannot -- cite to any statute, regulation, or provision of the Insurance Law showing otherwise.[9]

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[9] The NYID's approval of that unrelated transaction is the subject of a separate Article 78 proceeding commenced by the Banks. (*See* RX 11 (Verified Petition, *Barclays v. Wrynn*, No. 651811/10 (October 22, 2010)).)

(Banks' Reply 118.) Moreover, the Banks' characterization of MBIA Insurance's increase in earned surplus as "not result[ing] from historic profits" is factually incorrect. (Banks' Reply 118.) MBIA Insurance had sufficient earned surplus precisely because of the historic profits that were the result of writing both public finance and structured finance policies. The $760 million ceding commission that MBIA Insurance received as a part of the Reinsurance Transaction, along with the release of liabilities associated with the reinsurance of public finance policies, were direct results from these activities. The historic profits resulting from those activities thereby increased earned surplus sufficient to support the Dividend pursuant to Section 4105(a). (*See* Buttner Aff. ¶¶ 102, 116-19, 123, 135; Baker Aff. ¶¶ 63-66.)

B. The Banks' Attacks On The Legality Of The Share Redemption Are Meritless.

The Banks claim that the Share Redemption allegedly violated the Insurance Law. (Banks' Reply 118-25.) As shown (MBIA Opp. 15-16), the Share Redemption complied fully with the Insurance Law, and each of the Banks' arguments is meritless.

1. <u>The NYID Correctly Applied Insurance Law §1411(d) to the Share Redemption.</u>

The Banks erroneously argue that the Share Redemption really was an alleged "disguised" dividend. (Banks' Reply 118.) However, share redemptions and dividends are separate and distinct financial transactions, governed by different provisions of the Insurance Law. A share redemption is governed by Section 1411(d), and is an authorized and well-recognized method for a New York insurer to distribute assets to its shareholders, in exchange for shares previously issued to the shareholders. (*See* Baker Aff. ¶¶ 64-67; Buttner Aff. ¶¶ 104-05; Boisseau Aff. ¶ 48.) A dividend, on the other hand, is governed by Section 4105(a), and constitutes an authorized and well-recognized method for a New York insurer to distribute

earnings to its shareholders. (*See* Baker Aff. ¶¶ 64-67; Buttner Aff. ¶¶ 20, 104; Boisseau Aff. ¶ 48.)

The Banks thus ignore the plain meaning of Sections 4105(a) (governing dividends) and 1411(d) (governing stock redemptions). Not surprisingly, the Banks cite no statute, regulation, or provision of the Insurance Law to support their argument, but resort to a strained reading of the legislative history to support their erroneous contention that the Legislature intended Section 4105(a) to apply to all "distributions," including both share redemptions and dividends. (Banks' Reply 119-20.) However, the legislative history of Section 4105 does not include any discussion of share redemptions (*see* RX 12 (PX 136)), and in any event, cannot trump the plain language of Section 1411. Indeed, under the Banks' argument, Section 1411 of the Insurance Law impermissibly would be rendered meaningless.[10] (*See* Buttner Aff. ¶ 107; Baker Aff. ¶¶ 64-68.)

Further, share redemptions and dividends are subject to separate accounting requirements under the Insurance Law. Assets used to support a share redemption must come from the insurer's "paid in and contributed surplus," a specific line item on an insurer's official statutory financial statement that shows the amount of assets that the shareholder has paid in and contributed to the insurer. (Baker Aff. ¶¶ 67-68; Buttner Aff. ¶¶ 105-06.) The Insurance Law allows the insurer to return such capital to its shareholder, in exchange for shares previously issued. (*See* Baker Aff. ¶¶ 67-68.) Assets used to support a dividend, however, must come from the insurer's "earned surplus," which is derived from the "unassigned funds" line item from an insurer's official statutory financial statement and shows the amount of earnings an insurer may

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10 The Banks' expert, former Superintendent Stewart, admitted that he had no personal experience approving stock redemptions pursuant to Section 1411(d). (RX 7 (Stewart Dep.) 220:12-20.) However, former Superintendent Serio, another one of the Banks' experts, had experience approving not only stock redemptions, but share redemptions occurring simultaneously with dividends (RX 13 (Continental Ins. Co. Approval Letter)), and acknowledged -- consistent with the law -- that different standards and statutes apply to the determination to approve a dividend and share redemption. (Serio Dep. 397:17-398:9.)

distribute, after the NYID's approval (or after notifying the NYID in the case of dividends that may be distributed as of right). (Baker Aff. ¶¶ 64-65; Buttner Aff. ¶ 106.) The Banks' experts acknowledge as much. (*See* RX 14 (Corcoran Dep.) 236:14-22 (acknowledging that "dividends are paid out of earned surplus and funds for stock redemptions come from paid-in capital"); RX 7 (Stewart Dep.) 223:20-224:8 (same).)

The Banks contend incorrectly -- without basis -- that the requirements of Section 4105(a) apply to a distribution of assets made pursuant to Section 1411(d).[11] (Banks' Reply 119-20.) To the contrary, absent statutory authorization, Section 4105(a)'s requirements may not properly be applied to a transaction that is explicitly governed by the requirements in a separate provision, here Section 1411(d). (*See* MBIA Opp. 15-17 and the cases cited therein.)

Indeed -- when the Banks' own expert Mr. Serio was Superintendent -- the NYID approved a stock redemption and an extraordinary dividend at the same time, pursuant to the distinct Insurance Law provisions for each type of transaction. (Boisseau Aff. ¶ 48.) As Mr. Serio acknowledged at his deposition, during his tenure, the NYID approved National Continental's application both to pay an $8 million extraordinary dividend and to make a return of capital of $6 million through a stock redemption. (RX 15 (Serio Dep.) 385:13-390:15.) Moreover, National Continental's application to the NYID reflects that these two transactions were to be approved pursuant to distinct sections of the Insurance Law. (RX 13 (Continental Ins. Co. Approval Letter) 8; *see also* Baker Aff. ¶ 69 n.102.)

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[11] The Banks' authority for this contention concerns neither the Insurance Law nor the application of a share redemption where a separate statute speaks directly to that type of transaction. *See Official Comm. of Unsecured Creditors of Buckhead Am. Corp. v. Reliance Capital Group, Inc. (In re Buckhead Am. Corp.)*, 178 B.R. 956, 969 (Bankr. D. Del. 1994) (applying Del. Law of Corp. & Bus. Org. § 174, which expressly provides for "[l]iability of directors for unlawful payment of dividend <u>or</u> unlawful stock repurchase or redemption"); N.Y. Bus. Corp. Law §§ 510, 719(a)(1).

Far from a so-called "book keeping device" (Banks' Reply 121), the Share Redemption is exactly the type of transaction to which the Legislature intended Section 1411(d) to apply.[12] In fact, the NYID, on numerous occasions, has approved, pursuant to Section 1411(d), share redemptions from a New York insurer to its sole shareholder.[13] (Boisseau Aff. ¶ 48; *see, e.g.*, RX 16 (Rampart Report on Examination) 3 (permitting share redemption from subsidiary insurance company to its parent and sole shareholder).) Indeed, when Mr. Serio was first deputy Superintendent of the NYID in 1999, the NYID approved Compass Insurance Company's application for a stock redemption to its sole shareholder.[14] (RX 17 (Compass Report on Examination) 3.)

2. Although None is Required under the Insurance Law, the Share Redemption had a Legitimate Business Purpose.

The Banks also contend that the NYID's approval of the Share Redemption was unlawful because it allegedly lacked a "legitimate business purpose." (Banks' Reply 124-25.) The Banks' argument has no basis in fact or law.

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12 The Banks' citation to *People ex rel. Wedgewood Realty Co. v. Lynch*, 262 N.Y. 202 (1933) for the proposition that the Share Redemption was a "bookkeeping device" (Banks' Reply 121), is misplaced. There, the court agreed with an agency's interpretation and application of a statute providing for a tax rate for dividend transactions higher than for a distribution of capital where the agency determined that the distribution "constituted a dividend in fact." *Id.* at 207. Here, the NYID interpreted and applied the statute it administers, determining that the Share Redemption met the requirements of Section 1411(d).

13 That the Banks claim Section 1411(d) sought to "prevent possible self-dealing by management and insiders" (Banks' Reply 120), is of no moment. The NYID's review and analysis of the Application confirmed that the Share Redemption was "reasonable and equitable" and that the Transformation would leave policyholders with a solvent insurer with sufficient claims-paying resources. Thus, unlike in *Servomation Corp. v. State Tax Commission*, nothing in the NYID's determinations "countermand[s]" Section 1411(d) or any other provision of the Insurance Law. *See* 51 N.Y.2d 608, 612-13, 435 N.Y.S.2d 686, 688 (1980).

The Banks' reliance on *People v. Santi*, 3 N.Y.3d 234, 786 N.Y.S.2d 405 (2004) for the proposition that the NYID's interpretation of Section 1411(d) should be overturned as an "unreasonable or absurd application of law" (Banks' Reply 120), is entirely inappropriate. That case has nothing to do with the Insurance Law. Rather, it concerns a criminal defendant's interpretation of the Education Law, not that of an agency expressly charged with interpreting and implementing the statute. 3 N.Y.3d at 244, 785 N.Y.S.2d at 411.

14 The Banks' citation to *Small v. Sullivan*, 245 N.Y. 343 (1927) is entirely misplaced. *Small* stands for the uncontroversial proposition that a court should review the "actual facts" concerning a distribution of capital, as opposed to blindly relying on the form that the distribution takes. *Id.* at 354. That is precisely what the NYID did here under its legislative mandate, finding that the Share Redemption met the requirements of Section 1411(d).

First, neither the Banks nor their experts can point to a single provision of the Insurance Law that requires a separate or specific business purpose for the NYID to approve a share redemption.[15] (*See* RX 14 (Corcoran Dep.) 246:10-253:17; RX 7 (Stewart Dep.) 234:8-13; RX 18 (Stulz Dep.) 156:10-16.) This is not surprising. Neither Section 1411(d) nor any other Insurance Law provision contains any such requirement.[16] Section 1411 provides only that "[n]o domestic stock insurer shall purchase its own capital shares except . . . pursuant to a plan of stock redemption and retirement approved by the superintendent as reasonable and equitable." Absent from the wording of this statute is any suggestion, much less requirement, that a share redemption satisfy some undefined "business purpose."[17]

The Banks nonetheless contend, with no authority, that a "business purpose" is required by the "reasonable and equitable" standard. (Banks' Reply 124-25.) That is not so, and the NYID's interpretation and application of the "reasonable and equitable" standard (both here and in other cases (*see supra* n.18) are entitled to deference.

In any event, even if there were a "business purpose" requirement, the Transformation clearly meets that qualification. The business purpose of the Share Redemption, as with the

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[15] Indeed, when Mr. Serio was First Deputy Superintendent of the NYID in 1999, and the NYID approved Compass Insurance Company's application for a stock redemption, Compass Insurance was in run-off and could not be said to have any "legitimate business purpose" as defined by the Banks and their experts. (RX 17 (Compass Report on Examination) at 3.) Nevertheless, in September 1999, the NYID approved the company's stock redemption to its parent. (*Id.*)

[16] The cases cited by the Banks for the proposition that Section 1411(d) must be read to include the requirements of Section 4105(a) are inapplicable, as none even address the Insurance Law. *See Scott v. Mass. Mut. Life Ins. Co.*, 86 N.Y.2d 429, 433-35, 633 N.Y.S.2d 754, 756-57 (1995) (addressing whether defendant was employee or independent contractor and whether certain conduct was actionable discrimination pursuant to Human Rights Law); *Sanders v. Winship*, 57 N.Y.2d 391, 396-97, 456 N.Y.S.2d 720, 723 (1982) (addressing whether spouse of "cooperative shareholder" is herself a "cooperative tenant" under Civil Rights Law); *Servomation Corp. v. State Tax Comm'n*, 51 N.Y.2d 608, 612-13, 435 N.Y.S.2d 686, 688 (1980) (holding that State Tax Commission could not issue regulation that conflicted with court's prior interpretation of Tax Law).

[17] The Banks' only support for their assertion is the deposition testimony of Mr. Corcoran that a business purpose requirement is contained in SSAP # 25. (RX 14 (Corcoran Dep.) 241, 247-48.) SSAP # 25 does not contain any legal requirement for a Share Redemption, but relates only to the proper accounting for transactions, which differs, depending on whether or not the transaction had a business purpose. (Buttner Aff. ¶¶ 109-10.)

Transformation as a whole, was to "promptly establish a U.S. public finance financial guaranty insurance company at a capital adequacy level sufficient to provide lower-cost funds to public issuers and to assist in 'unfreezing' the public finance and infrastructure markets, while preserving MBIA [Insurance] as a well capitalized highly solvent insurer."[18] (RX 6 (Chaplin Dep.) 419-20; *see also* Brown Aff. ¶¶ 5-7; Miller Aff. ¶ 59; Baker Aff. ¶ 10.)

Ignoring this fact, the Banks assert that the Stock Redemption did not have a legitimate purpose because it allegedly "removed assets from MBIA Insurance to enrich its parent and affiliate, and to discriminatorily benefit one class of policyholders at the expense of another." (Banks' Reply 125.) Again, that is not so. In full compliance with Section 1411(d), the NYID reviewed the Share Redemption, including its purpose and its effect on MBIA Insurance policyholders, and determined that it was "reasonable and equitable," as it left MBIA Insurance policyholders with an insurer that was sufficiently capitalized and capable of paying its claims as they come due. (RX 2 (R00971-80 [Approval Letter]) at 976-77; RX 1 (NYID Press Release) 2.) That is all the policyholders are entitled to. "In short, the NYID found that MBIA Insurance could afford to return capital to . . . MBIA Inc., [which] could deploy this capital by contributing it to MBIA Illinois, which needed capital for its ongoing business plan." (Boisseau Aff. ¶ 54.)

Moreover, these conclusions are squarely within the NYID's expertise, and there is no basis for disturbing them. (*See* Baker Aff. ¶¶ 20-21 ("Open-ended standards such as 'reasonable and equitable,' 'surplus sufficient to support its obligations and writings,' and 'fair and equitable' vest broad administrative discretion in the Superintendent. This broad discretion reflects the fact that evaluating a major insurance company transaction is a complex, multi-faceted task that has no one right answer for all parties and all times.").) Indeed, Mr. Corcoran,

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[18] The Banks' arguments that the Transformation was carried out for other reasons are based on disingenuous distortions of the evidence. (*See, e.g.*, Brown Aff. ¶¶ 11-16.)

Mr. Serio, and Mr. Stewart all acknowledged that the Superintendent has the power to determine whether a proposed stock redemption is "reasonable and equitable" under Section 1411(d). (RX 14 (Corcoran Dep.) 168:24-169:14; RX 15 (Serio Dep.) 158:20-159:9; RX 7 (Stewart Dep.) 236:22-237:2.)

a. The NYID confirmed that MBIA Insurance received fair value from MBIA Inc. for the Share Redemption.

Contrary to the Banks' assertions (Banks' Reply 118, 125), the NYID confirmed that MBIA Insurance received fair value for the shares it redeemed as a part of the Share Redemption. (RX 2 (R00971-80 [Approval Letter]) at 976-77.)

MBIA and the NYID valued MBIA's common stock using book value pursuant to MBIA Insurance's policyholder surplus outstanding as of December 31, 2008, which was roughly $3.5 billion. (RX 4 (Moriarty Dep.) 110-11.) The Banks contend that the NYID's use of book value as a means of valuing stock is "inadequate" as a matter of law. (Banks' Reply 125.) However, neither the Insurance Law nor any other law requires that a specific financial analysis be performed in determining the value of shares being redeemed as a part of a share redemption. (Baker Aff. ¶ 21.) While the Banks contend that MBIA and the NYID should have evaluated MBIA Insurance's common shares based on prior valuations of MBIA Insurance's preferred stock, the market price of "credit default swaps" on MBIA Insurance, or the "investment value" of MBIA Insurance's common stock (Banks' Reply 126-27), these methods of valuation are not requirements, but at most are suggestions as to what the law should be.[19] The Banks do not, as

[19] Indeed, the Banks' own documents demonstrate that the prices of CDS and stock quotes during this time period suffered from "liquidity distortions." (*See, e.g.*, RX 19 (UBS_00050106-107) ("Credit spreads for these names suffer from liquidity distortions, while both credit spreads and stock prices are suffering from risk aversion overshooting among investors, so I realize that other, more market based measures are failing us as well.");

they cannot, identify a single provision of the Insurance Law that provides anything to the contrary.[20]

Moreover, the Banks' argument flies in the face of NYID precedent and practice. The NYID previously has permitted share redemptions based on book value. (*See, e.g.*, RX 16 (Rampart Report on Examination) 3 (permitting share redemption from subsidiary insurance company to its parent and sole shareholder at book value); Boisseau Aff. ¶ 55 (formula used by the NYID for valuing MBIA Insurance's common stock "was based upon the formula that [she had] used in similar share redemption transactions on behalf of other clients that [she has] represented before the NYID" and that the NYID had originally suggested to her).[21]

C. The Reinsurance Transaction Fully Complied With The Law.

The Banks contend that that the Reinsurance Agreement was somehow unfair and inequitable to them. (Banks' Reply 128.) This assertion is belied by the facts. As shown (MBIA Opp. 11 n.4; Chaplin Aff. ¶ 91), the NYID examined whether the Reinsurance Transaction was "fair and equitable" to MBIA Insurance and its policyholders both in terms of the Reinsurance Agreement itself, and the Transformation as a whole, determining that the Reinsurance Transaction satisfied Insurance Law §§ 1505(a) and (d).[22] (RX 2 (R00971-80 [Approval Letter]) at 977.)

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[20] *Friedman v. Beway Realty Co.*, 87 N.Y.2d 161, 167, 638 N.Y.S.2d 399, 403 (1995) and BCL § 623 relate solely to approval rights of dissenting shareholders and, contrary to the Banks' assertions (Banks' Reply at 125-126), therefore have no application here.

[21] Likewise, the Banks' contention that, when ascribing a value to MBIA Insurance's common stock, MBIA and the NYID should have accounted for the senior priority of MBIA's preferred stockholder and surplus note holders, is baseless. (Banks' Reply 127.) Even accounting for the value of these senior equity and debt interests ($1.23 billion), MBIA Insurance's policyholder surplus of $3.5 billion was more than sufficient to execute the $1.123 billion share redemption.

[22] The ceding commission paid to MBIA Insurance by MBIA Illinois for the reinsurance exceeded the amount of ceding commission that MBIA Insurance had recently paid, 21%, to FGIC, for a similar portfolio of business. (Chaplin Aff. ¶ 44; Boisseau Aff. ¶ 59; *see* MBIA Opp. 10.)

The Banks, nonetheless, allege that "MBIA Illinois indisputably could not have reinsured MBIA Insurance's ***$554 billion*** public finance bond portfolio without first being capitalized by MBIA Insurance." (Banks' Reply 129 (emphasis in original).) This is not so. As shown, the Transformation was not sequenced, all components occurred simultaneously. Neither the Dividend nor the Share Redemption occurred before the Reinsurance Transaction -- they all were executed simultaneously.[23]

Nonetheless, the Banks claim that the NYID should have included the $2.27 billion transferred from MBIA Insurance to MBIA Inc. through the Dividend and Share Redemption, in addition to the $3.48 billion unearned premium reserves, when evaluating the "fairness" of the ceding commission. (Banks' Reply 129-31.) The Banks, however, do not -- because they cannot -- cite to any statute, regulation, or law to support such revisions to the terms of the Reinsurance Transaction.[24] The NYID was required to and did review the *actual* terms of the Reinsurance Transaction, and after a thorough review of these terms, the NYID concluded that the Reinsurance Transaction was "fair and equitable" to MBIA Insurance and that it did not "adversely affect the interest of the policyholders." (RX 2 (R00971-80 [Approval Letter]) at 977.)

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[23] The Banks quote Mr. Moriarty's deposition testimony, in which he stated that "[i]f the reinsurance transaction was entered into stand-alone, the Department would not allow it to be done with a company with $185 million surplus because immediately post transaction the company -- the assuming company would be insolvent." (Banks' Reply 129 (quoting Moriarty Dep. 185).) It is indisputable that the Reinsurance Transaction was not "stand-alone," but one part of an interdependent set of transactions executed simultaneously, and the Banks' reliance on Mr. Moriarty's deposition testimony is thus misplaced.

[24] The Banks' authority for the proposition that the NYID's finding of "reasonable and equitable" must be annulled because the Banks disagree with MBIA's calculation of MBIA Insurance's market value are inapposite. Unlike here, that authority concerns scenarios where the agency disregarded key facts, or key evidence simply did not exist. *See, e.g.*, *Trump on the Ocean, LLC v. Cortes-Vasquez*, 76 A.D.3d 1080, 1085, 908 N.Y.S.2d 694, 699 (2d Dep't 2010) (reversing agency determination "disregard[ing] the facts").

D. The Banks' Attacks On The Transformation, As A Whole, Are Meritless.

As shown (MBIA Opp. 11), the NYID properly determined that the Transformation, in its entirety, complied with the relevant provisions of the Insurance Law, and was "fair and equitable" to all policyholders. (RX 2 (R00971-80) [Approval Letter].) Nothing the Banks argue undercuts these findings. While the Banks put forward a number of arguments -- all meritless -- as to why *they and their experts* believe the Transformation did not meet the "fair and equitable" standard, the Banks fail to establish that Superintendent Dinallo's determination to the contrary was arbitrary and capricious so as to justify overturning it. As Mr. Stewart acknowledged, whether a transaction meets the "fair and equitable" standard is entirely within the authority and discretion of the Superintendent. (RX 7 (Stewart Dep.) 244:3-11; *see also* Baker Aff. ¶¶ 20, 153.)

The Banks claim that the Transformation unfairly removed assets, including the public finance business, from MBIA Insurance (while essentially ignoring the transactions that added assets to the company). However, the Banks do not and cannot show that they have any right to their insurer's future potential earnings. No law so provides, and the Banks cite to none, and their policies do not provide them with any such right.[25] Indeed, the Banks' argument proves too much. Policyholders do not even have a right to their insurer's past earnings; if they did, the Insurance Law would not, for example, have provided for the payment of dividends, which it does. What policyholders are entitled to is an insurer able to pay claims as they come due -- and have concluded, reasonably and correctly, that MBIA Insurance, post-Transformation, would be able to pay its claims as they come due.

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[25] The policyholders of MBIA Insurance held no contractual right, implied or express, to any "future earnings" associated with MBIA's public finance insurance business. (RX 21 (Standard MBIA Ins. FGI Policy).)

The Banks also argue that the Transformation was not "fair and equitable" because it "ring-fenced" assets from the potential claims of MBIA Insurance's structured finance policyholders, such that MBIA Inc. and MBIA Illinois had no legal obligation to support MBIA Insurance in the event that MBIA Insurance cannot pay structured-finance policyholder claims. (Banks' Reply 133-34.) Unsurprisingly, however, neither the Banks nor their experts identify any authority in New York or elsewhere that prohibits "ring-fencing."[26]

In fact, as Professor Baker explains, not only is ring-fencing *not* expressly prohibited, but multiple insurers have completed restructurings, which involved, among other things, ring-fencing, in order to separate different lines of business: these precedents "demonstrate that the New York Superintendent and other insurance regulators have approved the separation of insurance businesses to allow an insurance company to reenter or reinvigorate an insurance market, even in cases where some policyholders were treated differently than others, so long as the company makes adequate provisions for all of its policyholders."[27] (Baker Aff. ¶ 16.) Thus, the Transformation was proper in that it "unlocked value by setting the stage for MBIA to reenter the public finance insurance business, enhancing the availability and affordability of that insurance for public entities in New York and elsewhere while preserving the claims-paying ability of MBIA's structured finance insurance unit." (*Id.* ¶ 10.)

Among the restructuring precedents discussed by Professor Baker is the Lloyds-Equitas transaction -- portions of which were approved by Superintendent Muhl, now an expert for the

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26 The Banks also ignore the fact that MBIA Inc. and MBIA Illinois would have a strong incentive to support MBIA Insurance. If MBIA Inc. were to allow MBIA Insurance to default on its obligations, the MBIA franchise would suffer reputational harm that would adversely affect all MBIA entities. (Brown Aff. ¶ 21; Baker Aff. ¶ 120.) As Mr. Brown clearly explains, "MBIA always understood that, even with the separation of the public finance and structured finance businesses, a default by MBIA Insurance on a structured finance obligation would damage the entire MBIA franchise." (Brown Aff. ¶ 21.)

27 Despite the Banks' (and their experts') attempts to characterize the Transformation as "unprecedented," Professor Baker confirms that numerous transactions serve as precedents for the Transformation. (*See* Baker Aff. § VIII (exploring in detail 9 separate precedential insurer restructurings).)

Banks in this proceeding. In that restructuring, Lloyd's created a financially separate run-off entity called Equitas to handle mounting asbestos and environmental liability claims. (*Id.* at. ¶¶ 78-79.) Through the creation of Equitas, Lloyd's separated "volatile, difficult-to-value asbestos and environmental business from Lloyd's ongoing business," unlocking value "in the form of new business that otherwise would not have been written," while treating separate classes of policyholders differently.[28] (*Id.* at ¶ 80; *see also id.* at ¶ 81 ("Like the Transformation, the Equitas transaction shared that unlocked value with the more volatile part of the old business through a reinsurance transaction.").) As Professor Baker also points out, the NYID under Mr. Muhl approved a key component of the Equitas transaction (a decision about the appropriate level of funding for a newly created Equitas trust fund) without high quality estimates about Equitas's liabilities. (*Id.* at ¶ 82.) As Professor Baker observes, both the Equitas transaction and the Transformation "sought to promote the availability and affordability of insurance by separating volatile legacy liabilities from the entity writing new business." (*Id.* at ¶ 87.)

III. THE NYID'S APPROVAL OF THE TRANSFORMATION WAS NOT ARBITRARY AND CAPRICIOUS, AND HAD A RATIONAL BASIS

The Banks' contention that the NYID's approval of the Transformation was "taken without sound basis in reason" and "without regard to the facts" is wholly unsupported. (Banks' Reply 135; *id.* 112-13, 135-60.) As shown, the Transformation complied with all relevant provisions of the Insurance Law and the Superintendent's approval was based on the NYID's "thorough" and "extensive" review of MBIA Insurance's post-Transformation financial

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[28] Professor Baker notes that while Mr. Muhl testified during his deposition that the Equitas transaction did not involve the different treatment of separate classes of policyholders, Mr. Muhl's testimony was inaccurate and calls into question his understanding of the transaction. (*Id.* at ¶ 81 n.129 (citing, among other things, Muhl Dep. 357:10-359:2).)

condition.[29] (MBIA Opp. 5-17; Chaplin Aff. ¶¶ 53-89; *see also* RX 2 (R00971-80 [the Approval Letter]); NYID Opp. 13-15; Buchmiller Aff. ¶¶ 19-58.)[30] The Banks offer nothing to rebut that showing. In fact, the very record on which the Banks base their arguments confirms that the NYID was not arbitrary or capricious, and that there was an eminently rational basis for its approval.[31]

The record is clear that MBIA provided the NYID with, among other things, "thorough and detailed information concerning the legal and financial basis for the Transformation, including an analysis of all the statutory and regulatory requirements and why each was satisfied." (Chaplin Aff. ¶ 46.) Thereafter and throughout the NYID's post-Application review of MBIA Insurance's post-Transformation financial condition, MBIA provided the NYID with unfettered access to its employees, loss models, and financial information. (Chaplin Aff. ¶ 53; McKiernan Aff. ¶ 11; Brown Aff. ¶ 19; Miller Aff. ¶ 28(f); Baker Aff. ¶¶ 33-37.) Following the NYID's review, the Superintendent approved the Transformation, finding that both MBIA

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29 The propriety of the Superintendent's review and determinations is confirmed by the findings of Mr. Finkel, a structured-finance expert, and Mr. Dudney, a solvency expert, who independently verified the reasonableness of MBIA Insurance's loss reserving methodology and post-Transformation solvency, respectively. (*See generally* Finkel Aff.; Dudney Aff.)

30 The Banks' reliance on *Paramount Communications, Inc. v. Gibraltar Casualty Co.*, 90 N.Y.2d 507, 663 N.Y.S.2d 133 (1997) and *Kurcsics v. Merchants Mutual Insurance Co.*, 49 N.Y.2d 451, 426 N.Y.S.2d 454 (1980), is misplaced. In both cases, unlike here, the NYID's interpretation of a statute contradicted its plain wording. *See Paramount*, 90 N.Y.2d at 510, 663 N.Y.S.2d at 134; *Kurcsics*, 49 N.Y.2d at 459, 426 N.Y.S.2d at 458.

31 The Banks do not -- because they cannot -- allege that the NYID's review and approval of MBIA's Transformation Application violated any provision of the Insurance Law. In fact, the former Superintendents retained by the Banks confirmed that they were not claiming that the Superintendent acted outside his statutory authority in approving the Transformation. (RX 8 (Muhl Dep.) 75:8-76:25, 91:3-11, 258:24-259:10; RX 15 (Serio Dep.) 143:12-147:24, 149:6-12; RX 7 (Stewart Dep.) 70:5-71:5, 82:24-83:4, 123:19-124:14.) The Banks and their experts do criticize the NYID based on the absence of pre-approval notice. (Banks' Reply 21, 34-35; Corcoran Aff. ¶¶ 80, 82; Serio Aff. ¶¶ 84-88, 93.) However, the lack of policyholder notice tellingly does not appear in their legal analysis, which is not surprising -- as none of the statutes pertaining to the Transformation require MBIA or the NYID to provide any type of notice to any policyholder. *See* Ins. Law §§ 1411(d), 4105(b), 1505(a). And the Banks' experts agree. (*See, e.g.*, RX 15 (Serio Dep.) 199:5-17; RX 8 (Muhl Dep.) 276:9-25). Although Mr. Muhl faulted the Superintendent for not providing notice (RX 8 (Muhl Dep.) 101:10-102:21), he testified that the Superintendent could not act unless he is explicitly authorized to do so under the Insurance Law (*id.* at 71:13-73:19), and that none of the provisions at issue here provided the Superintendent with the authority to provide notice to policyholders or to hold public hearings. (*Id.* at 101:4-9.)

Insurance and MBIA Illinois "would have sufficient resources to meet policyholder claims as they come due" and would "continue to pay all valid claims in a timely fashion." (RX 1 (NYID Press Release) 1-2.) That finding is supported by an extensive administrative record, which includes, among other things, interview transcripts of meetings between NYID and MBIA employees, and Mr. Buchmiller's fifty-nine page memorandum memorializing the NYID's findings.[32] (RX 22 (NYSID0002794-852 [Buchmiller Memo]) at 794.)

Faced with this record, the Banks are left to contend that the Superintendent was somehow unaware of Mr. Buchmiller's findings and to create phantom requirements through which they criticize the NYID's review. (Banks' Reply 142-52.) The Banks' contentions are meritless.

First, Mr. Buchmiller did not "backdate" his final memorandum to allegedly "paper the record." (Banks' Reply 112.) Although he did not complete the memorandum until after the approval, the evidence is undisputed that Mr. Buchmiller communicated his findings to his

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32 MBIA and its experts have identified a number of errors in certain of the materials in the record MBIA submitted to the NYID. (Chaplin Sur-Reply Aff. ¶ 3.) None of these corrections, however, would have changed the outcome of the NYID's review of the Transformation, or alter the fact that MBIA Insurance was solvent and fully able to pay its claims as they come due at the time of the Transformation. The fact that the complex issues addressed in Mr. Chaplin's affidavit were not identified before or during the NYID's review of the Application and MBIA Insurance's financial condition in no way impacts the soundness, completeness, or thoroughness of the NYID's review. (*Id.* ¶ 3.) Notably, the Banks have had these same materials for nearly two years, and neither they nor their experts -- including Mr. Greenspan, an expert in the field of monoline solvency and restructuring -- have identified any of these issues.

Moreover, the issues identified by Mr. Chaplin, albeit complex, are immaterial insofar as they do not affect MBIA Insurance's solvency or its ability to pay policyholder claims. The corrected materials demonstrate that, while MBIA Insurance's projected policyholder surplus and statutory capital would have been lower in the base, stress and extreme stress scenarios that were provided to the NYID, MBIA Insurance still was solvent and maintained assets sufficient to pay all policyholder claims as they came due. (Dudney Aff. 35-37, 47-49.) Although correcting certain issues in the extreme stress scenario decreased policyholder surplus to negative $291 million, MBIA Insurance still maintained more than $1.3 billion in contingency reserves, which provided MBIA Insurance with positive statutory capital of approximately $1 billion. (Chaplin Sur-Reply Aff. ¶ 13; Dudney Aff. 40) That MBIA Insurance's policyholder surplus projected to be negative for a limited amount of time in the extreme stress scenario is immaterial as well. (Chaplin Sur-Reply Aff. ¶ 13; Dudney Aff. 38-40.) The extreme stress scenario was specifically created for the NYID as a "break-the-bank" analysis to which "no probability" was associated, not as an actual measure of MBIA Insurance's post-Transformation claims-paying ability. (RX 22 (NYSID0002794-2852 [Buchmiller Memo]) at 805.) Nor does the extreme stress scenario take into account certain capital adjustments, such as other reserves, deferred tax assets, and potential put-back claims, all of which would make MBIA Insurance's surplus positive if included in the analysis. (Dudney Aff. 38; *see also* Chaplin Sur-Reply Aff. ¶ 14.)

supervisors prior to the approval date through, among other things, lengthy, detailed memorandums dated January 30 and February 11, 2009. (*See* RX 23 (Buchmiller Dep.) 93:23-94:16 (testifying that he communicated his conclusion prior to approval date that "[t]hrough [his] work [he] didn't find any reason for the Department to not approve [T]ransformation"); RX 24 (NYSID0002939-44 [January 30, 2009 memo]); RX 25 (NYSID0002855-56 [February 11, 2009 memo]).) Additionally, as Mr. Buchmiller testified at deposition, while the memorandum was created following approval of the Transformation, he dated it as of February 16, 2009 because it memorialized his Transformation-related work "as of" the Transformation decision. (RX 23 (Buchmiller Dep.) 283:21-22.) Moreover, Mr. Buchmiller testified that the memorandum also was created "for the purposes of the [ongoing] examination [of MBIA] as well as [T]ransformation" (*id.* at 133:22-24), and thus, it is unsurprising that he worked on the document following approval of the Transformation.

Second, the scope and process utilized by the NYID and Mr. Buchmiller to review MBIA Insurance's post-Transformation financial condition were entirely appropriate.[33] (Baker Aff. ¶¶ 33-50; Miller Aff. ¶¶ 14-22, 30-46, 65-69; Dudney Aff. 71-73.) In fact, because the statutes governing the Transformation "do not contain any specific procedural requirements," the "Superintendent has the authority to determine the process to be employed in approving a major insurance transaction like the Transformation." (Baker Aff. ¶ 153.) Moreover, because "the Transformation approval process employed an 'examination within an examination' that provided an independent check on the accuracy of the information submitted by MBIA and the

33 The Banks' experts' contentions to the contrary are irrelevant, as they constitute nothing more than their disagreement with the decision, which is insufficient for a court to overturn the decision of an agency. *See Idlewild 94-100 Clark, LLC v. City of N.Y.*, 27 Misc. 3d 1006, 1017, 898 N.Y.S.2d 808, 818 (Sup. Ct. Kings County 2010) (holding that "[c]ontrary to plaintiffs' suggestion, issues such as whether the Building was actually in imminent danger of collapse and whether demolition was the only appropriate remedy are discretionary determinations of [the agency] to which the Court must defer"), *aff'd sub nom, One Monroe, LLC v. City of N.Y.*, No. 2010-05417, 2011 N.Y. App. Div. LEXIS 8019 (2d Dep't Nov. 9, 2011).

solvency of MBIA Insurance," the approval process "went well beyond what would have been sufficient to protect policyholders in light of the concurrent financial examination of MBIA Insurance." (*Id.* at ¶ 154.)

Notably, each of the former Superintendents retained by the Banks conceded that the Superintendent has the discretion to determine the process by which to review a regulated insurer's application and that the Superintendent had the power to decide whether to approve such application. (RX 8 (Muhl Dep.) 93:22-94:2; RX 14 (Corcoran Dep.) 152:17-21; RX 15 (Serio Dep.) 187:19-88:5, 387:24-88:20; RX 7 (Stewart Dep.) 75:11-76:23.) Therefore, because the Superintendent was acting in his discretion and in an area within his expertise, his determination is entitled to deference.

Apparently recognizing that the review and approval of the Transformation complied with all applicable provisions of the Insurance Law, the Banks assert a series of meritless arguments challenging the NYID's review of the Application.

A. The Approval Letter Complies With New York Law.

The Banks incorrectly contend that the Approval Letter is inadequate. (Banks' Reply 136-41.) Nothing in the Insurance Law or elsewhere sets forth requirements of what must be included in an approval letter. In fact, it is well-established that where, as here, an agency grants an application, the agency need not make any "findings of fact." *See Hub Wine & Liquor Co. v. State Liquor Auth.*, 16 N.Y.2d 112, 119, 262 N.Y.S.2d 457, 461 (1965) ("The Authority is under no obligation to make findings of fact when it grants an application.") (internal quotation marks omitted). By contrast, to the extent courts have required specific findings to accompany an agency determination, they have only done so in cases involving administrative denials or

disapprovals.[34] *See, e.g.*, *Fink v. Cole*, 1 N.Y.2d 48, 54, 150 N.Y.S.2d 175, 179 (1956) (holding that "an administrative denial unaccompanied by specific factual findings" will "not satisfy the purposes of the statute" where "the errors are . . . so prejudicial to the petitioner as to call for a remission to the commission"). Thus, the Banks' own expert, former Superintendent Serio, issued an approval letter permitting an extraordinary dividend and a share redemption, which contained considerably less information than the Approval Letter.[35] (*See* RX 13 (Continental Ins. Co. Approval Letter) 8.)

In any event, the ten-page Approval Letter clearly demonstrates that the Superintendent and the NYID carefully analyzed the Transformation under the applicable provisions of the Insurance Law, and assessed the financial condition of MBIA Insurance both pre- and post-

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[34] This is confirmed by the cases cited by the Banks, all of which concern instances where, unlike here, an agency issued a disapproval, denial, termination, or otherwise adverse determination. *See, e.g.*, *Scanlan v. Buffalo Pub. Sch. Sys.*, 90 N.Y.2d 662, 665 N.Y.S.2d 51 (1997); *N.Y. Water Serv. Corp. v. Water Power & Control Comm'n*, 283 N.Y. 23 (1940); *Weill v. N.Y. City Dep't of Educ.*, 61 A.D.3d 407, 876 N.Y.S.2d 51 (1st Dep't 2009); *Basile v. Albany Coll. of Pharmacy of Union Univ.*, 279 A.D.2d 770, 719 N.Y.S.2d 199 (3d Dep't 2001); *Fariel v. Bd. of Educ.*, 230 A.D.2d 854, 646 N.Y.S.2d 545 (2d Dep't 1996); *Collins v. Governor's Office of Employee Relations*, 211 A.D.2d 1001, 621 N.Y.S.2d 748 (3d Dep't 1995); *Cent. NY Coach Lines, Inc. v. Larocca*, 120 A.D.2d 149, 508 N.Y.S.2d 639 (3d Dep't 1986).

[35] The Banks' assertion that the Approval Letter should have explained so-called "policy reversals" by the Superintendent has no basis in law' there is no obligation for the NYID to explain a supposed "policy reversal" absent *identical* circumstances. (Banks' Reply 140.) This is certainly the case where the circumstances – here, the financial crisis and MBIA Insurance's loss of its triple-A credit rating – drastically differ. *See, e.g.*, *In re Charles A. Field Delivery Serv., Inc.*, 66 N.Y.2d 516, 521, 498 N.Y.S.2d 111, 116 (1985) (reversing and remanding to agency for further consideration where "*the impossibility of distinguishing* [the instant and prior decisions] . . . require[s] explanation by the Board of why it reached a different result" where the facts were essentially identical) (emphasis added); *Klein v. Levin*, 305 A.D.2d 316, 320, 760 N.Y.S.2d 462, 467 (1st Dep't 2003) (granting petition and remanding for further proceedings because "petitioner's application presented *essentially identical facts* as those underlying the Insurance Department's prior decision" with respect to same applicant) (emphasis added). Here, the Banks have failed to identify a precedent or prior practice -- let alone a determination based on substantially identical facts -- with which the NYID's approval of the Transformation is inconsistent. *See, e.g.*, *In re Lafayette Storage & Moving Corp.*, 77 N.Y.2d 823, 826, 566, N.Y.S.2d 198, 199 (1991) (reversing and remanding for further consideration because "an administrative [decision that] . . . neither adheres to . . . prior precedent nor indicates [a] reason for reaching a different result on essentially the same facts is arbitrary and capricious") (internal quotation marks omitted); *Knight v. Amelkin*, 68 N.Y.2d 975, 978, 510 N.Y.S.2d 550, 550 (1986) (reversing Appellate Division and remanding to Zoning Board for further review because "petitioners have shown earlier determinations of the Board reaching contrary results on essentially the same facts"); *Buffalo Civic Auto Ramps, Inc. v. Serio*, 21 A.D.3d 722, 725, 800 N.Y.S.2d 686, 689 (1st Dep't 2005) (vacating and annulling NYID's determination reclassifying petitioner's cashiers for workers' compensation purposes because "[w]here two cases are so similar as to require the same treatment, to treat them differently would be . . . arbitrary and capricious"); *Civic Ass'n of the Setaukets v. Trotta*, 8 A.D.3d 482, 483, 778 N.Y.S.2d 524, 525 (2d Dep't 2004) (affirming annulment because "there was no rational basis for reaching a different result on essentially the same facts").

Transformation. (RX 2 (R00971-80 [Approval Letter]).) Likewise, the formal administrative record sets forth the evidentiary basis for the NYID's approval of the Transformation. Among other things, the record memorializes months of financial analysis, interviews with dozens of MBIA employees, and loss modeling methodology validation conducted by the NYID.[36] (*See generally* RX 2 (NYSID0002794-2852 [Buchmiller Memo]).)

In addition, the NYID's contemporaneous press release announcing the approval of Transformation, confirmed that the Transformation was "fair to all policyholders [including] the [petitioner] bank counterparties." (Chaplin Aff. ¶ 91; RX 1 (Press Release) 1.) In the press release, the Superintendent stated that: (1) the NYID had "facilitated and supervised" the Transformation; (2) the NYID "only approved [the transactions] after deciding that both [MBIA Insurance and MBIA Illinois] would have sufficient statutory capital to meet the letter and spirit of the Insurance Law;" and (3) both companies "will have sufficient resources to meet policyholder claims as they come due" and would "continue to pay all valid claims in a timely fashion." (*Id.* at 1-2.)

In arguing that the Approval Letter required additional findings of fact, the Banks incorrectly rely on cases concerning the "substantial evidence" standard in a quasi-judicial or adjudicatory proceeding, not the "arbitrary and capricious" standard at issue here. (Banks' Reply 136; *see, e.g.*, *Montauk Improvement, Inc. v. Proccacino*, 41 N.Y.2d 913, 913, 394 N.Y.S.2d 619, 620 (1977) (involving "State Tax Commission, acting in a quasi-judicial capacity"); *Simpson v. Wolansky*, 38 N.Y.2d 391, 392-94, 380 N.Y.S.2d 630, 631-32 (1975) (adjudicating sexual misconduct charges against agency employee); *Gitlin v. Hostetter*, 27 N.Y.2d 934, 935,

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36 The Banks' assert that the record reflects the "NYID's revisionist" justification for its approval of the Transformation is misplaced. (Banks Reply 137.) The Banks are wrong. Far from post-hoc rationalizations, the record contains contemporaneous documentation reflecting the intensive and thorough review conducted by the NYID, as well as the factual basis supporting the approval of the Transformation.

318 N.Y.S.2d 147, 148 (1970) (involving whether "substantial evidence" supported hearing officer determination to suspend liquor license).) Those cases, which involve a party's right to be apprised of the evidence and rebut it, are clearly inapplicable here, where the Banks' rights derive exclusively from their MBIA insurance policies subject to the Insurance Law provisions authorizing the NYID to approve the Transformation.[37]

B. Mr. Buchmiller Plainly Shared His Review And Analysis With His Supervisors At The NYID.

The Banks argue that the NYID's approval should be annulled because there is no evidence that Mr. Buchmiller ever shared his findings with appropriate supervisors, including the Superintendent. (Banks' Reply 142-43.) This argument is meritless.

By the date of the Approval Letter, Mr. Buchmiller had concluded his risk-focused review of MBIA Insurance's post-Transformation financial condition. (RX 23 (Buchmiller Dep.) 89:9-25.) Although he did not submit his Final Memorandum memorializing his findings until some weeks after the NYID approved the Transformation, it is clear from Mr. Buchmiller's testimony that by the Approval Date he had not seen "any reason not to approve the request, [and] that [MBIA Insurance's] reserving methods, methodologies, [and] procedures were

[37] The cases the Banks cite for the proposition that findings of fact cannot be based on "extralegal considerations" are inapposite insofar as they -- unlike here -- concern agency determinations: (1) based on improper considerations or insufficient factual findings, *see Simpson v. Wolansky*, 38 N.Y.2d 391, 396, 380 N.Y.S.2d 630, 632 (1975) (affirming remand of determination because agency improperly relied "on matters not appearing in the record in making the determination under scrutiny"); (2) where, unlike here, the agency failed to support its determination, *see ADC Contracting & Constr. Corp. v. N.Y. City Dep't of Design & Constr.*, 25 A.D.3d 488, 488, 808 N.Y.S.2d 69, 70 (1st Dep't 2006) ("There appears to be no transcript or other attempt at a formal record, and the Deputy Commissioner did not set forth his findings of fact to explain his reasoning"); or (3) or that failed to comply with express statutory mandates, *see Brady v. City of N.Y.*, 22 N.Y.2d 601, 606-07, 294 N.Y.S.2d 215, 218 (1968) (reversed and remanded to pension board for further review because board adopted "conclusory" opinion of a medical panel, and thereby impermissibly delegated its statutorily mandated duty to consider "all the available evidence"); *Howard v. N.Y. State Div. of Hous. & Cmty. Renewal*, No. 110686/2009, 2010 N.Y. Misc. LEXIS 1277, at *8 (Sup. Ct. New York County Feb. 1, 2010) (granting petition and annulling order permitting rent increase because Commissioner failed to make specific findings). Indeed, other case law cited by the Banks strongly supports affirmance of the NYID's approval. *See, e.g.*, *Wooley v. N.Y. State Dep't of Corr. Servs.*, 15 N.Y.3d 275, 280, 907 N.Y.S.2d 741, 741 (2010) (affirming denial of petition and finding that where agency determination "was made after consideration of the facts of the case," it "simply cannot be said [to have] lacked a rational basis").

reasonable, consistently applied and among what [he] would call best practices," and that he conveyed that conclusion to his superiors. (RX 23 (Buchmiller Dep.) 93:23-94:4; *see also* Finkel Aff. ¶ 24.) Additionally, Mr. Moriarty, the author of the Approval Letter, noted that the NYID's review also included two Transformation-related opinions from respected advisory firms, and independent reviews conducted by other members of the NYID staff, its legal staff, and its special advisor Perella Weinberg, all of which were confirmed by a clean audit opinion from PwC issued weeks after the NYID's approval of the Transformation. (RX 4 (Moriarty Dep.) 166:21-167:10.) Moreover, as shown, it is undisputed that Mr. Buchmiller regularly communicated the progress of his Transformation-related work to his supervisors, including through two lengthy memos. (*See* RX 24 (NYSID0002939-44 [January 30, 2009 memo]); RX 25 (NYSID0002855-56 [February 11, 2009 memo]); *see also* RX 8 (Muhl Dep.) 262:16; 265:11-19.)

C. The NYID's Review Confirmed That, Post-Transformation, MBIA Insurance Would Remain Adequately Capitalized And Able To Pay All Claims As They Come Due.

The Banks' claim that the NYID's review "could not supply a basis for any conclusion about MBIA Insurance's financial condition" is meritless. (Banks' Reply 144.) As shown, the NYID had more than sufficient resources, time, and expertise to perform an exhaustive, independent review and analysis of MBIA Insurance's policies, procedures, and loss reserving methodologies. (NYID Opp. 13-21, 31, 38; Buchmiller Aff. ¶¶ 19-55; Dudney Aff. 73.)

From that review, the NYID determined that post-Transformation MBIA Insurance would remain adequately capitalized and able to pay all claims as they came due. (Buchmiller Aff. ¶¶ 22, 57; Chaplin Aff. ¶¶ 31, 69-74; Miller Aff. ¶ 17; Baker Aff. ¶¶ 33-37.) Further, this determination has been independently verified by MBIA's solvency expert, Mr. Dudney. (Dudney Aff. 47-49.) Despite this evidence, the Banks assert baseless claims and assert phantom

requirements concerning the process employed by the NYID to review the Transformation, all of which are belied by the record. Incredibly, revealing the lengths to which the Banks will go to cast their simple disagreement with the NYID's approval of the Transformation as a legal basis for overturning that approval, Mr. Corcoran, without citing a single provision of the Insurance Law, goes so far as to say that "[e]ven if MBIA Insurance were able to pay all its claims as they came do[,]" the Transformation "was improper and should be reversed." (RX 14 (Corcoran Dep.) 343:11-344:7.)

Indeed, the Banks, with all of their resources -- and all of their experts -- have not been able, for two and one-half years, to come up with any valid or sustainable reason why the Transformation should not have been approved.

1. The NYID Used Sufficient Resources to Analyze the Application.

The Banks' assertion that the NYID was "not equipped to review" MBIA Insurance's structured-finance portfolio lacks any basis. (Banks' Reply 144.) The NYID, including Mr. Buchmiller, was well-qualified and experienced in evaluating the financial condition of a monoline insurance company, such as MBIA Insurance, and validating its loss modeling methodology.[38] (Buchmiller Aff. ¶¶ 2-6; NYID Opp. 3, 13-15; *see also* Miller Aff. ¶¶ 18-22; Baker Aff. ¶¶ 15, 23, 43-46.)

The Banks distort language from e-mails to support their contention that MBIA's employees believed the NYID lacked sufficient expertise. (Banks' Reply 146.) However, the Banks' distortions are belied by the testimony of those MBIA employees. For example, the

[38] The Banks contend that the NYID's review did not comply with National Association of Insurance Commissioners' ("NAIC") standards. (Banks' Reply 159.) Notably, Mr. Buchmiller himself was recently appointed to the second-highest position within the NAIC's newly-formed Capital Markets Bureau -- the division responsible for developing consistent standards regarding structured finance modeling and insurance company examinations. (RX 27 (Buchmiller Biography).) Thus, while the Banks paint Mr. Buchmiller as unqualified to lead the Transformation review, his pre- and post-Transformation experience shows otherwise.

Banks cite a single e-mail from Mr. Pastore to Mr. McKiernan wherein he suggests that MBIA use a "spoon-fed approach" to explain MBIA's loss modeling methodology to the NYID, to claim that MBIA believed the NYID lacked the requisite expertise. The suggestion is wrong. As Mr. Pastore testified at deposition, after working with Mr. Buchmiller throughout the Transformation review, Mr. Buchmiller's qualifications and expertise in the field were apparent. (RX 5 (Pastore Dep.) 95:15-98:17.)

The Banks, and their experts, allege further that the NYID improperly placed the responsibility for reviewing the Transformation Application solely with Mr. Buchmiller. (Banks' Reply 144; Serio Aff. ¶¶ 8, 42-44; Greenspan Aff. ¶¶ 23, 30, 36, 40, 52, 164, 212; Corcoran Aff. ¶ 69; Muhl Aff. ¶¶ 27, 38; RX 8 (Muhl Dep.) 196:21-24, 294:4-6; 305:24-306:5; RX 15 (Serio Dep.) 208:2-8; RX 7 (Stewart Dep.) 79:11-16.) This is inaccurate.[39] The Banks ignore the active involvement of, among others, the NYID's leadership, including Superintendent Dinallo, Deputy Superintendents Hampton Finer and Michael Moriarty, and special counsel Scott Fischer, and the NYID's outside counsel, Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank"), who analyzed the structure and reasonableness of the Transformation, as well as its overall purpose. (RX 4 (Moriarty Dep.) 131:6-8 ("[Hampton Finer] played a critical role, if not the leading role, in the review of the application of the transformation"); *id.* at 138:21-139:2 (between December 5, 2008 and February 17, 2009, John Kenny, the NYID's Special Counsel to Superintendent Dinallo, spent more time per week than Moriarty had reviewing the Transformation); *id.* at 142:19-23 (Robert Easton, the NYID's

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[39] MBIA's loss reserve methodology was independently verified not only by Mr. Buchmiller, but by Bridge as well. (*See* RX 28 (R00502-08) at 504-08.) Consistent with Mr. Buchmiller's and Bridge's findings, Mr. Finkel also determined that MBIA Insurance utilizes "reasonable methodologies in [its] . . . loss projections." (Finkel Aff. ¶ 24.) Indeed, PwC issued unqualified audit and actuarial opinions as to the propriety and adequacy of MBIA Insurance's loss reserves as of December 31, 2008. (*See* Buttner Aff. ¶ 58.)

General Counsel, "was also engaged in the review" of the Transformation); *see also* Miller Aff. ¶¶ 16-20; Baker ¶ 33; Boisseau Aff. ¶ 32.)

Further, Mr. Buchmiller was joined throughout the NYID's review by other NYID professionals who traveled with him to MBIA's offices for in-house modeling sessions as part of the NYID's ongoing examination of MBIA Insurance. Indeed, as a result of its on-going examination of MBIA Insurance, the NYID had acquired a wealth of institutional knowledge concerning MBIA Insurance leading up to the Transformation application, which provided a significant foundation for a comprehensive review process. (*See* Miller Aff. ¶ 27.) These individuals included: (i) Glenda Gallardo (examiner in charge of MBIA Insurance's risk surveillance examination as of December 31, 2008 (the "Solvency Exam"), which culminated in the Report on Examination of MBIA Insurance as of December 31, 2008 (the "Examination Report")); (ii) James Murphy (examiner assisting Ms. Gallardo in the Solvency Exam, and who had previously led the New York portion of MBIA Insurance's solvency exam during 2004-2005);[40] and (iii) Karen Gard (another subordinate of Ms. Gallardo assisting on the MBIA Solvency Exam).[41] (*See* Miller Aff. ¶ 16; *see also* RX 7 (Stewart Dep.) 274:24-275:11 (testifying that he believed NYID Deputy Superintendent Hampton Finer was an MBIA executive, and admitting that he was unaware of the extent to which individuals other than Mr.

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40 (*See* RX 29 (MBIA Ins. Co. 2003 Report on Examination).)

41 As Mr. Buchmiller testified, although there was no "formal reporting structure" associated with his review of MBIA, he did "communicate with a number of people" at the NYID regarding his review. (RX 23 (Buchmiller Dep.) 80:23-81:2.) This is confirmed by Mr. Buchmiller's correspondence regarding the review. (*See* RX 26 (NYISD0002853-54); RX 25 (NYSID0002855-56 {February 11, 2009 Memo).) Moreover, throughout the course of Mr. Buchmiller's review of MBIA, members of the NYID's Property Bureau who were working on the then on-going Examination of MBIA, "work[ed] with [Mr. Buchmiller] on the[] issues, [and] attend[ed] virtually all of the meetings." (RX 26 (NYSID0002853-54) at 854; *see also* RX 25 (NYSID0002855-56) at 55 (noting participation of Property Bureau Examination team in CMBS meetings); RX 22 (NYSID0002794-852 [Buchmiller Memo]) at 794 ("The Property Bureau's examiners have participated in nearly all of the [Transformation review] meetings").)

Buchmiller were involved in the process).)[42] Even had Mr. Buchmiller not been supported by these NYID professionals, his review would have been more than sufficient. As Professor Miller explains, "the single-reviewer model is a hallmark of state and federal agencies that rely on a single, highly-trained regulator to holistically review the agency's collective work product for consistency and quality before making a final ruling on behalf of the agency." (Miller Aff. ¶ 28; *see also* Baker Aff. ¶¶ 15, 35-37, 42-50.)

Likewise, the Banks' experts also erroneously allege that the NYID's determination relied too heavily on the views of "political appointees" as opposed to "career" staff. (Serio Aff. ¶¶ 8, 34-41; RX 8 (Muhl Dep.) 247:19-248:6; RX 14 (Cocoran Dep.) 293:16-294:25.) This assertion is entirely unsupported. The NYID review team consisted of career personnel, such as Mr. Buchmiller, Ms. Gallardo, Mr. Moriarty, Mr. Levine and Mr. Gingrass, and political appointees, such as Mr. Finer, Mr. Dinallo, Mr. Kenny and Mr. Easton. (Miller Aff. ¶ 21.) The division of labor between the career staff and political team broke down as follows: the career staff employed their "institutional memory and expertise" to investigate the facts and determine whether the Transformation should proceed from a risk perspective, and the political appointees determined whether the Transformation should be approved from a policy perspective. (*Id.*) Notably, when the Federal Reserve conducted its stress testing of the major investment banks in early 2009, this is exactly the type of "open relationship" that existed between the career employees at the Federal Reserve and political appointees, such as Federal Reserve Bank Chairman Ben Bernanke and U.S. Treasury Secretary Timothy Geithner. (*Id.* at ¶¶ 21-22.) As Professor Miller explains, both the composition of the NYID review team and the division of

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[42] Though these three examiners focused primarily on MBIA Insurance's loss reserving methodology from the perspective of the Solvency Exam, their participation in these sessions with MBIA, and their contemporaneous insight into MBIA Insurance's modeling methodology aided Mr. Buchmiller's review, serving as a quality control check on the information being presented simultaneously to each of them. (*See* RX 26 (NYSID0002853-54); RX 25 (NYSID0002855-56 [February 11, 2009 Memo]).)

labor among the members of that team was entirely consistent with best practices in the regulation of financial institutions. (*Id.*)

Moreover, as Professor Baker demonstrates and the Banks' own experts concede, the Superintendent has authority to approve insurance company restructurings, as well as the discretion to determine the resources and procedures to employ in the approval process. (Baker Aff. ¶¶ 16, 20-24.) Superintendent Serio confirmed during his deposition that the individuals staffed on the NYID's review of the Transformation application had the necessary experience to evaluate the transaction. (RX 15 (Serio Dep.) 187:19-191:24 (testifying that the "established regulatory practice[s]" of the NYID were "embodied in the professional staff of the department that had . . . done transactions of this nature and transactions with similar implications for policyholders and for the financial soundness and safety of institutions under their protection," and that specifically Messrs. Buchmiller, Moriarty and Dinallo were in this "club.").) Superintendent Muhl testified that no one at the NYID was more qualified than Mr. Buchmiller to conduct the review of MBIA's financial condition, and agreed that the NYID "[had] the expertise to do the financial examination," including the solvency review. (RX 8 (Muhl Dep.) 280:10-21, 290:18-292:25.) Each of the former-Superintendents agreed that the NYID itself is an expert in insurance regulation. (RX 15 (Serio Dep.) 131:23-147:24; RX 14 (Corcoran Dep.) 177:5-16; 298:10-299:4; 336:22-337:2; RX 7 (Stewart Dep.) 73:21-75:4; RX 8 (Muhl Dep.) 65:21-66:11; *see also* Baker Aff. ¶¶ 15, 23, 43-46.)

2. The NYID Appropriately did not Engage a Third-Party.

The Banks contend that the NYID's review of the Transformation Application was flawed because the NYID did not retain a third-party to analyze MBIA's structured finance portfolio. (Banks' Reply 145.) The Banks are wrong.

The Banks' position is entirely unsupported. The Banks' experts do not -- as they cannot -- cite to a single authority requiring the Superintendent to retain outside advisors. Indeed, each of the former Superintendents retained by the Banks conceded that the law does not require the NYID to retain a third-party to evaluate an insurer's financial condition. (RX 8 (Muhl Dep.) 94:3-6; RX 7 (Stewart Dep.) 75:11-76:23; RX 15 (Serio Dep.) 264:24-265:7; RX 14 (Corcoran Dep.) 183:7-184:20; *see also* RX 30 (Greenspan Dep.) 215:22-216:20.) In fact, Mr. Serio agreed that the NYID generally does not use third-parties to review "specific transactions," and when it does, that decision is left to the discretion of the Superintendent. (RX 15 (Serio Dep.) 266:3-6, 285:2-10.)

Moreover, the Banks and their experts do not identify a single instance where the NYID used an outside advisor to review a company's financial condition or modeling in connection with an application for a dividend, stock redemption, or reinsurance agreement. Mr. Serio, for example, could recall using outside advisors only for demutualization, liquidation, or rehabilitation proceedings, proceedings plainly inapplicable here. (RX 15 (Serio Dep.) 268:2-271:9.)

Tellingly, the Banks and their experts fail to square their insistence that the NYID should have retained an outside advisor and that the NYID lacked the ability to analyze complex structured finance products, with the NYID's performance of a tri-annual solvency examination of MBIA (or other monoline insurers for that matter). (*See* RX 15 (Serio Dep.) 277:22-279:15.) Specifically, the Examination Report contains a solvency finding by the NYID. (RX 31 (Examination Report) 22.) The Examination Report includes, among other things, a detailed balance sheet, as a solvency review customarily does, that reflects "the assets, liabilities and surplus as regards policyholders as of December 31, 2008 *as determined by this examination* and

as reported by the company," as well as an "Underwriting and Investment Exhibits" that reflects the "[s]urplus as regards policyholders *per report on examination* as of December 31, 2008." (*Id.* at 19-22 (emphasis added).) Indeed, the Examination Report clearly provides that MBIA was solvent as of December 31, 2008, maintaining a surplus of $3,482,422,224, and that fact remains entirely uncontroverted. (*Id.* at 22.) The Banks and their experts do not, as they cannot, cite an iota of evidence to support their contention to the contrary.[43]

The NYID's decision whether or not to retain an independent third-party is entirely discretionary, and not required under the Insurance Law. (*See* Baker Aff. ¶ 24 ("[T]he Legislature delegated to the NYID the decision as to whether to hire an outside firm to estimate an insurer's liabilities, analyze the reasonableness of MBIA's estimates on its own, or completely rely on MBIA's submissions without attempting to independently evaluate their merit."); *see also* Miller Aff. ¶ 43 ("If anything belongs to the discretion of a financial institution regulator, it is the question of whether to utilize outside experts to assist in the regulator's official functions.").)

Likewise, Mr. Buchmiller's background, position, and expertise made him the "natural choice" for evaluating the reasonableness and consistency of MBIA's loss modeling methodology to determine whether, post-Transformation, MBIA would have sufficient capital to pay all claims as they came due and MBIA's financial condition.[44] (Miller Aff. ¶¶ 17-18.) Specifically, among other things, at the time of the Transformation, Mr. Buchmiller had "decades of structured finance and capital markets experience"; as the financial crisis unfolded,

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43 Remarkably, despite being unable to cite a shred of evidence to support his opinion, Mr. Corcoran would not concede that the NYID is ever qualified to evaluate a financial guaranty insurer's solvency, even when presented with the Examination Report at deposition. (RX 14 (Corcoran Dep.) 198:6-201:7.) Mr. Corcoran also incredibly refused to concede that the NYID's examination contained any review of MBIA's solvency. (*Id.* at 372:5-375:8.)

44 Professor Baker also observes that Mr. Buchmiller possessed the requisite experience to review MBIA's loss reserving methodology. (Baker Aff. ¶¶ 35-37, 46.)

had worked with established financial institutions, rating agencies and other market participants concerning structured-finance issues; and had extensive experience with MBIA Insurance dating back to 2004. (*Id.* at ¶¶ 18-19.) Indeed, despite the Banks' and their experts' criticisms of Mr. Buchmiller (Banks' Reply 45-46; 145-150; Serio Aff. ¶ 8; RX 8 (Muhl Dep.) 267:10-21), Mr. Buchmiller was well qualified to perform the substantive review required in the present case and his participation in the NYID's review was consistent with best practices in the regulation of financial institutions. (Miller Aff. ¶¶ 19-20.)

3. The Use of Third-Parties in the Other Monoline Restructurings is Irrelevant.

Although the Banks' experts attempt to draw comparisons to other monoline restructurings in which the NYID allegedly used a third-party (Banks' Reply ¶¶ 49-50, 145-148; Greenspan Aff. ¶¶ 5, 16, 51-52, 221-22, 226-27; Muhl Aff. ¶¶ 25-32, 61; Serio Aff. ¶¶ 22, 31-32), the use of such third-parties occurred where either: (1) the third-party was hired by the policyholder with the aim to provide a fair commutation price to the monoline insurer and its counterparties with respect to a given deal (Finkel Aff. ¶ 3); or (2) the restructuring was initiated by the relevant regulatory agencies and subject to the regulatory requirements of different states.[45] (Baker Aff. ¶¶ 109-11.)

Moreover, much of this expert testimony is not credible. For example, Mr. Greenspan could not testify whether the NYID -- or any other regulator -- had in fact obtained an independent third-party analysis in connection with the other monoline restructurings referred to

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[45] The case law cited by the Banks to support their contention that the Court should annul a transaction where the determination was made by an agency regarding an area beyond the agency's expertise are inapposite. *See Buffalo Civic Auto Ramps, Inc. v. Serio*, 21 A.D.3d 722, 725, 800 N.Y.S.2d 686, 689-90 (1st Dep't 2005) (annulling determination reached after a quasi-judicial proceeding because there was "no evidence of record" -- let alone "substantial evidence" -- to support the department's decision; *Dreves v. N.Y. Power Auth.*, 131 A.D.2d 182, 184-87, 520 N.Y.S.2d 956, 957-59 (3d Dep't 1987) (observing that delegation of environmental review was proper where delegating board -- unlike the NYID -- "lack[ed] the time and know-how required" for each project).

in his affidavit. (RX 30 (Greenspan Dep.) 46:11-24; 52:8-13; 61:10-24.) Indeed, despite the Banks' assertion that the Transformation review was flawed because the NYID did not retain an *independent* third-party analysis (Banks' Reply 145), Mr. Greenspan testified that the NYID need not be concerned with the independence of the third-party providing such an analysis. (RX 30 (Greenspan Dep.) 231:4-32:17, 233:16-234:11 (Q: "You wouldn't want to see the NYID hire a third party that is independent of policyholders as well?" R: "[I]t may be most appropriate to have somebody review the transaction who has the interest of maintaining adequate protection for these very substantial policyholders.").) Mr. Greenspan even goes so far as to suggest that interested parties, like Citibank, Bank of America, JP Morgan, and Merrill Lynch -- all original petitioners in this action -- would have been appropriate third-party experts for the NYID's review. (*Id.* at 225:16-26:22, 230:8-14.)

4. BlackRock's Involvement in the Transformation Review <u>would not have Impacted the NYID's Decision.</u>

The Banks also argue that their own modeling expert, BlackRock, would have been the appropriate choice to review MBIA's loss projections, and that BlackRock's supposedly superior models would have shown that MBIA Insurance could not have remained solvent post-Transformation. In support of this argument, the Banks rely on a suggestion by the NYID, prior to MBIA's submission of the Application, that the NYID "may want a third party analysis of the expected loss" and that "others have used Blackrock with some success." (Banks' Reply 49 (citing MBIA_NYS0006213).) However, the NYID never required that MBIA retain such a third-party, and determined that such a third-party was not necessary. (RX 23 (Buchmiller Dep.) 122:14-125:5.) Indeed, the decision as to whether to retain such a third-party rests entirely in the discretion of the NYID, as the Banks' own experts concede. (RX 8 (Muhl Dep.) 93:22-94:6; *see also* RX 15 (Serio Dep.) 155:19-156:19.)

Further, BlackRock's involvement in the Transformation review would not have led to more accurate modeling of MBIA Insurance's loss reserves. To the contrary, the retention of BlackRock was entirely unnecessary. (*See* Finkel Aff. ¶¶ 87-97.) The NYID's review already included the appropriate personnel, including, among others, over a dozen NYID executives and examiners, MBIA senior executives and relevant staff, the NYID's outside counsel Fried Frank, and the NYID's outside advisor Perella Weinberg. (*See* Miller Aff. ¶ 16.) With this collective expertise, as Mr. Buchmiller testified at his deposition, the NYID was "doing a pretty good job ourselves." (RX 23 (Buchmiller Dep.) 124:22–125:5.) And, Mr. Moriarty testified that, upon receiving Mr. Finer's e-mail, the NYID deliberated internally about whether to retain a third-party firm, but ultimately chose to use its own internal resources. (RX 4 (Moriarty Dep.) 304:10-305:19.)

While the Banks argue that the NYID's failure to retain a third-party advisor, like BlackRock, prevented the NYID from "critically analyzing" MBIA's loss projections (Banks' Reply 147), the opposite is true. The NYID always maintained that it was critical for it to "recreate and verify" MBIA's modeling and related analysis as part of the Transformation review. (Buchmiller Aff. ¶ 25.) The "black box" nature of BlackRock's modeling would, thus, render the hiring of BlackRock pointless, as BlackRock considers "replication [of its modeling a] trade secret." (RX 32 (Paltrowitz Dep.) 144:11-142:11; *see* Finkel Aff. ¶ 351; Baker Aff. ¶ 24 n.19.) Indeed, as Mr. McKiernan explained, MBIA too had investigated the possibility of retaining BlackRock, but BlackRock was unwilling to grant MBIA transparent access to its models -- *i.e.*, BlackRock refused to grant MBIA access to its intermediate work product, assumptions and calculations that were used to reach those conclusions. (RX 33 (McKiernan Dep.) 239:20-240:13; *see also* Miller Aff. ¶ 28(h).) Such transparency was critical to MBIA, as

(among other things) BlackRock's projections could not be independently verified by PwC in a way that would be acceptable for audited financial statements. (RX 33 (McKiernan Dep.) 240:2-10; *see also* Finkel Aff. ¶ 301.) Therefore, MBIA concluded that it could not hire BlackRock. Indeed, in this litigation, BlackRock refused to produce numerous materials considered and relied on in its loss analysis.[46] Given the lack of transparency that would have resulted in retaining BlackRock, it was entirely proper for the NYID not to retain BlackRock.[47]

In addition to its utter lack of transparency, BlackRock's models also ascribed improper assumptions to MBIA's RMBS and CDO transactions. (Finkel Aff. ¶¶ 303, 352, 367, 428.) As Mr. Finkel explains, MBIA's RMBS transactions consisted of collateralized "loans of what were believed to be high quality, 'prime' and near prime borrowers" with average FICO scores in excess of 700. (*Id.* at 171.) However, the assumptions utilized by BlackRock are consistent with far riskier subprime borrowers, which resulted in an increase in projected losses. (*Id.* at 296-98.) Additionally, BlackRock's CDO projections were "on the high end of 'Wall Street' loss

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[46] Indeed, Mr. Paltrowitz testified at deposition that, despite the Banks' obligations under the Stipulation Regarding Discovery in Connection with Experts, dated June 22, 2011, he and BlackRock did not produce numerous materials considered in forming his opinion and the BlackRock Report, including, among others, documents relating to: the "mathematical infrastructure" and "algorithms" relied upon by BlackRock for its analysis (RX 32 (Paltrowitz Dep.) 15:25–16:17); the "back testing" BlackRock performed to ensure modeling done for MBIA assignment was conducted as it would have been in December 2008 (*id.* at 154:11-155:6); the "other analyses that [BlackRock] did, throughout 2008 and 2009" from which the "base case" and "stress case" scenarios for the MBIA assignment was derived (*id.* at 79:3–80:5); the "test[ing]" of BlackRock's results "versus things we actually ran contemporaneous two years earlier" (*id.* at 125:25-126:5); the "historical data" relied upon by BlackRock in conducting its regression analysis (*id.* at 141:3-10); the "portfolio manager adjustments" that are "tracked" by BlackRock (*id.* at 149:14-23); the "complete assumption set from BlackRock which would include CDR, CPR, loss severity" (*id.* at 175:8-176:6); the information on which BlackRock "base[d] its prediction that 10% would be the base case unemployment for the year-end 2009" (*id.* at 236:8–25); and the "subsets of where [BlackRock] made certain qualitative adjustments" not yet produced. (*Id.* at 303:4-9.)

[47] The Banks' own experts blindly accepted BlackRock's conclusions regarding projected losses without scrutiny. For example, Mr. Greenspan, who urged the use of a "third-part[y] such as BlackRock" (Greenspan Aff. ¶ 225), cites to BlackRock's analysis multiple times throughout his report and bases many of his own conclusions on BlackRock's analysis. However, Mr. Greenspan never performed any independent verification of the correctness of that analysis. (RX 30 (Greenspan Dep.) 152:4-17, 153:5-12.) Indeed, Mr. Greenspan has never even spoken with anyone from BlackRock about its analysis of MBIA (*id.* at 13:10-13; 175:18-176:10), and had no access to BlackRock's assumptions (*id. at* 240:7-16; 245:18-246:9; 265:2-266:1), was unable to evaluate those assumptions for bias, and never tested or verified BlackRock's ultimate work product. (*See, e.g., id.* at 281:10-18.)

projections, which were themselves already stressful." (*Id.* at 355.) Finally, with respect to their CMBS projections, BlackRock used assumptions that were not in line with historical performance, and which resulted in significantly large loss projections. (*Id.* at 423-33.) Therefore, given BlackRock's overly bearish views, its projections would not have been appropriate for use in the NYID's review.

Likewise, the Banks' assertion that BlackRock is an "independent" third-party (Banks' Reply 78) is belied by the facts. As Mr. Paltrowitz testified, "BlackRock has lots of relationships day-to-day ongoing with all of [the Bank Petitioners] as counterparties for trading, as investing back and forth." (RX 32 (Paltrowitz Dep.) 67:14-17.) Indeed, at the time of Transformation, petitioner Merrill Lynch "was a large shareholder" of BlackRock Inc., owning approximately 44% of the outstanding voting common stock in the company (*id.* at 64:15–65:1; RX 34 (March 2009 BlackRock Inc. 10-K) 1, 24), and BlackRock stated publicly that its "ability to maintain a strong relationship with [Merrill Lynch] is material to [its] future performance" (RX 34 (March 2009 BlackRock Inc. 10-K) 24; RX 35 (February 2008 BlackRock Inc. 10-K) 20; *see* Miller Aff. ¶ 43 ("BlackRock's myriad of financial stakes in this litigation represents a conflict of interest that diminishes the weight of its opinion as to MBIA Insurance's loss reserve models.").)

5. The NYID's Review of MBIA Insurance was Appropriate and Supported the Superintendent's Approval of the Application.

The Banks' contentions that the NYID's review was rushed and incomplete are entirely unfounded.[48] (Banks' Reply 148-50.) As demonstrated previously, the NYID's review of the

[48] The cases on which the Banks rely for the proposition that the NYID's determination should be annulled because Mr. Buchmiller's review of the MBIA's loss modeling methodology was inadequate are inapposite insofar as those cases, unlike here, concern an agency's non-compliance with statutorily mandated modes of review that do not exist under the Insurance Law. *See Chinese Staff & Workers Ass'n v. City of N.Y.*, 68 N.Y.2d 359, 368, 509 N.Y.S.2d 499, 504 (1986) ("Since respondents did not consider these potential effects on the environment in their environmental analysis, their determination does not comply with the statutory mandate and therefore is arbitrary and capricious."); *Brady v. City of N.Y.*, 22 N.Y.2d 601, 606-07, 294 N.Y.S.2d 215, 218 (1968) (reversing and

Application was extensive, and fully supported the Superintendents' determination that post-Transformation MBIA Insurance would remain solvent and capable of paying all claims as they came due. (MBIA Opp. 9-11; NYID Opp. 3, 13-15; Chaplin Aff. ¶¶ 53-84, 91; McKiernan Aff. ¶¶ 11-41; Buchmiller Aff. ¶¶ 22-57; Moriarty Aff. ¶¶ 30-74; Boisseau Aff. ¶¶ 38-41; *see also* Finkel Aff. ¶¶ 468-74; Miller Aff. ¶¶ 23-29 ("In particular, I see no evidence that Mr. Buchmiller's investigation was adversely affected by time pressures, real or perceived.").) Indeed, as attested to by Ms. Boisseau, "when an approval letter is issued within 60 to 90 days of a filing that has been preceded by months of preliminary work with the regulators, I would conclude that it has been 'timely,' not rushed." (Boisseau Aff. ¶ 41.) Nothing in the Banks' Reply alters this conclusion. Indeed, the Banks' charge that the NYID's review of MBIA's loss reserves was in any way "rushed" is absurd, particularly considering the U.S. Treasury's due diligence (or lack thereof) with respect to nine major American banks -- including several of the Banks here -- that were provided with a $250 billion tax payer bail out in October 2008 following a meeting with Treasury Secretary Hank Paulson, under a plan he formulated over a single weekend that month. (Miller Aff. ¶ 27.)

D. Mr. Buchmiller Established An Appropriate Risk-Focused Approach To The Transformation Review Consistent With Regulatory Best Practices.

The Banks somehow claim that Mr. Buchmiller's review was limited. (Banks' Reply 148.) This is wrong. As demonstrated previously (Buchmiller Aff. ¶¶ 22-55), Mr. Buchmiller conducted a comprehensive, risk-focused review of MBIA Insurance's loss reserving and overall financial condition.[49] (NYID Opp. 3, 13-15; McKiernan Aff. ¶¶ 15-17; RX 36

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remanding to pension board for further review because board adopted "conclusory" opinion of medical panel, and thereby impermissibly delegated its statutorily mandated duty to consider "all the available evidence").

[49] The Banks focus only on Mr. Buchmiller's statement in an e-mail that this process would require "some significant hand-holding" to infer that Mr. Buchmiller lacked the appropriate expertise in structured finance and modeling. (Banks' Reply 146.) However, as Messrs. McKiernan and Buchmiller note in their affidavits, Mr.

(MBIA_NYS0004162-4164); *see also* Miller Aff. ¶¶ 32-33; Finkel Aff. ¶¶ 24, 29; Dudney Aff. 72-73; Baker Aff. ¶¶ 33-37.) Mr. Buchmiller's risk-focused approach embraced these attributes by taking the worst-performing transactions, applying stress scenarios to those loss models, and then ensuring that the assumptions made in those loss models were consistently and uniformly applied across the rest of the sector. (Buchmiller Aff. ¶¶ 23-26; RX 22 (NYSID0002794-2852 [Buchmiller Memo]) at 2799, 2805.) Indeed, Mr. Buchmiller's "risk focused" approach was consistent with the NYID's prior practice and that of other regulators, including, among others, the Federal Deposit Insurance Corporation, the Federal Reserve, and the National Credit Union Administration. (Miller Aff. ¶¶ 40, 45, 46, 68; Baker Aff. ¶¶ 33-37.) Additionally, the NAIC adopted a risk-focused surveillance framework as early as 2004 and, in 2010, adopted an accreditation standard requiring that all insurance company examinations be performed using the risk-focused approach. (Miller Aff. ¶ 45.) Mr. Buchmiller's risk-focused approach is further endorsed by MBIA's solvency expert, Mr. Dudney (Dudney Aff. 72), and structured-finance expert, Mr. Finkel (Finkel Aff. ¶¶ 183, 319, 437.)

Far from "incomplete" or "limited" (Banks' Reply 148), Mr. Buchmiller's review encompassed an extensive "top down" and "bottom up" analysis of MBIA's financial condition. As part of his "top-down" approach, Mr. Buchmiller "look[ed] at the cashflows (claims paid, salvage) projections for all reserves, and future or contingent reserves -- much like the back-up to the Bridge report [MBIA] gave [him] but listed by transactions (*e.g.*, deals by row, years by columns), and how they are discounted" and "look[ed] at how [MBIA] sensitivity [sic] -- and/or stress-test overall cashflows." (RX 36 (MBIA_NYS0004162-4164).) He also reviewed "a cashflow model of MBIA [Insurance] going forward (on a closed-book basis, no new business or

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Buchmiller already was well-versed in the theory and substance of structured finance modeling; the "hand-holding" requested here was for computer-based training to learn MBIA's loss modeling software programs such as Intex and LoanPerformance. (Buchmiller Aff. ¶¶ 4-7, 10-13.)

'transformation') and how those cashflows are present-valued into financial statements." (*Id.*; *see* Miller Aff. ¶ 38.)

In addition, Mr. Buchmiller employed a "bottom-up" approach, which consisted of an intensive review of a sample transaction from each of the three structured finance sectors he had identified as key to the review. Mr. Buchmiller "select[ed] a few (one or two to start) transactions from each collateral or structural type . . . for a detailed review," which included "go[ing] through the entire reserving process for each in a very hands-on manner. Ideally, as if [he] were hired into IPM and assigned the transactions -- getting the deal experience data, developing roll rates, loading Intex, etc., for 4th quarter 2008." (RX 36 (MBIA_NYS0004162-4164).) Mr. Buchmiller used these sample transactions to focus on MBIA's transaction-level modeling assumptions and the reasonableness thereof, personally choosing RMBS and CDO transactions that were exhibiting signs of distress and high loss severity.[50] (RX 23 (Buchmiller Dep.) 106:10-111:17; Buchmiller Aff. ¶ 24.) He followed those transactions "step-by-step . . . in order to recreate and verify" MBIA Insurance's loss reserves from the raw performance data through the setting of reserves and accounting of those losses in MBIA's financial statements. (Buchmiller Aff. ¶ 25.)

Contrary to the Banks' contention that Mr. Buchmiller did not conduct a "detailed hands-on analysis" (Banks' Reply 149), through this sampling approach, he was able to closely scrutinize the above-referenced sectors. The Banks' contention that Mr. Buchmiller should have "conduct[ed] a detailed review of every transaction in these sectors" (Banks' Reply 149) ignores the fact that "[t]he use of non-statistical sampling has long been standard practice in financial services regulation" (Miller Aff. ¶¶ 37, 66; *see also* Finkel Aff. ¶¶ 29, 183, 319, 437), and that it

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50 Reviewing these transactions provided Mr. Buchmiller with an appropriate basis to evaluate MBIA's RMBS and CDO portfolios. Further, the CMBS transaction chosen was "highly representative" and appropriate for Mr. Buchmiller's review. (Finkel Aff. ¶¶ 183, 319, 437.)

was not "Mr. Buchmiller's mandate to independently value the loss reserves on over 1,300 insured policies." (Dudney Aff. 72.) Even BlackRock has recognized that certain structured finance sectors, particularly those collateralized with residential mortgages, are appropriate for a sampling-and-extrapolation approach. For example, a December 2010 BlackRock presentation to the NAIC noted that RMBS "tends to be backed by relatively homogenous collateral" with "more consistency in loan documentation" that permits "probabilistic outcome" modeling "based on law of large numbers."[51] Likewise, BlackRock has itself performed similar sample based reviews in connection with engagements for the New York Federal Reserve Bank. (RX 32 (Paltrowitz Dep.) 124:8-21.)

The Banks' criticism of Mr. Buchmiller's review as having covered only "three sectors" also is flatly wrong. (Banks' Reply 149.) Other sectors were given a lower-level review because "in terms of dollars, the way that sector was performing generally as well as at MBIA specifically, [they were] not an area of great concern." (RX 23 (Buchmiller Dep.) 139:13-19.) For those sectors, Mr. Buchmiller verified MBIA's loss reserve methodology to ensure it was consistent with those areas he reviewed in greater detail.[52] (*Id.* at 140:9-144:19.) This was entirely appropriate. (Finkel Aff. ¶¶ 468-74.)

The Banks, nonetheless, allege that Mr. Buchmiller's reference during a modeling session with MBIA to a "shortcut to get to the decision on transformation" shows that his review was expedited and not comprehensive. (Banks' Reply 52, 148-49.) This is not so. (*See* Miller Aff. ¶ 37.) As Mr. Moriarty testified at deposition, he believed that the phrase was not meant to imply

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51 RX 58 ("BlackRock Solutions CMBS Modeling Overview," (December 8, 2010) (available at http://www.naic.org/documents/structured_securities_blackrock_cmbs_method.pdf)) 4.

52 The Banks mischaracterize a statement made by Mr. Buchmiller to Mr. McKiernan concerning the Superintendent's "uncertainty threshold" for the proposition that the NYID's review failed to account for every sector. (Banks' Reply 149.) As shown, however, Mr. Buchmiller's review encompassed all of MBIA's structured finance sectors. Moreover, as demonstrated by Mr. Finkel, these other sectors did not represent potential problem areas for MBIA. (Finkel Aff. ¶ 474.)

any sort of "expedited schedule" or strict review deadline; rather, the "shortcut" was "performing essentially an examination within an examination" to test MBIA's loss reserve methodology, and to confirm that "MBIA was not out of line with industry standards." (RX 4 (Moriarty Dep.) 316:14-317:18; *see* Miller Aff. ¶ 37 ("A principal purpose of the bottom-up approach was to allow Mr. Buchmiller to assess the reasonableness and consistency of the models and methodology"); *see also* Baker Aff. ¶ 36.)

In fact, Mr. Buchmiller's review was anything but curtailed. Throughout his review, Mr. Buchmiller was given full and unfettered access to MBIA executives and staff, as well as MBIA's books and records, including full access to modeling and assumptions. (Buchmiller Aff. ¶ 19; Miller Aff. ¶¶ 28(f), 35, 38; Brown Aff. ¶ 19.) Mr. Buchmiller held a series of meetings with MBIA where he reviewed MBIA Insurance's loss reserves, loss projection modeling, and the overall financial condition of the company in a detailed and interactive manner. Mr. Buchmiller's review included several hands-on tutorials of MBIA Insurance's loss projection and financial models. (Buchmiller Aff. ¶¶ 19, n.6, 25, n.10.) Mr. Buchmiller's access to MBIA was not limited to these select demonstration sessions. He frequently e-mailed and spoke with MBIA employees to procure further information about MBIA's loss reserves. (*See, e.g.*, RX 37 (MBIA_NYS0025949) (regarding PwC's audit work papers); McKiernan Aff. ¶ 22, RX 38 (MBIA_NYS0004285-88) (regarding the "tracking error" of RMBS Q3 projections versus Q4 actual performance); RX 39 (MBIA_NYS0036708-09); RX 40 (MBIA_NYS0004998-5001) (to address follow-up issues concerning the RFC and [REDACTED] transactions); RX 41 (MBIA_NYS0005982) (to address follow-up issues concerning the [REDACTED] transaction and CMBS modeling issues).) In fact, "an on-site review of an insurer's financial condition to evaluate proposed affiliated transactions is unusual" (Boisseau Aff. ¶ 34; *see also* RX 15 (Serio

Dep.) 283:10-11; RX 8 (Muhl Dep.) 319:6-320:6), and should be viewed "as a strong positive" (Boisseau Aff. ¶ 34).

E. Mr. Buchmiller's Review Covered All Material Aspects Of MBIA's Loss Reserves And Was Completed By The Transformation Approval Date.

The Banks argue that Mr. Buchmiller's review was prematurely halted, and that consequently he failed to review MBIA Insurance's entire portfolio. (Banks' Reply 149.) The Banks' contention is belied by the facts: Mr. Buchmiller reviewed all material aspects of MBIA's loss reserves prior to the approval of the Transformation (Finkel Aff. ¶ 29); Mr. Buchmiller was given no deadline for completing the Transformation review (Buchmiller Aff. ¶ 21; RX 22 (NYSID0002794-2852 [Buchmiller Memo]) at 2796); and Mr. Buchmiller never felt pressured by anyone within the NYID to provide a final conclusion by a certain date, and he had as much time as he needed to complete his work (RX 23 (Buchmiller Dep.) 63:3-63:9, 381:7-381:14). In short, there is simply no evidence to suggest that Mr. Buchmiller's review was affected adversely by time pressures, real or perceived.[53] (*See* Miller Aff. ¶ 28; Baker Aff. ¶ 41.)

Indeed, despite the fact that Mr. Buchmiller believed that MBIA executives had requested a final decision on the Transformation application no later than January 31, 2009, Mr. Buchmiller determined that, because the NYID's "duty of care is to policyholders[,]" his examination was not yet completed, and he so informed his colleagues at the NYID and MBIA. (RX 24 (NYSID_0002939-944 [January 30, 2009 Memo]).) Mr. Buchmiller did so at that time, despite having already (i) participated in numerous in-house modeling sessions for the RMBS and CDO sectors (the only two portfolios on which MBIA was projecting material losses); (ii) independently verified the consistency and reasonableness of IPM's RMBS and CDO loss

[53] The conclusions reached by Mr. Buchmiller's thorough review are confirmed by the independent review of MBIA's structured-finance expert, Mr. Finkel. (Finkel Aff. ¶ 24.)

projections across dozens of other transaction-level models; and (iii) interviewed more than a dozen MBIA executives concerning the company's governance, risk management and business strategies. NYID executives agreed with Mr. Buchmiller that MBIA's deadline was arbitrary and that, in light of "our duty of care . . . to all policyholders," Mr. Buchmiller should take as much time as needed to scrutinize MBIA's remaining portfolios to cover all "known unknowns." (RX 26 (NYSID_0002853-54).) Accordingly, on February 5, 2009, Mr. Buchmiller e-mailed Mr. McKiernan to address the list of remaining sectors to review, from CMBS through sectors with limited volatility and exposure such as MBIA Insurance's intellectual property portfolio. (RX 42 (MBIA_NYS0004998-5001) at 4998.) Thereafter, MBIA provided Mr. Buchmiller with several further sessions on MBIA's other sectors, including modeling sessions over two days concerning CMBS. (McKiernan Aff. ¶¶ 34-40.)

Given the lack of evidence calling into question the adequacy of the NYID's review, the Banks absurdly rest their entire argument on a single reference to "Mission Impossible" in an e-mail exchange between Mr. Buchmiller and Mr. McKiernan. (Banks' Reply 54, 146-47.) The Banks baselessly allege that the reference stands for the proposition that Mr. Buchmiller felt that he could not adequately analyze these sectors without third-party expert assistance. (*Id.*) Nothing could be further from the truth. As Mr. Buchmiller and Mr. McKiernan explained, Mr. Buchmiller was simply referring to the difficult task that MBIA faced in providing him with all of the information he desired quickly. Both Mr. Buchmiller and Mr. McKiernan testified that MBIA was able to fulfill this "impossible" mission. (RX 23 (Buchmiller Dep.) 63:10-64:18, 396:7-19; RX 33 (McKiernan Dep.) 498:12-499:22; Buchmiller Aff. ¶ 20 & n.7.)

The record clearly rebuts any contention that time constraints prevented Mr. Buchmiller from reviewing all of the remaining sectors of MBIA's structured-finance portfolio. Indeed, on

February 6, 9, and 10, 2009, Mr. Buchmiller participated in all-day meetings and modeling sessions at MBIA concerning the other sectors and CMBS, in particular (*see* RX 43 (NYSID0002644-2763)) and, on February 11, 2009, Mr. Buchmiller e-mailed his colleagues at the NYID to inform them that he had received "overview" presentations from MBIA on all the remaining sectors; which together comprised about half the exposure value of the three main real estate sectors he had reviewed from the "bottom up."[54] (RX 25 (NYSID0002855-56 [February 11, 2009 Memo).)

Despite this review, Mr. Serio faults the NYID for allegedly working under "deadlines" and a "sooner rather than later mandate." (Serio Aff. ¶ 50.) However, Mr. Serio could not identify any provision of the Insurance Law requiring that a minimum number of hours be spent performing financial reviews. (RX 15 (Serio Dep.) 342:20-343:17.) Nor was he aware of the details of Mr. Buchmiller's review, including how many hours he had worked, how many nights and weekends he had dedicated to his review, or how many phone calls and e-mails he had exchanged with employees at the NYID and MBIA regarding it. (RX 15 (Serio Dep.) 339:20-342:7.) Moreover, during his own tenure as Superintendent, Mr. Serio conducted a similarly expedited review of a major international insurer during a period of great financial uncertainty. Due to the massive influx of post-September 11 claims, Lloyd's of London was unable to

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[54] The Banks misleadingly argue that Mr. Buchmiller's review did not include a review of MBIA's CDO squared portfolio. (Banks' Reply 54, 149.) However, the evidence is clear that Mr. Buchmiller's review included analysis of the loss modeling utilized in and collateral underlying MBIA's CDO squares exposures. (Finkel Aff. ¶¶ 453-57.) As a result of Mr. Buchmiller having reviewed and verified the reasonableness of MBIA's CDO modeling and the collateral underlying MBIA's CDO squared portfolio, he was able to make a determination as to the propriety of the CDO squared modeling. (*Id.*) Also, during an in-house modeling session with members of MBIA's IPM team, Mr. Buchmiller specifically addressed the CDO squared portfolio. (*See* RX 44 (NYSID0002037-144) at 46-49; *see* Finkel Aff. ¶¶ 453-57 (MBIA's CDO squared transactions were not of the "risky" or "toxic" variety).) Similarly, Mr. Buchmiller previously reviewed MBIA's loss reserving methodology with respect to CDO squareds in 2008, and was aware that the portfolio had shrunk considerably since that time due to commutations. (RX 23 (Buchmiller Dep.) 192:4-16.) Consistent with Mr. Buchmiller's understanding, "by the end of 2010 MBIA had successfully commuted all but $200 million of its $8.3 billion of CDO-squared exposure previously outstanding at year-end 2008, at a cost consistent with MBIA's loss reserves and credit impairments." (Finkel Aff. ¶ 457.) The Banks offer no evidence to contradict these facts, as none exists.

adequately fund its American Trust Fund. However, after an "expedited" review that lasted just a month and a half, then-Superintendent Serio approved a curative plan by which Lloyd's could delay funding its trust fund in full. (*Id.* at 9:2-11:16; 38-39.)

Moreover, as the Banks' experts confirm, the NYID must balance the interests of policyholders with the interest of allowing an insurance company to compete in the marketplace when determining whether sufficient information has been gathered to inform a determination. (RX 8 (Muhl Dep.) 139:18-24 (testifying that it is "a balance that you try to find" between interests of policyholders and business interests of insurance companies and that "[i]t's not an easy balance to find.").) Ultimately, however, Mr. Muhl stated that the Superintendent must "make a decision." (RX 8 (Muhl Dep.) 140:14-24.) Thus, Mr. Muhl himself acknowledged that undue delay of a request for approval would be "outrageous" and contrary to the NYID's mission to promote a robust industry. (RX 8 (Muhl Dep.)139:7-9.)

As Mr. Muhl also testified, the decision as to when sufficient information has been gathered to allow the NYID to make a determination on an application, including the Transformation Application, rests entirely in the Superintendent's discretion. (*See* RX 8 (Muhl Dep.) 145:8-13 (Q: "[T]he Insurance Department, whether it's the superintendent or others, makes a decision and has the power to decide when they have enough information [to make an informed decision], right?" A: "Yes.").)

1. The NYID's Review Confirmed the <u>Reasonableness of MBIA Insurance's Loss Projections.</u>

The NYID's review of MBIA Insurance's loss reserving methodology was comprehensive and thorough. (Finkel Aff. ¶ 24.) In criticizing the NYID's approval of the Transformation, however, the Banks fundamentally misconstrue the proper purpose of the NYID's review. The aim of the NYID's review was not to provide a valuation of every

structured-finance deal insured by MBIA Insurance (Banks' Reply 149), but rather to evaluate MBIA Insurance's financial condition post-Transformation. (Buchmiller Aff. ¶ 22; NYID Opp. 3, 13, 22; MBIA Opp. 1-2, 8, 20; Baker Aff. ¶¶ 33-37; Miller Aff. ¶¶ 17, 37; Finkel Aff. ¶ 29.)

It is undisputed that the NYID affirmatively determined that, post-Transformation, MBIA Insurance would retain "sufficient surplus to support its obligations and writings." (RX 2 (R00971-80 [Approval Letter]) at 976.) Contrary to the Banks' assertions (Banks' Reply 150; Greenspan Aff. ¶ 285), the NYID's validation of MBIA Insurance's modeling methodology provided an adequate and reasonable basis for that determination.[55] (Finkel Aff. ¶ 24; Dudney Aff. 8-9, 47-49.) This conclusion is further bolstered by Mr. Buchmiller's request that MBIA create a loss projection scenario using assumptions that were significantly more stressful and pessimistic than the most conservative "stress" case scenario that MBIA already conducted. (Chaplin Aff. ¶¶ 73-74.) In response to that request, MBIA prepared a "break the bank" or "extreme stress" scenario that would test how long a period of additional market depression MBIA Insurance could sustain before reaching insolvency. (Chaplin Aff. ¶¶ 77-79.) Even under these extreme, unprecedented conditions, MBIA Insurance would still be solvent both in the short-term on a cash-flow basis and long-term on an asset-adequacy basis. (Chaplin Aff. ¶¶ 77-79; McKiernan Aff. ¶¶ 23-24; RX 45 (MBIA_NYS0008246-74); Chaplin Sur-Reply Aff. ¶ 12-13.)

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[55] For example, despite Mr. Greenspan's criticism of the NYID for allegedly failing to properly analyze loss exposures of MBIA Insurance, Mr. Greenspan himself did not perform any such analysis to determine whether they would have a material impact on the NYID's overall analysis. (*See, e.g.*, RX 30 (Greenspan Dep.) 152:4-8 ("We did not do any independent loss modeling nor were we capable of running them through the MBIA model with current information."); 156:18-157:6 ("As far as actually analyzing [potentially problematic transactions], FTI did not [do that]"), 161:15-162:8 (Q: "[W]hat work has FTI done to analyze those multi-sector CDOs and MBIA's projections with respect thereto?" A: "We have not done any work with respect to that.").) Further, Mr. Greenspan testified that he has no opinion whatsoever on whether MBIA was adequately capitalized or solvent, either pre- or post-Transformation, and that he did not perform any solvency analysis whatsoever on MBIA. (RX 30 (Greenspan Dep.) 281:16-282:5.)

The Banks further argue that the NYID did not explicitly state that MBIA Insurance was solvent. (Banks' Reply 150.) This is a frivolous argument. The entire underpinning -- indeed, the *sine qua non* -- of the Approval Letter was the NYID's finding that MBIA Insurance would be solvent post-Transformation. For example, the NYID, under Section 4105(a), explicitly found, among other things, that post-Transformation, MBIA Insurance "will retain sufficient surplus to support its obligations and writings" -- *i.e.*, it will be solvent. (RX 2 (R00971-80 [Approval Letter]) at 976.) Likewise, the NYID's contemporaneous press release approving the Transformation makes clear that the NYID determined MBIA Insurance would be solvent post-Transformation. (RX 1 (NYID Press Release) 2.) The Banks cite to Mr. Buchmiller's deposition testimony for the erroneous assertion that he did not reach any conclusions concerning MBIA Insurance's solvency. (Banks' Reply 151.) To the contrary, Mr. Buchmiller's deposition testimony and affidavit make clear that, through his review, he determined that MBIA "would remain solvent and that its reserves post-Transformation would be sufficient to pay claims as they come due." (Buchmiller Aff. ¶¶ 56-57; RX 23 (Buchmiller Dep.) 102.)

The Banks cite Insurance Law § 1309 to contend that MBIA was insolvent at the time of Transformation. (Banks' Reply 151.) Section 1309 addresses whether an insurer is "unable to pay its outstanding lawful obligations as they mature in the regular course of business, as shown by an excess of required reserves and other liabilities over admitted assets." The NYID, pursuant to Section 4105(a), found that MBIA Insurance "will retain sufficient surplus [*i.e., admitted assets in excess of capital and liabilities*] to support its obligations and writings." (RX 2 (R00971-80 [Approval Letter]) at 976; *see also* 3 Dunham and Abramovsky's Appleman on Insurance 2d § 34.18 ("The principal objective of statutory accounting practices [under the Insurance Law] is the protection of policyholders. Statutory accounting practices build

conservatism into the balance sheet to stress the recoverability of assets and solvency . . . so that surplus serves as an indicator of solvency . . . .").)

In fact, the record demonstrates that the NYID examined MBIA Insurance's solvency -- both before and after giving effect to the Transformation -- using three distinct tests: (1) the asset adequacy test -- reviewing MBIA's balance sheets and measuring whether MBIA Insurance had sufficient assets to cover its reserves and loss claims over the long term (30+ years); (2) a cash-flow test -- measuring whether MBIA Insurance would have sufficient cash flow to meet reasonably expected losses in the short term (2 years); and (3) a statutory test -- measuring whether MBIA Insurance has sufficient policyholder surplus and statutory capital (net of expected losses) as required by the Insurance Law to maintain a license to write insurance. (*See* Dudney Aff. 8; Chaplin Aff. ¶¶ 5, 79.) Significantly, the Banks' contention that MBIA Insurance was insolvent post-Transformation entirely ignores MBIA Insurance's contingency reserve as of December 31, 2008. (Buttner Aff. ¶ 89.) As Mr. Buttner explains, the contingency reserve is separate and apart from MBIA Insurance's loss reserves, and is available to satisfy policyholders' claims in the event that the loss reserves develop adversely. (*Id.* at ¶ 91.)

MBIA's solvency expert, Mr. Dudney, also has performed an independent analysis of MBIA Insurance's solvency using these tests, as well as on a claims paying resources basis, and has confirmed the NYID's findings. (Dudney Aff. 47-49.) Even Mr. Stewart acknowledges that the Superintendent determined that MBIA Insurance would be sufficiently capitalized post-Transformation (RX 7 (Stewart Dep.) 192:07-13), and testified that he does not challenge the NYID's determination as to MBIA Insurance's solvency. (RX 7 (Stewart Dep.) 198:15-19.) Indeed, the Banks themselves have acknowledged that MBIA is solvent post-Transformation.

(RX 46 (CARG_00007273-74) ("MBIA is presently solvent and is making payments to [redacted] as required.").)

The Banks also falsely and disingenuously contend that MBIA Insurance was insolvent under the second prong of Section 1309 (Banks' Reply 151), which addresses whether an insurer can reinsure its book of business. However, such an inquiry takes into account not just the strength of the insurer, but also the strength of the marketplace and the motives and financial position of the hypothetical counterparty. Accordingly, as Mr. Moriarty testified (without dispute), in his thirty-one years with the NYID, the NYID has "never used the second part of [Section 1309] to determine an insolvency." (RX 4 (Moriarty Dep.) 345:23-46:6.) Moreover, the market for reinsurance was so distorted at the time of the Transformation review that an analysis of MBIA's solvency under the reinsurance test of Section 1309 would have been futile, at best. (*Id.* at 347:14-22, 348:5-12.)

F. MBIA Provided Accurate And Current Loss Projections To The NYID.

The Banks contend that MBIA used "illegal, stale, and inaccurate data and assumptions" in its loss projections. (Banks' Reply 152.) However, indisputably, MBIA Insurance used the most up-to-date available data and assumptions. (Chaplin Aff. ¶¶ 86-89; Finkel Aff. ¶ 201-205.) The Banks' claim that other market participants projected greater losses in connection with MBIA Insurance's policies than MBIA Insurance (Banks' Reply 78-85) is irrelevant.[56]

MBIA's loss reserving methodology was entirely reasonable. (Finkel Aff. ¶ 24; RX 47 (R00090-133); *see also* Buttner Aff. ¶¶ 17, 46, 49-50, 58-59 (PwC issued an unqualified

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[56] Contrary to the Banks' assertions (Banks' Reply 43-45), the NYID's reliance on information provided by MBIA Insurance is entirely proper. (Miller Aff. ¶ 47 ("Financial institution regulators invariably and inevitably rely on information provided by the regulated entity."). In fact, it is a "practical necessity" for regulators to rely on data provided by a regulated entity. (*Id.* at 47; *see also* RX 15 (Serio Dep.) 49:7-17.) Nevertheless, "the Department did not simply accept MBIA's representations at face value" and took steps to verify the information provided by MBIA, including, among other things, checking performance data for particular deals against third-party sources. (Miller Aff. ¶ 47; *see also* Baker Aff. ¶¶ 36-37.)

actuarial opinion as to the propriety and adequacy of MBIA Insurance's loss reserves as of December 31, 2008.).) Much of the Banks' arguments concerning the alleged inadequacy of MBIA's loss reserving methodology relies on BlackRock's analysis. (Banks' Reply ¶¶ 131-38; Greenspan Aff. ¶¶ 53-55, 230-32.) However, BlackRock's Mr. Paltrowitz testified that he never even reviewed MBIA's loss projections, and could not opine as to their reasonableness. (RX 32 (Paltrowitz Dep.) 226:18-20, 223:8-11.) Further, Mr. Paltrowitz expressly rejected the Banks' argument that MBIA's loss projections were unreasonable because they were less than BlackRock's, acknowledging that MBIA's projections were not "unreasonable out of hand" merely because they were half of BlackRock's. (*Id.* at 226:23-227:2.) In fact, the divergence between MBIA's loss projections and those of BlackRock reflects the "highly stressful" and "bearish" assumptions concerning the economic environment used by BlackRock, not on the methodology or data on which they rely. (Finkel Aff. ¶¶ 291-93, 426-31.) In fact, certain of the assumptions employed by BlackRock were "well beyond the consensus forecasts of market participants at the time," and thus should not be used for evaluating the reasonableness of MBIA's assumptions. (*Id.* at 433.) For instance, BlackRock's base case unemployment rate of 10% was above the expectations of virtually all 55 economists surveyed by the Wall Street Journal, as well as the forecasts of major financial institutions (including the Banks themselves), in early 2009. (Finkel Aff. ¶ 388.) Thus, BlackRock's loss projections are irrelevant to the issue of whether MBIA's projections were reasonable.[57] (*See* Edelstein Aff. ¶¶ 12-19.)

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[57] Indeed, BlackRock itself admits it made numerous errors in modeling MBIA's loss projections. (RX 15 (Paltrowitz Dep.) 258:9-10 ("this stuff is really hard and we know and we're well aware of [mistakes] and are actively combating [them]").) During Mr. Paltrowitz's deposition alone, he testified as to multiple objective errors in BlackRock's CMBS modeling, which concerned hundreds of millions of dollars of exposure in MBIA's portfolio. (*See* RX 32 (Paltrowitz Dep.) 247:21-260:15, 272:3-277:6; *see* Finkel Aff. ¶ 34.)

BlackRock's own analysis makes clear that MBIA Insurance's methodology was entirely consistent with industry practice. Among other things, BlackRock confirmed that MBIA's roll rate methodology for modeling losses for RMBS and CDOs with underlying residential mortgage collateral was consistent with industry practice in late 2008 and early 2009. (RX 32 (Paltrowitz Dep.) 130:18-21; 123:4-6.) Mr. Paltrowitz testified further that had BlackRock analyzed certain CMBS transactions in the same manner as MBIA did, BlackRock's loss projections would actually have been *more accurate*. (*Id.* at 298:21-299:5.)

At bottom, there is a wide range of projections based on varying assumptions and inputs, and modeling of losses is not a science. (Finkel Aff. ¶¶ 16, 22, 32; RX 32 (Paltrowitz Dep.) 141:20-143:15.) As the Banks themselves concede

Likewise, the perspective of a market participant dictates the severity of its loss projections, with traders projecting more severe projections than buy and hold investors, like MBIA. (Finkel Aff. ¶¶ 149-52; RX 50 (CITI_00012005-20) at 8 ("We note that it is possible that our stress test is too severe. Loss estimates on prices provided by our trading desk and many include too high premium for illiquidity, which is not relevant to MBI's hold-to-maturity posture.").)

1. MBIA's Loss Projections on Second-Lien RMBS did not Rely on "Stale" Data.

The Banks contend that the data used by MBIA in setting its loss reserves in the RMBS sector[58] was "stale" because it allegedly: (1) relied on mortgage data from prior to August 2008 (Banks' Reply 56-59, 153; Stulz Aff. ¶¶ 130-31, 136, 139; Greenspan Aff. ¶¶ 66, 69, 193, 245, 247-49, 265); (2) failed to account for a fourth quarter rise in "early-stage delinquencies" (Banks' Reply 60-61, 154; Stulz Aff. ¶ 148; Greenspan Aff. ¶¶ 67, 69, 74, 245, 247, 249, 259, 263, 279); and (3) ignored certain economic developments (Banks' Reply 154; Stulz Aff. ¶¶ 124-69). These contentions are unavailing and demonstrate a fundamental lack of understanding regarding MBIA's loss modeling and assumptions, as well as macro-financial data.[59] (*See* Edelstein Aff. ¶¶ 12-19.)

First, the Banks' contention that the data utilized in MBIA's RMBS models was "stale" because it originated prior to August 2008 ignores the proper methodology for determining RMBS loss projections. While MBIA's RMBS loss models used to set MBIA's third quarter loss reserves (which were reviewed by Mr. Buchmiller) incorporated data from April 2008 through August 2008, this data was not "stale" -- either in the third quarter when the reserves

58 The Banks' contention that MBIA utilized not "up-to-date" data in connection with its CDO and CMBS modeling similarly is false. (Banks' Reply 57, n.76.) As Mr. Finkel explains, MBIA utilized the most current data available at the time in connection with its CDO modeling (Finkel Aff. ¶ 325), and, with regard to its CMBS modeling, utilized research data that was confirmed as current in the fourth quarter of 2008. (*Id.* at ¶ 395.)

59 The Banks' reliance on *New York Telephone Co. v. Public Service Commission*, 29 N.Y.2d 164, 324 N.Y.S.2d 53 (1971) for the proposition that agencies cannot rely on stale data is entirely misplaced. (Banks' Reply 154-55.) There, the court reviewed whether an agency relying on data that was known at that time to be incorrect was arbitrary and capricious. The court held that "the law is well-settled that the Commission may not rely on a reckoning when actual experience is available and establishes that the predictions have been substantially incorrect." *Id.* at 169, 324 N.Y.S.2d at 53. In contrast, at the time the NYID approved the Transformation, there were a variety of reasonable macro-economic outlooks and no "actual experience" or updated data could have indicated that MBIA's loss projections were unreasonable. (Edelstein Aff. ¶¶ 23-27.)

were first set, or as of the end of the fourth quarter.[60] (Finkel Aff. ¶¶ 193-95.) MBIA's third quarter loss models utilized an appropriate roll-rate methodology, through which MBIA's models calculated the rate at which loans moved through various stages of delinquency to default, based on historical data. (*Id.*) Further, Mr. Buchmiller was fully informed regarding MBIA's use of a roll-rate methodology, including the natural lag associated with the data used in the methodology. (*See* RX 22 (NYSID0002794-852 [Buchmiller Memo]) at 801-02; RX 52 (NYSID000987-1062) at 1003.) Under the roll-rate methodology, MBIA necessarily utilized six months of loan performance data. (Finkel Aff. ¶¶ 199-206.) MBIA's utilization of this data was entirely proper and consistent with approaches used by other market participants at the time and, indeed, unavoidable.[61] (Finkel Aff. ¶¶ 193-200.) Through his review, Mr. Buchmiller specifically analyzed and vetted MBIA's RMBS loss modeling methodology, as well as the data and assumptions utilized therein. (*See* RX 22 (NYSID0002794-852 [Buchmiller Memo]) at 801-04; RX 38 (MBIA_NYS0004285-288); RX 53 (R00368-96) at 370-76; RX 23 (Buchmiller Dep.) 211:6-13.)

Second, contrary to the Banks' assertions, MBIA's decision not to re-run its RMBS loss models in the fourth quarter, despite a rise in early-stage delinquencies (loans experiencing payment delinquencies of thirty days) was proper. (Finkel Aff. ¶¶ 212-28.) As MBIA explained to Mr. Buchmiller, those delinquencies presented less default risk than late-stage delinquencies, as early-stage delinquencies were statistically much more likely to return to current. (RX 23

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60 The Banks' definition of "stale" is flawed insofar as, under their definition, all real estate related structured finance data would be "stale" due to the inevitable and unavoidable lag in the compilation of data from servicers and trustees. (Finkel Aff. ¶¶ 182-87; Edelstein Aff. ¶¶ 21-22, 27.)

61 A regulator's reliance on a valuation analysis from several months earlier may be entirely "reasonable" where those valuations concern "highly illiquid securities" like the structured finance products at issue in this action. (RX 32 (Paltrowitz Dep.) 234:19-35:6.) For example, Mr. Paltrowitz testified that the Federal Reserve Bank of New York's reliance on a BlackRock analysis of certain securities held by one of the Banks as of November 21, 2008 in connection with proposed federal assistance in February 2009 was not unreasonable. (*Id.* at 234:12-35:13.)

(Buchmiller Dep.) 304:12-304:19.) Of greater importance was the fact that the rate of late-stage delinquencies (those of 60 days or more) and outright defaults were showing initial signs of improvement in the fourth quarter. (*See* RX 54 (MBIA_NYS0008276-305) at 286.) Indeed, MBIA's preliminary fourth quarter numbers indicated that the RMBS sector losses and conditional default rates were, in fact, topping out by December 2008.[62] (*See* RX 55 (NYSID0001230-355) at 1269.)

Third, MBIA did not "ignore" (Banks' Reply 59) economic data from the fourth quarter of 2008. MBIA's decision not to re-run loss models in the fourth quarter of 2008 was entirely appropriate given that MBIA had taken an additional $1 billion in loss reserves in the third quarter of 2008 (Finkel Aff. ¶ 170), and continuously monitored its actual losses on these insured transactions to confirm that "actual performance in Q4 has tracked closely to [MBIA's] projections in the loss-reserve analysis." (RX 38 (MBIA_NYS0004285-288).) Therefore, MBIA reasonably believed that its third quarter loss reserves accounted for the underlying issues driving its RMBS-related losses. (RX 33 (McKiernan Dep.) 197:12-198:2.) This was entirely reasonable given that, among other things, its models were intended to, and appeared to, accurately calculate the lifetime loss expectations on MBIA's RMBS insured transactions. (Finkel Aff. ¶¶ 216-19.)

Fourth, although MBIA did not run RMBS loss models in the fourth quarter, Mr. Buchmiller was provided full access to "real time" performance data on MBIA's structured

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62 The Banks ignore the historically quantified seasonal effects of early-stage delinquencies. (Finkel Aff. ¶¶ 220-25.) These delinquencies tended to increase throughout the year, with a "peak" in December. (*Id.*) However, "the increase in early stage delinquencies observed in Q4 2008 was quickly followed by a decline of 24% in the first half of 2009, including a decline of 16.4% in February 2009 alone and a steady decline in almost every month since then." (*Id.* at ¶ 220.) Moreover, MBIA believed that the fourth quarter rise in early-stage delinquencies was merely accelerating inevitable losses that would have occurred in later quarters. (RX 33 (McKiernan Dep.) 397:10-22.) The reasonableness of this view is confirmed by looking at historical macro-economic cycles. (Edelstein Aff. ¶¶ 12-19.) In fact, even if every loan that experienced an early-stage delinquency in the fourth quarter of 2008 resulted in a total loss (which would not reasonably occur), "MBIA's [third quarter] projection would have easily accounted for this amount." (Finkel Aff. ¶ 217.)

finance portfolio. (RX 56 (NYSID0001487-564) at 503.) Unlike the Banks' experts, Mr. Buchmiller did not focus undue attention on a single data point in the latest quarterly results as a harbinger of performance of MBIA's RMBS insured transactions until maturity. Instead, he recognized that MBIA's models appropriately were built to focus on MBIA's (very) long-term payment obligations, rather than on short-term changes in market data that did not necessarily bear any relation to MBIA's ultimate losses. (Miller Aff. ¶ 39.)

Lastly, the Banks and their experts attempt to support their claim that MBIA intentionally understated its loss projections to the NYID by disingenuously referring to the fact that MBIA increased its loss reserves in the first quarter of 2009. (Greenspan Aff. ¶¶ 60, 118, 342, 343; Stulz Aff. ¶ 151.) Indeed, virtually all of the major financial institutions, including the Banks themselves, were regularly increasing write downs and provisions for losses during that time frame, and that MBIA did so as well in now way implicates any intention to mislead the NYID. (Finkel Aff. ¶ 158.) Indeed, the "significant uncertainty" as to the "ultimate impact of the financial crisis" -- not inadequate loss projection methodologies and assumptions -- resulted in financial institutions, like MBIA and the Banks, increasing their loss reserves throughout 2009. (Finkel Aff. ¶ 159.) Further, given that the 2007-2009 recession "was deeper than previously believed" (Finkel Aff. ¶ 162), it would be "unreasonable" to expect that MBIA, the Banks or any market participant "could have anticipated the full extent of the economic downturn and potential credit losses around the time of the Transformation." (*Id.*)

2. MBIA's Qualitative Analysis on its CMBS CDO Models is Entirely Consistent with Industry Practice.

The Banks deride MBIA's use of "overrides" in modeling the performance of CMBS deals. (Banks' Reply 157-58; Greenspan Aff. ¶¶ 30, 97-101, 273, 320-24; Stulz Aff. ¶¶ 71, 157; Corcoran Aff. ¶¶ 99-105.) "Overrides" -- or, as they are more appropriately described, loan level

analytics -- refer to the process by which MBIA and other market participants, individually review, in projecting the performance of CMBS deals, certain "large loans" to determine whether there are factors present in the loans that counter the application of standard loss curves. (Finkel Aff. ¶¶ 407-25.) MBIA utilized these large loan analytics only in one of its two CMBS models at the time of Transformation. (*Id.* at ¶ 416.) The Banks do not contend that the other CMBS modeling relied on by MBIA was erroneous. (*See* Banks' Reply 67-71).

Contrary to the Banks' assertions, MBIA's use of the loan level analytics was entirely consistent with industry practice. (Finkel Aff. ¶¶ 54, 412-17 (MBIA's use of loan-level analytic methods in favor of macroeconomic loss curves "represented standard market practice, given the support of historical research."); Miller Aff. ¶ 39 ("Because there was nothing suspicious about the practice, Mr. Buchmiller appropriately did not consider it a material factor in his evaluation.").) Even the Banks' own experts conceded that the use of loan level analytics is proper and consistent with best practices. (RX 18 (Stulz Dep.) 267:20-268:4; RX 14 (Corcoran Dep.) 353:21-354:9; RX 30 (Greenspan Dep.) 263:20-264:19.) In fact, Mr. Paltrowitz testified that BlackRock uses loan level analytics in its CMBS loss modeling.[63] (RX 32 (Paltrowitz Dep.) 287:11-17.)

The Banks argue that Mr. Buchmiller was unaware of MBIA's use of loan level analytics. That is also entirely baseless. MBIA made him aware of its use of loan level analytics in its modeling of CMBS transactions during the Transformation review. (RX 23 (Buchmiller Dep.) 179:9-19 ("Yes, I believe I was aware of that.").) Among other things, the very PowerPoint presentation cited by the Banks detailed MBIA's methodology. (RX 57 (MBIA_NYS00027932-42) at 933 (stating that MBIA conducted "large loan overrides" on large trophy-property

63 RX 58 ("BlackRock Solutions CMBS Modeling Overview") 4.

transactions where factors such as "strong sponsorship, improved financial statements [and] better tenancy" meant that the defaults and loss rates would be lower than generic CMBS models ordinarily would project).)

The Banks nonetheless argue that, even if MBIA disclosed to Mr. Buchmiller the existence of such overrides, MBIA intentionally failed to disclose their magnitude. (Banks' Reply 157-58.) The Banks misstate the facts. At deposition, Mr. McKiernan testified that he disclosed to Mr. Buchmiller, during a meeting at MBIA, that the impact of the loan-level analysis on one of its stress modeling was up to $950 million. (RX 33 (McKiernan Dep.) 510:4-15, 537:8-21.) Even if MBIA had not informed the NYID of the magnitude of the loan level analytics on its CMBS loss modeling, the validity and soundness of the NYID's review would not be compromised. As Mr. Buchmiller testified, the magnitude of MBIA's loan level analytics was not "material" to his analysis. (RX 23 (Buchmiller Dep.) 184:17-185:2.)

3. <u>MBIA Insurance's Stress Testing Complied with Industry Practice and Standards.</u>

The Banks argue that MBIA Insurance's stress testing was "flawed" because the data and assumptions upon which it was based supposedly were "months out of date by February 2009." (Banks' Reply 159.) This contention is also baseless.[64] In fact, MBIA used the most current data available, consistent with industry practice and standards, including those set forth by the NYID. (Finkel Aff. ¶¶ 193-200; Edelstein Aff. ¶¶ 20-27; Miller Aff. ¶¶ 39-42.)

First, it is undeniable that MBIA's stress testing was entirely consistent with the purpose of stress testing: "to account for potential variations in available data, economic conditions and

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64 The Banks rely on inapplicable case law to support their "stale data" argument. *See, e.g., Sabol v. Perales,* 82 N.Y.2d 685, 687, 601 N.Y.S.2d 468, 470 (1993) (finding that agency acted arbitrarily and capriciously in applying sanctions and requiring strict compliance with statute where it had previously stated statute only required "diligence of effort" to complete documentation); *People ex rel. Consol. Water Co. v. Maltbie,* 275 N.Y. 357, 368, 9 N.E.2d 961, 964 (1937) (reviewing rates set by company and finding that the rates "must be based upon prediction and [such determination] is not invalid if it is based upon prediction which is reasonable") .

actual performance over a given period of time." (Finkel Aff. ¶ 252.) MBIA conducted two primary stress tests as part of its normal modeling of loss reserves, a "Sensitivity" scenario and a "Stress" scenario. (*Id.*) In each of these scenarios, MBIA extended the period during which elevated defaults would persist by 6 and 12 months, respectively, beyond the already assumed period of projected defaults. (*Id.* at ¶ 253.) MBIA's stress tests clearly accounted for then-unknown factors or potential variations affecting its Q1 2009 performance, which is the exact purpose of stress testing. While the Banks attack the adequacy of MBIA's stress testing as having excluded the "impact of the fourth quarter financial crisis," "the most significant driver of future losses beyond MBIA's Q3 2008 projections was not the short-term increase in delinquencies or timing of data, . . . , but rather the length of time those conditions would eventually persist and the pace at which a recovery would occur, in both cases materially affected by the previously unpredictable levels of ineligible loans collateralizing MBIA's Second Lien RMBS." (Finkel Aff. ¶ 256.)

The Banks' claim that MBIA disregarded a NYID November 2008 Circular Letter (the "Circular Letter") requiring that "stress scenarios and the resulting impact must be continuously monitored, assessed and updated" (Banks' Reply 72), is entirely unsubstantiated and belied by the facts. The NYID Capital Markets Bureau confirmed Mr. Buchmiller's "top-down" approach to MBIA's balance sheet and risk focused review as consistent with the guidance concerning stress testing examinations provided by the Circular Letter. (Miller Aff. ¶ 40.) Likewise, MBIA "considered factors similar to those delineated in [the Circular Letter] including factors related to credit risk, market risk, operational risk, political risk, regulatory risk, and governance risk" when setting its loss reserves. (Dudney Aff. 70.)

Indeed, the Banks' suggestion that MBIA's stress testing was inadequate is "simply not supportable in the context of the significant extension of the projected period of elevated defaults in MBIA's various stress tests," which included extending the period of elevated losses to the end of 2009 (Sensitivity scenario) and to 2010 (Stress scenario).[65] (Finkel Aff. ¶¶ 252-56.) Far from inadequate, "Mr. Buchmiller's stress testing methodologies as of the Transformation review were in line with -- if not superior to -- the practices of some . . . banking institutions."[66] (Miller Aff. ¶ 42.)

4. MBIA Insurance's Calculation of its Discount Rate to Set its Loss Reserves Complied Fully with the Insurance Law And Statutory Accounting Principles.

The Banks argue that MBIA used an illegal discount rate, which enabled it to set lower loss reserves than would have otherwise been calculated. (Banks' Reply 155-57.) However, MBIA Insurance's calculation of its discount rate complied fully with the Insurance Law and all applicable statutory accounting principles. (Buttner Aff. ¶¶ 13, 51, 57.) The Banks' arguments are contrary to the law, industry practice, and common sense.

Under Insurance Law § 6903(b)(1), "[a] deduction from loss reserves shall be allowed for the time value of money by application of a discount rate equal to the average rate of return on

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65 Contrary to the testimony of Mr. Greenspan, the difference between the stress testing results of BlackRock and MBIA stems not from the time period from which the data used was drawn, but rather from the difference in economic outlook and modeling assumption utilized by BlackRock and MBIA Insurance. (Finkel Aff. ¶¶ 144-48.) MBIA Insurance, which as a monoline appropriately had a perspective more akin to a "buy-and-hold" investor, was therefore less bearish than BlackRock, and utilized assumptions that fell within the spectrum of reasonable views concerning the economic outlook at the time. (*Id.* at ¶¶ 149-51.) In any event, to the extent that other data was available to MBIA Insurance, and would have made a material difference in MBIA's loss projections, MBIA Insurance's stress modeling provided a more than sufficient "cushion" in MBIA Insurance's potential losses. (*Id.* at ¶ 255.)

66 That the Banks would challenge the sufficiency of MBIA's stress testing is, to say the least, ironic, given that just eight months after the Transformation, a supervisory group made up of the Federal Reserve, the Federal Reserve Bank of New York, the Office of the Comptroller of Currency, the Securities and Exchange Commission and other banking regulators, concluded that "most [banks] still do not have regular, robust, firm-wide stress tests," and that thirteen of the twenty banks failed to comply with the supervisory group's stress testing guidelines. (Miller Aff. ¶ 41.)

the admitted assets of the [financial guarantee] insurer as of the date of the computation of any such reserves." This permits an insurer to reduce the amount of admitted assets set aside to support loss reserves by an amount equal to the expected future investment earnings on those assets. (Buttner Aff. ¶¶ 17, 69-71.) Section 6903(b)(1) neither mandates nor provides a specific formula for calculating the discount rate. To the contrary, the calculation of a loss reserve discount rate necessarily is subject to reasonable and informed interpretation. (*Id.* at ¶ 53.) In compliance with Section 6903(b)(1) and applicable statutory accounting principles, MBIA Insurance calculated its loss reserve discount rate by using a weighted average of its fixed-income investment portfolio, excluding cash, money market accounts, and certain short-term investments. (Buttner Aff. ¶¶ 12-13, 54-55.)

Nonetheless, relying solely on the testimony of Mr. Corcoran, who is not an accountant and who has no accounting background (RX 14 (Corcoran Dep.) 107:5-108:6, 209:24-210:9), the Banks argue that this discount rate was somehow "illegal" because MBIA Insurance did not use "all" admitted assets in its calculation. (Banks' Reply 156; Corcoran Aff. ¶ 89.) The Banks are wrong.

First, the NYID in fact found no violation in MBIA Insurance's discount rate as of December 31, 2008. In its review of the Transformation Application and its Report of Examination, the NYID concluded that MBIA's loss reserves were consistent with "best practices," and its "review did not indicate any basis for rejecting or amending [MBIA Insurance's] 2008 reserves, despite the dramatic increase in [MBIA Insurance's] reserves from 2008 to 2009."[67] (RX 31 (Examination Report) 23; Buttner Aff. ¶¶ 66, ¶ 23.) Because the

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[67] The Banks cite the NYID's draft examination report, claiming that it states MBIA Insurance's discount rate "deviated" from Section 6903(b). (Banks' Reply 66, 156 n.226.) In fact, the draft stated only that the discount rate "appear[ed]" to deviate. (MBIA_NYS0430424-25; Buttner Aff. ¶ 63.) The final examination report does not

calculation of an insurer's discount rate is governed by the Insurance Law, and the NYID in no way acted contrary to the law, its determination is entitled to deference.

Second, the unambiguous language of Section 6903(b)(1) does not require the use of "all" admitted assets in the calculation of a discount rate. (*See* Buttner Aff. ¶¶ 16-17, 68-72.) Nor is there any support in the Insurance Law or any other statutory accounting principle for the use of "all" admitted assets in calculating an insurer's discount rate, and the Banks cite nothing to the contrary. Indeed, under the Banks' argument, the Court would be required to add a word -- namely, "all" -- to Section 6903(b)(1). This is impermissible. *See Am. Transit Ins. Co. v. Sartor*, 3 N.Y.3d 71, 76, 781 N.Y.S.2d 630, 633 (2004) ("A court cannot amend a statute by adding words that are not there."); *Bank of N.Y. v. Resles*, 78 A.D.3d 469, 472, 912 N.Y.S.2d 35, 37-38 (1st Dep't 2010) (rejecting interpretation of statute that would include "words that the Legislature did not see fit to include"). Had the Legislature desired to include the word "all" in Section 6903(b)(1), it easily could have done so. *See People ex rel. Glick v. Russell*, 181 A.D. 322, 326, 168 N.Y.S. 472, 475 (2d Dep't 1917) (noting that the Legislature could have included the word "by the use of the simple word 'all'").

Finally, the Banks' argument evinces a fundamental misunderstanding of statutory accounting and is contrary to common sense. Admitted assets are those assets that are used to assess the solvency of an insurer. (Buttner Aff. ¶¶ 16, 70.) However, not all admitted assets are used to calculate an insurer's discount rate; only those admitted assets that are available to satisfy anticipated liabilities are properly used. (*See id.* at ¶¶ 17, 35, 69-71.) Thus, for example, if admitted assets are illiquid, not readily marketable, have no earning capacity or will be needed in the short-term, they are properly excluded from the calculation of an insurer's discount rate.

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contain the word "deviate," and does not in any way take exception with MBIA's loss reserves, including the discount rate. (RX 31 (Examination Report) 23; Buttner Aff. ¶¶ 63, 80.)

(Buttner Aff. ¶¶ 16-17, 56-57, 70-71; RX 59 (NAIC Statement of Statutory Accounting Principles #87) ¶ 3.) Under the Banks' view, however, an insurer would have to calculate its discount rate using even those assets that are not marketable and never generate income (*e.g.*, real estate and goodwill). (Buttner Aff. ¶¶ 17, 70-71.) That is not the law, and the Banks cite nothing to support their flawed argument.

Here, MBIA Insurance's discount rate as of December 31, 2008 complied with the Insurance Law and applicable statutory accounting principles, even though it excluded cash, money market accounts, and short-term investments from the calculation. (Buttner Aff. ¶¶ 17, 51-54, 57, 70-71.) The Banks nonetheless assert that those assets were excluded, not for a legitimate purpose, but so that MBIA Insurance could increase its discount rate (and thereby decrease its loss reserves), as it "was readying its Transformation application." (Banks' Reply 63.) This is contrary to the record. MBIA Insurance conducted a liquidity analysis that indicated it had significant short-term obligations to policyholders and otherwise.[68] Accordingly, MBIA Insurance significantly increased its liquidity position as of December 31, 2008 to satisfy those obligations. (RX 5 (Pastore Dep.) 153:19-157:14, 163:18-164:20; RX 60 (MBIA_Plenary_01093386); *see also* Buttner Aff. ¶ 56.) Cash and short-term investments necessary to satisfy those obligations were thus properly excluded from MBIA Insurance's calculation of its discount rate, as they could not be set aside to support loss reserves. (Buttner Aff. ¶¶ 51, 57, 70-71; RX 59 (NAIC Statement of Statutory Accounting Principles #87) ¶ 3.) Indeed, MBIA's independent auditor, PwC -- which also audits several of the Banks -- issued

[68] The Banks cite certain documents in which MBIA employees are discussing whether to petition the NYID for a permitted practice before excluding such assets in the calculation of the discount rate, and suggest that MBIA's failure to do so somehow violated the Insurance Law. (Banks' Reply 63-65, 156; Corcoran Aff. ¶¶ 90-91.) This is incorrect. First, as shown herein, MBIA's exclusion of those assets fully complied with the Insurance Law and applicable statutory accounting principles. Second, these documents merely reflect internal discussions, and, in fact, it would have been more troubling had MBIA's employees not discussed the issue.

unqualified audit and actuarial opinions concluding that MBIA Insurance's loss reserves, including its discount rate, complied with the Insurance Laws and all applicable statutory requirements. (Buttner Aff. ¶¶ 17, 49-50, 58-61.)

5. The Opinions of the Banks' Financial Experts are Tainted by <u>Hindsight.</u>

The Banks' and their experts' criticism of the data and assumptions employed in MBIA's loss reserve analysis and stress testing as "stale" or "inadequate" (Banks' Reply 56-69; Stulz Aff. ¶¶ 128-35; Greenspan Aff. ¶¶ 243-306), all invariably depend on "20/20 hindsight and an unrealistic account of macro-financial reporting" and take "overly pessimistic" and bearish views based on "ex-post knowledge of how things *actually* turned out." (Edelstein Aff. ¶¶ 21-23; Finkel Aff. ¶¶ 51-53.) Specifically, the Banks and their experts assert that MBIA's loss reserves were inaccurate because MBIA did not take into account the deteriorating economic and financial marketplace in late 2008 and early 2009 (Banks' Reply 59-62; Stulz Aff. ¶¶ 5, 16, 140-64; Greenspan Aff. ¶ 244), and that MBIA's stress testing was inadequate because they "rested on a false premise that the economic conditions had essentially bottomed out months earlier and would improve in the ensuing months." (Stulz Aff. ¶¶ 5, 165-69; *see* Banks' Reply 59-60; Greenspan Aff. ¶¶ 311, 318.) In support of their arguments, the Banks and their experts repeatedly refer to the BlackRock Report submitted in connection with the affidavit of Mr. Paltrowitz. (Greenspan Aff. ¶¶ 256-58, 317; Banks' Reply 78-82.)

Notably, the Banks and their experts are unable to square their attacks on MBIA's data and assumptions with the fact that "there simply was *no* consensus view in the fall and winter of 2008/2009 that the economy and financial system were assured of a further lengthy downturn." (Edelstein Aff. ¶ 24.) Indeed, despite Mr. Stulz's attacks on MBIA's view that "economic conditions had essentially bottomed out months earlier and would improve in the ensuing

months" (Stulz Aff. ¶ 5), a number of reasons existed to "reasonably have expected a near-term economic recovery." (Edelstein Aff. ¶ 25.) First, "there was an unprecedented series of public sector actions undertaken by the Federal Reserve Banks, the United States Treasury, the President, and the United States Congress to repair and refurbish the economy and the financial system" that "led many market participants and contemporaneous observers to conclude . . . that the economy was likely to stabilize and potentially enter an upturn period in the near-term." (*Id.* at ¶ 24.) Second, "the ultimate severity of the recession was far from obvious during the September 2008 through February 2009 period," and the "[a]vailable macro-financial data relevant to MBIA's assumptions for modeling and computing loss reserves in the months prior to the Transformation had both positive and negative features, and in many ways appeared at the time to be no different than many earlier recessions since the Second World War," which, consistent with previous recessions, indicated a likelihood for economic recovery in the short term. (*Id.* at ¶¶ 25, 26.) In addition, the economic outlook and performance data in late 2008 and early 2009 did not, as it could not, account for "the material and then-unknown level of ineligible loans," which in many cases were originated by certain of the Banks in this proceeding. (Finkel Aff. ¶ 46.)

On the other hand, as Professor Edelstein shows, the Banks' and their experts' contentions and analysis rely on pessimistic assumptions and views undoubtedly informed by their actual knowledge of the severity of the economic downturn.[69] For example, Professor Stulz

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[69] The Banks' and Mr. Stulz's arguments concerning MBIA's stock price and CDS spread fluctuations (Banks' Reply 86-88; Stulz Aff. ¶¶ 112-13) are unavailing. Mr. Stulz argues that the increase in MBIA Inc.'s stock price and CDS spread on the day the Transformation was announced evidences that the Transformation was a "gift" at the expense of MBIA Insurance and its policyholders. (Stulz Aff. ¶ 112-13; Edelstein Aff. ¶ 28.) However, the fluctuations of MBIA Inc.'s stock price and the CDS spreads were not isolated incidents and, in fact, MBIA Inc. experienced fluctuations equal to or greater than that which it experienced on February 18, 2009 on numerous occasions prior to that date. (Edelstein Aff. ¶¶ 29, 35.) Accordingly, any contention that the movement of MBIA Inc.'s stock price or CDS spreads on the day of Transformation is indicative of anything at all concerning the

contends that MBIA did not account for "rapid deterioration" of the economy in the lead up to the Transformation, but he fails to acknowledge, as he must, that the "rapidity" of the deterioration only became apparent ex-post. (Edelstein Aff. ¶ 23 n.9.) Likewise, he points to the fact that the economy continued to deteriorate after the Transformation, and claims that MBIA should have "assumed the worst" before that date, but fails to acknowledge that those claims are entirely "informed by his superior ex-post knowledge of how things *actually* turned out." (Edelstein Aff. ¶ 23; *see also* Finkel Aff. ¶¶ 29, 51-53, 242, 377-80.)

Accordingly, the Banks' and their experts' criticisms concerning the adequacy of the data and assumptions used by MBIA in running its loss reserves and stress testing are "unfair" and "unfounded." (Edelstein Aff. ¶ 27.)

6. The Opinions of the Banks and their Financial Experts Entirely Ignore MBIA's Long-Term View of Risk.

The Banks contend that the differences between MBIA's loss projections and those of the Banks' expert, BlackRock, demonstrate that MBIA "understated its expected losses" or that its projections are somehow inadequate. (Banks' Reply 152.) However, the Banks and their experts ignore the crucial fact that MBIA's perspective differs from the perspectives of the Banks and BlackRock.[70] Whereas "buy-to-hold" investors, like MBIA, maintain a "fundamental long-term" view of risk, institutions involved in trading activity, such as the Banks or hedge funds, are primarily concerned with "capturing relatively short-term gains by actively purchasing and selling securities on an ongoing basis." (Finkel Aff. ¶¶ 150-51.) As a result, the market value of any given security will have a significantly greater impact on the loss projections of a

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legality and propriety of the NYID's approval of the Transformation is, to say the least, "unconvincing." (*Id.* at ¶¶ 33, 36.)

70 As Mr. Finkel explains, "modeling approaches and assumptions can vary significantly" based on user perspective and objectives. (Finkel Aff. ¶¶ 149-57.)

trading institution than those of a buy-and-hold investor, for which market value may have no relevance whatsoever. (*Id.* at ¶¶ 151-152.) The distinction is confirmed by the Banks' own internal analysis, which admits that loss estimates and stressful assumptions "provided by [a Bank's] trading desk" are too "severe," and are not "relevant to [MBIA's] hold-to-maturity posture." (RX 50 (CITI 00012005-20) at 08.) While implied market value may be a determinative factor for a trading institution, like BlackRock or the Banks, in determining whether to buy or sell a security in the short term, market value is irrelevant to the analysis of whether a buy-to-hold investor, like MBIA, has sufficient claims paying ability to make payments of principal and interest as they come due until final maturity.[71] (RX 32 (Paltrowitz Dep.) 308:9-11; *see* Finkel Aff. ¶ 151.)

Indeed, BlackRock, a firm with billions of dollars of assets under management, including "presumably" structured finance securities insured by MBIA Insurance (RX 32 (Paltrowitz Dep.) 62:14-64:7), like any other trading institution, relies on implied market losses in modeling its loss projections.[72] (*Id.* at 307:11-21 (testifying as to why the BlackRock Report provides implied market value of MBIA's exposures).) For instance, among other things, BlackRock benchmarks its loss projections against the ABX, an index based on research from investment banks that often refers to "market-implied" loss projections for RMBS securities. (Finkel Aff. ¶¶ 153-54.) Likewise, Mr. Paltrowitz, also admits that BlackRock's loss projections are consistent with those of trading institutions, commonly referred to as the "street," stating in his report and testifying at

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[71] Indeed, certain Banks in this proceeding recently considered a "shift away from mark-to-market accounting" whereby, for the purposes of accounting, securities will be valued at their "original value or purchase price" as opposed to their market value, explaining that the "accounting treatment is appropriate because the *firms intend to hold most of these loans until they are repaid.*" (RX 62.)

[72] As Mr. Paltrowitz testified, BlackRock is merely a brand name and no legal separation exists between BlackRock's financial advisory and asset management businesses. (RX 32 (Paltrowitz Dep.) 24:7-12 ("I know for sure [BlackRock Solutions] [is] not a separate legal entity" from BlackRock Financial Management.).) Likewise, as Mr. Paltrowitz testified, BlackRock "use[s] the exact same models on the portfolio management side" as it used for its analysis in this case. (*Id.* at 15:8-10.)

deposition that BlackRock's "base case [loss scenario] is in line with the street." (RX 32 (Paltrowitz Dep. 319:22-320:13.) As evidenced by the Banks' own

The Banks and their experts utterly fail to take into account this distinction, choosing, instead, to repeatedly refer to the divergence between BlackRock's loss projections and those of MBIA as supposed evidence that MBIA's loss reserve modeling were inadequate. However, as Mr. Finkel concludes, "[w]hat is clear is that with respect to financial modeling and loss projections for structured products, there is a wide range of reasonable methodologies to use, dependent on one's outlook, and that using anything but a fundamental analysis to assess the future losses for an entity such as MBIA would be circumspect." (Finkel Aff. ¶ 157.)

G. Superintendent Dinallo's Motivations For Approving The Transformation Were Appropriate.

In a last ditch effort to cast the NYID's approval of the Transformation as improper, the Banks contend -- for the first time[73] -- that the Superintendent's motivation -- to unfreeze the public finance bond market -- was "extra-legal."[74] (Banks' Reply 160.) This argument is

[73] Therefore, this contention is not properly before the Court. *See Rodriguez v. Lloyd*, 233 A.D.2d 120, 120, 649 N.Y.S.2d 782, 782 (1st Dep't 1996) (trial court correctly refused to consider evidence that was submitted by petitioner for first time in reply); *see also Gregory v. Town of Cambria*, 69 N.Y.2d 655, 656-57, 511 N.Y.S.2d 829, 830 (1986) (refusing to consider petitioner-appellant's alternative argument "since that issue was not raised in the petition and thus has not been preserved for review").

[74] The cases the Banks cite for the proposition that the NYID's approval should be annulled because the Superintendent sought to unfreeze the public finance bond market are inapposite because they involve (1) agencies ignoring material facts and basing their determinations entirely on policy-oriented goals, *see, e.g.*, *Swalbach v. State Liquor Auth.*, 7 N.Y.2d 518, 523, 200 N.Y.S.2d 1, 5 (1960) (rejecting agency's decision that all applications for liquor licenses in "modern shopping centers" should be denied, and stating that each individual case must be decided on its facts); (2) agency determinations based on insufficient facts, or that totally disregard the particular facts before the agency, *see, e.g.*, *Barry v. O'Connell*, 303 N.Y. 46, 51, 100 N.E.2d 127, 129-30 (1951) (finding action arbitrary and capricious where no findings of fact were made despite a statutory mandate to set forth the reasons for denying liquor license); *Estate of Mollineaux v. Michaelis*, 29 Misc. 2d 933, 935, 218 N.Y.S.2d 900, 902-03 (Sup. Ct. Nassau County 1961) (finding objection of community members was not sufficient to support denial of property

baseless. In fact, the Superintendent acted entirely within his discretion pursuant to his statutory authority and consistent with the stated mission of the NYID. (Baker Aff. ¶¶ 13-14, 20.)

1. <u>The Superintendent's Policy Goals Were Entirely Permissible.</u>

The NYID's own mission statement expressly lists one of the goals of the NYID as promoting "the continued development of a sound, fair and robust Insurance Industry." (RX 68 (NYID homepage).) Indeed, "[t]here is no Insurance Law provision that prohibits a sitting Superintendent from considering the impact of his decisions on the insurance market or on the public that depends on that market." (Baker Aff. ¶ 25.) In fact, "[i]nsurance regulation exists because robust insurance markets cannot exist without government support," and "[e]fforts to promote the public finance insurance market are just one example of the kind of 'availability and affordability' efforts that are a common and well regarded aspect of insurance regulation." (*Id.* ¶ 72.)

Moreover, the Banks' expert, Mr. Stewart, agreed that the "Superintendent's stated goal of reinvigorating the market for municipal bonds by making insurance for those bonds available was within the mission of the NYID." (RX 7 (Stewart Dep.) 112:23-113:3; 115:20-24.) So too, Mr. Muhl conceded that "Superintendent Dinallo's goal of reinvigorating the municipal bond market was within the fundamental regulatory goals of NAIC," and that "making municipal bond insurance available to prospective consumers was certainly within the scope of the mission statement [of the NYID]." (RX 8 (Muhl Dep.) 154:16-155:24, 165:13-18; Baker Aff. ¶ 25 n.23.)

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owner's application to build motel in area zoned for business); (3) agencies improperly exercising legislative functions by creating policy, *see, e.g.*, *Health Ins. Ass'n of Am. v. Corcoran*, 76 N.Y.2d 995, 997, 564 N.Y.S.2d 713, 713 (1990) (holding that state-wide regulation issued by NYID prohibiting use of HIV testing when writing policies was invalid); *Boreali v. Axelrod*, 71 N.Y.2d 1, 14, 523 N.Y.S.2d 464, 471 (1987) (finding that agency exceeded regulatory authority and that "no special expertise or technical competence in the field of health was involved in the development of the antismoking regulations challenged here"); or (4) agencies acting in a flagrantly arbitrary or capricious manner, *Picone v. Comm'r of Licenses of City of N.Y.*, 241 N.Y. 157, 162, 149 N.E. 336, 338 (1925) (where petitioner satisfied requirements for obtaining license but it was denied because of thefts committed by other licensees, the court found that the denial was an abuse of discretion).

Indeed, all of the former Superintendents hired by the Banks acknowledged that they had considered the impact of their decisions on the insurance market during their tenure as Superintendent. For example, Mr. Serio testified that the NYID took actions in the aftermath of the September 11, 2001 terrorist attacks to "stabilize the insurance marketplace." (RX 15 (Serio Dep.) 46:2-5; 227:10-18.) Mr. Muhl testified that, in approving the Lloyd's-Equitas restructuring, he considered the public interest in keeping Lloyd's in business. (RX 8 (Muhl Dep.) 118:21-25.) Likewise, Mr. Corcoran acknowledged the public interest in promoting the availability of liability insurance during his time in office, and Mr. Stewart acknowledged that it is a permissible goal of the NYID and the Superintendent to aid a struggling yet necessary market for a certain type of insurance. (RX 14 (Corcoran Dep.) 92:15-95:25; RX 7 (Stewart Dep.) 112:12-115:24, 120:23-121:17, 125:19-132:25, 162:12-166:8.)

The Banks' own experts also testified that the Superintendent may use his discretion in making policy, provided he does not violate the Insurance Law in doing so.[75] (RX 15 (Serio Dep.) 132:19-133:8; 226:4-16; 230:9-232:14; RX 7 (Stewart Dep.) 192:7-193:11, 244:3-17; RX 8 (Muhl Dep.) 63:14-20; RX 14 (Corcoran Dep.) 152:1721; 276:3-6; 284:14-23; 285:7-16.) Thus, they testified that the Superintendent has broad power to determine whether a proposed transaction, like the Transformation, implements the policy objectives of the Insurance Law. (RX 15 (Serio Dep.) 148:11-16; 153:15-21; RX 7 (Stewart Dep.) 214:13-19.)

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[75] The cases relied on by the Banks for the proposition that the Superintendent's policy goals were not permitted are entirely inapposite because they, unlike here, concerned the unauthorized promulgation of regulation by an agency beyond its statutory mandate. *See Boreali*, 71 N.Y.2d at 6, 523 N.Y.S.2d at 466 (1987) (holding that agency "overstepped the boundaries of its lawfully delegated authority when it promulgated a comprehensive code to govern tobacco smoking in areas that are open to the public"); *Health Ins. Ass'n of Am. v. Corcoran*, 154 A.D.2d 61, 75, 551 N.Y.S.2d 615, 623 (3d Dep't 1990) (invalidating agency's regulations because "administrative determination . . . makes unlawful what the Legislature chose to make fully lawful"), *aff'd*, 76 N.Y.2d 995, 564 N.Y.S.2d 713 (1990). Here, unlike in those cases, the Superintendent's determination, which enhanced the availability of municipal bond insurance while protecting the rights of all policyholders, was entirely consistent with the provisions of the Insurance Law.

Notably, Mr. Serio also testified that it is within the Superintendent's broad powers to determine the proper procedure for implementing the review and approval of a given transaction under the Insurance Law, how to staff the review team, and how to prescribe the logistics of that review. (RX 15 (Serio Dep.) 154:15-156:3; *see also* RX 8 (Muhl Dep.) 145:8-13; Baker Aff. ¶¶ 13, 21-23.)

Likewise, they all agreed that regulatory authorities, like the NYID, may and should exercise their discretion in a policy-making capacity, particularly in the face of unprecedented circumstances (Miller Aff. ¶¶ 51-57; Baker Aff. ¶¶ 15-16; RX 15 (Serio Dep.) 22:24-24:9, 229:8-230:19), or where the consequences of failing to do so would be "socially catastrophic." (RX 7 (Stewart Dep.) 100:06-100:22). In fact, Mr. Stewart testified that the harm that could result to the public interest without approval of a particular transaction would provide "collateral justification" for the approval. (RX 7 (Stewart Dep.) 102:06-103:11.)

Thus, while "the NYID's primary objective is to protect policyholders," it "may consider other important public values" such as "foster[ing] growth of the insurance industry in the [s]tate." (Miller Aff. ¶ 53.) Accordingly, "[g]iven the NYID's conclusion that the Transformation would provide reasonable protection for all policyholders, it was permissible for the Department to consider other important public policies, such as stabilizing credit markets and strengthening public finance." (Miller Aff. ¶ 56; Baker Aff. ¶¶ 16, 22, 28, 72.) Here, the NYID "performed functions for the insurance industry similar to that which the U.S. Treasury and the Federal Reserve performed for other financial sectors -- monitoring the crisis and seeking creative solutions under conditions of extreme urgency and stress."[76] (Miller Aff. ¶ 77.)

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[76] Certainly, the "alleged excesses of the NYID pale in comparison with decisions made by federal financial regulators," including, among others, (1) the Treasury Department's committing billions of TARP dollars to interim rescue funding for General Motors and Chrysler, although the funds were obtained for the express purpose of assisting the financial services industry; (2) the Treasury's decision to use much of the TARP funds to make equity

2. There is no Evidence that the Superintendent Prejudged the Transformation Application or Favored Municipal Bond Policyholders over Structured-Finance Bond Policyholders.

The Banks argue that the NYID prejudged the Application, and favored public finance policyholders to the detriment of the structured finance policyholders. (Banks' Reply 165-67.) This is baseless.

As shown, the NYID, in approving the Transformation, conducted a thorough review of MBIA Insurance's financial condition, protecting the interests of all policyholders.[77] (*See* Miller Aff. ¶¶ 53-59; Buchmiller Aff. ¶¶ 19-58; Baker Aff. ¶¶ 36-37.) Indeed, the Banks' assertion that the NYID's review was "window dressing" (Banks' Reply 165), is rebutted squarely by the record. Among other things, on two occasions, the Transformation structure and allocation of capital were revised at the NYID's direction. (Chaplin Aff. ¶¶ 42, 89.) Indeed, Mr. Stulz acknowledged that one of those revisions, the NYID's request that MBIA leave $750 million in additional capital with MBIA Insurance, is indicative of the NYID's concern that MBIA Insurance maintain adequate capital post-Transformation. (RX 18 (Stulz Dep.) 196:8-14.) Further, multiple meetings among NYID employees, the NYID's counsel, MBIA's outside counsel, and MBIA personnel, over the course of nearly ten weeks, concerning, among other

investments in banks and other financial institutions, despite those funds being obtained in order to purchase troubled assets from distressed financial institutions; and (3) the Federal Reserve's using "discount window" loans to provide more than $1.4 trillion in liquidity assistance to non-depository financial institutions, despite such loans traditionally only being made to depository institutions. (Miller Aff. ¶ 78.)

[77] The cases cited by the Banks either support MBIA's argument, *see 1616 Second Ave. Rest. v. N.Y. State Liquor Auth.*, 75 N.Y.2d 158, 162, 551 N.Y.S.2d 461, 463 (1990) (recognizing that "administrative officials are expected to be familiar with the subjects of their regulation and to be committed to the goals for which their agency was created," and that "a predisposition on questions of law or policy and advance knowledge of general conditions in the regulated field are common, and it is expected that they will influence an administrator . . . . [M]ere familiarity with the facts of a pending proceeding or taking a public position on a policy issue related to the proceeding have been held insufficient to require disqualification"); *Warder v. Bd.of Regents*, 53 N.Y.2d 186, 881, 440 N.Y.S.2d 875, 880 (1981) (affirming dismissal of Article 78 petition because the record did not support a claim of "bias" or that the decision of the Board of Regents denying a provisional charter "flowed from," such bias), or are inapposite insofar as they involve agency determinations that were wholly lacking in legal justification, *see, e.g.*, *Town of Orangetown v. Magee*, 88 N.Y.2d 41, 47, 643 N.Y.S.2d 21, 24 (1996) (finding that none of the reasons given in support of the revocation of defendant's building permit were authorized by town's ordinances and that permit was revoked for purely political purposes).

things, the regulatory and legal requirements for the Transformation and MBIA Insurance's pre- and post-Transformation financial condition clearly invalidate the Banks' claim that the Superintendent pre-determined the approval of the Transformation. (Chaplin Aff. ¶¶ 53-61; Buchmiller Aff. ¶¶ 19-21; McKiernan Aff. ¶¶ 11-40; Moriarty Aff. ¶¶ 38-46; Boisseau Aff. ¶¶ 25-29; Miller Aff. ¶¶ 25, 31; Baker Aff. ¶¶ 38-41.)

Likewise, the Banks' assertion that the Superintendent exhibited favoritism to the public finance policyholders and "animosity" toward the structured finance policyholders is equally baseless. The record demonstrates that the Transformation was approved by the Superintendent based on, among other things, a determination that, pre- and post-Transformation, the policyholders of both MBIA Insurance and MBIA Illinois would have access to a solvent, well-capitalized insurer with sufficient claims paying resources. (RX 2 (R00971-80 [Approval Letter] at 976); Buchmiller Aff. ¶ 57; Moriarty Aff. ¶ 74; Boisseau Aff. ¶ 87; Miller Aff. ¶ 32 n.112.) Tellingly, at least one of the Banks concluded

The Banks' only support for this assertion is language taken out of context from the record. First, the Banks misleadingly reference a February 8, 2008 document -- ten months before the Application was even submitted -- describing a discussion between Perella Weinberg and MBIA for the proposition that the NYID allegedly favored public finance policyholders

because it was willing to treat structured finance policyholders and public finance policyholders "differently." (Banks' Reply 165, RX 65 (MBIA_NYS0438187- 90) at 8190), but fail to acknowledge that in that same document, MBIA discussed its desire to ensure "equal policyholder treatment." (RX 65 (MBIA_NYS0438187- 90).) Mr. Stewart acknowledged that a restructuring that treats groups of policyholders differently is not unfair where the right of all policyholders to have their claims paid is preserved. (RX 7 (Stewart Dep. 266:23-268:19); Baker Aff. ¶¶ 51-53; Miller Aff. ¶ 58 ("However, an insurance company does not unfairly discriminate when it undertakes actions that leave both groups with adequate security that their claims will be paid.").) In short, "[t]reating policyholders differently is not improper 'discrimination' under the Insurance Law." (Baker Aff. ¶¶ 52-53.)

Second, the Banks misleadingly quote testimony the Superintendent gave before the U.S. Congress. (Banks' Reply 166.) The Banks quote Superintendent Dinallo as stating that if efforts to "strengthen bond insurers" failed, "our first priority will be to protect the municipal bondholders and issuers." (RX 66 (Dinallo Testimony).) The statement quoted by the Banks was made by the Superintendent in the middle of testimony regarding what the NYID would do in the event that "efforts to strengthen each individual bond insurer" failed. (*Id.* at 220.) Nothing in that testimony demonstrated favoritism towards one group of policyholders over another.

Third, the Banks misleadingly quote a statement made by an NYID employee concerning a FGIC reinsurance agreement in the fall of 2008 for the proposition that the NYID did not want "money going out the door to structured credits" at the expense of public finance policyholders. (Banks' Reply 166; RX 67.) This is inaccurate. Read in its entirety, it is clear that the NYID employee was aware that FGIC had already initiated discussions with its structured-finance

counterparties (including many of the Banks here) regarding their policies and FGIC's deteriorating financial condition, but had not yet provided any proposals as to how all policyholders, including the public finance policyholders, would be protected. (RX 67.) The statement reflects nothing more than the NYID's desire to ensure that public finance policyholders were treated fairly relative to the structured finance policyholders, despite not being represented by some of the largest financial institutions in the world.

Fourth, the Banks distort entirely the contents of "talking points" prepared by an NYID employee concerning the Transformation. (Banks' Reply 166.) The Banks ignore that the document makes clear that: (1) both groups of policyholders had access to "solvent" "companies hav[ing] assets to cover obligations," and (2) MBIA's "goal [was] to eventually be strong enough to write new business separately for both muni and structured markets." (RX 68 (MBIA_NYS0455975-76).)

Finally, the Banks erroneously cite e-mails between Mr. Brown and the Superintendent as evidence that the Superintendent favored the public finance policyholders. (Banks' Reply 166-67; RX 69 (MBIA_Plenary_01194986); RX 70 (MBIA_NYS0006109); RX 71 (MBIA_NYS0005897); RX 72 (MBIA_NYS0005347); RX 73 (MBIA_NYS0005896).) Those e-mails simply reflected his belief in the importance of providing assistance to the thousands of municipalities and millions of public finance policyholders by allowing MBIA's re-entry into the public finance bond market. (Brown Aff. ¶ 20.) They do not, as the Banks suggest, demonstrate that the Superintendent had an improper motivation or otherwise favored the public finance policyholders at the expense of the structured finance policyholders.

IV. THE BANKS ARE NOT ENTITLED TO A CONSTRUCTIVE TRUST

In their second cause of action, the Banks seek a constructive trust under Insurance Law § 4105(b). This claim should be dismissed.[78]

First, as shown (MBIA Opp. 17-19), the constructive trust claim should be denied because it seeks relief beyond the limited scope of relief available under Article 78.[79]

Second, Section 4105(b) does not provide a private right of action. "'Typically, courts do not construe the Insurance Law as providing for a private right of action, in the absence of express language authorizing such enforcement.'" *Shah v. Metro. Life Ins. Co.*, No.108887/00, 2003 N.Y. Misc. LEXIS 2016, at *32 (Sup. Ct. New York County Feb. 21, 2003) (quoting *McKinnon v. Int'l Fid. Ins. Co.*, 182 Misc. 2d 517, 520-21, 704 N.Y.S.2d 774, 777 (Sup. Ct. New York County 1999)), *aff'd in part and modified in part sub nom., Fiala v. Metro. Life Ins. Co.*, 6 A.D.3d 320, 776 N.Y.S.2d 29 (1st Dep't 2004); *McKinnon*, 182 Misc. 2d at 521, 704 N.Y.S.2d at 778 ("[E]nforcement is more appropriate within the province and jurisdiction of the State Superintendent of Insurance.").

Third, even if a private right of action existed under Section 4105(b), such relief would be inappropriate here. Under New York law, a constructive trust can only be granted where,

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78 The Banks' request that the Reinsurance Transaction be set aside because MBIA did not disclose that MBIA Illinois would allegedly be insolvent after entering the transaction but for the dividend and share redemption components of the Transformation is also without merit. (Banks' Reply 170-71.) There is no evidence anywhere that MBIA Illinois was ever insolvent, nor is there any evidence that the financial condition of MBIA Illinois was not properly disclosed pursuant to the applicable regulations or any request of the NYID. (RX 2 (R00971-80[Approval Letter]) at 976 [Approval Letter]).) Further, the Banks' request for the rescission of the Reinsurance Transaction is improper given, among other things, that they were not a party or a beneficiary to that agreement. *See Mercantile & Gen. Reinsurance Co. v. Colonial Assurance Co.*, 184 A.D.2d 177, 180, 591 N.Y.S.2d 1015, 1017 (1st Dep't 1992) (upholding insured's counterclaims against reinsurer, on grounds that insured was third-party beneficiary of reinsurance agreement, giving rise to those claims), *rev'd on other grounds*, 82 N.Y.2d 248, 604 N.Y.S.2d 492 (1993).

79 Tellingly, none of the cases the Banks rely on involve Article 78 proceedings.

unlike here, a fiduciary relationship exists.[80] *See Bankers Sec. Life. Ins. Soc'y v. Shakerdge*, 49 N.Y.2d 939, 940, 428 N.Y.S.2d 623, 624 (1980) ("[T]o establish a constructive trust there must be provided [*inter alia*] . . . a confidential or fiduciary relation."); *Kopelowitz & Co. v. Mann*, 23 Misc. 3d 1112A, 1112A, 886 N.Y.S.2d 67, 67 (Sup. Ct. Kings County 2009) (citing *Sharp v. Kosmalski*, 40 N.Y.2d 119, 121, 386 N.Y.S.2d 72, 74-75 (1976)) (dismissing plaintiff's cause of action for imposition of constructive trust because plaintiff failed to demonstrate the existence of a fiduciary duty), *aff'd in part and modified in part*, 83 A.D.3d 793, 921 N.Y.S.2d 108 (2d Dep't 2011). Here, it is undisputed that no fiduciary relationship exists between MBIA and its policyholders, including the Banks. *See Goshen v. Mut. Life Ins. Co.*, No. 600466/95-006, 1997 N.Y. Misc. LEXIS 486, at *26 (Sup. Ct. New York County Oct. 21, 1997) ("Except as required by statute, insurance companies deal with insureds at arm's length. No relationship involving trust or confidence is present.") (internal quotation marks omitted); *see also* MBIA Opp. 18-19.

V. NO TRIABLE ISSUE OF FACT EXISTS IN THIS ARTICLE 78 PROCEEDING AND THE COURT SHOULD DISMISS THE PETITION ON THE PARTIES' SUBMISSIONS

The Banks erroneously contend that issues of fact may remain requiring a trial in this Article 78 proceeding. (Banks' Reply 112-13.) However, the sole issue before the Court is whether the NYID acted arbitrarily or capriciously in approving the Transformation. That

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80 The Banks erroneously assert that "a constructive trust can be imposed absent a fiduciary relationship if equities require." (Banks' Reply 170, n.243.) In support, they cite *In re Koreag, Controle et Revision S.A.*, 961 F.2d 341 (2d Cir. 1992). But that case is inapposite because, unlike MBIA Insurance, the trustee there "act[ed] in some fiduciary capacity." *Id.* at 354. (emphasis in original). The Banks citation to *Simonds v. Simonds*, 45 N.Y.2d 233, 408 N.Y.S.2d 359 (1978) is equally unavailing. There, the court found, among other things, that a fiduciary duty existed by virtue of the obligations of decedent to his first wife, as set forth in a separation agreement executed between them prior to his death. Here, MBIA Insurance is not, and never has, acted in any fiduciary capacity with respect to the Banks, who are nothing more than counterparties to an insurance agreement. The other cases relied on by the Banks concern facts far afield from those at issue here. *See Trainor v. John Hancock Mut. Life. Ins. Co.*, 54 N.Y.2d 213, 215, 445 N.Y.S.2d 81, 81 (1981) (addressing "whether an insurance company's failure to follow Insurance Department regulations when issuing a replacement life insurance policy estops it from raising the insured's material misrepresentation on an application for life insurance as a defense to liability under that new policy"); *Latham v. Father Divine*, 299 N.Y. 22, 26-27, 85 N.E.2d 168, 169-70 (1949) (in order to prevent testator by fraud, duress or undue influence from revoking will and executing new will, court found that devisee or legatee had a claim for a constructive trust).

question should be determined on the parties' submissions, and does not raise a triable issue of fact.

It is well established that in order for there to be a trial in an Article 78 proceeding a "triable issue of fact" must exist. CPLR § 7804(h). If no triable issues of fact are raised, then the Court must make a determination based on the parties' submissions under the standard for summary judgment. *See Garofano v. New York*, 122 A.D.2d 209, 210, 504 N.Y.S.2d 742, 743 (2d Dep't 1986).

While the Banks allege that the Superintendent did "not have a 'sound basis in reason' for any determinations about MBIA's financial condition, [and] issued determinations without 'regard to the facts'" (Banks' Reply 112), as shown above, the so-called material "facts" that the Banks allege are either statements of opinion or mischaracterizations of the facts. *See Garofano*, 122 A.D.2d at 210, 504 N.Y.S.2d at 743 (maintaining that "[m]ere averments stating conclusions of fact and law are insufficient to defeat a motion for summary judgment" or to raise a triable issue of fact sufficient to require an evidentiary hearing). Further, where, as here, the factual record indicates a rational basis for a discretionary agency determination, conclusory allegations of bias are not sufficient to raise a triable issue requiring a hearing. *See Currier v. Tompkins-Seneca-Tioga Bd. of Coop. Educ. Servs.*, 80 A.D.2d 979, 979-80, 438 N.Y.S.2d 605, 606 (3d Dep't 1981).

Finally, when a court reviews an agency decision to determine whether it "was affected by an error of law or was arbitrary and capricious or an abuse of discretion . . . it is not the role of the court to weigh the desirability of the proposed action, choose among alternatives, resolve disagreements among experts, or substitute its judgment for that of the agency." *Fisher v. Giuliani*, 280 A.D.2d 13, 19-20, 720 N.Y.S.2d 50, 54 (1st Dep't 2001) (internal quotation marks

omitted). A disagreement between experts as to whether the agency made the correct determination, especially when the petitioner's expert conducted an examination after the decision was made, is not sufficient to raise a triable issue of fact. *See Med. Malpractice Ins. Ass'n v. Superintendent of Ins.*, 72 N.Y.2d 753, 763, 537 N.Y.S.2d 1, 6 (1988) (holding that Superintendent's reliance on actuary's calculations when making determinations regarding solvency of an insurance company was not arbitrary or capricious and that "[a] disagreement among actuaries . . . is not evidence that the Superintendent's acceptance of one set of conclusions was arbitrary"); *see also Idlewild 94-100 Clark*, 27 Misc. 3d at 1017, 898 N.Y.S.2d at 818 (concluding that plaintiff's expert's "affidavit does not raise a triable issue of fact . . . . There is no need for an additional fact-finding hearing here, for judicial review of the [the agency's] determination is limited to assuring that, based on the information before it, [the agency's] decision was not arbitrary, capricious or affected by an error of law").

Here, each of the Banks' experts conducted their examinations long after the review and approval of the Transformation. And, despite the hundreds of pages of expert affidavits and exhibits submitted by the Banks' experts, they simply disagree with the opinions of the NYID and MBIA's experts. And, as Mr. Muhl testified in response to Mr. Stewart's criticism of his approval of the Lloyd's transaction, Mr. Stewart was not "in his shoes" at that time, just like Mr. Muhl was not in the Superintendent's shoes when he approved the Transformation. (Muhl Dep. 116:16-117:18.)

CONCLUSION

For the foregoing reasons, the Petition, and each of the claims alleged therein, should be denied and this Article 78 proceeding should be dismissed with prejudice.

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Respectfully submitted,

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