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November 25, 2020

Mr. Steven J. Berkowitz
President and Chief Executive Officer
ACA Financial Guaranty Corporation
555 Theodore Fremd Avenue, Suite C-205
Rye, NY 10580

Via Email sberkowitz@aca.com; sleonard@aca.com; rtundermann@fblaw.com

RE: ACA Financial Guaranty Corporation's Updated 2020 Requests for Contingency Reserve Release and Payment on Surplus Notes

Dear Mr. Berkowitz:

This letter is in response to a letter dated July 15, 2019, which was amended and replaced by a letter dated January 15, 2020, from ACA Financial Guaranty Corporation ("ACA" or the "Company") requesting approval to release approximately $59.5 million of ACA's current contingency reserve balance of $63.9 million. This letter is also in response to ACA's July 13, 2020, request to make a series of payments totaling $81.4 million over three years to ACA's surplus note holders. In preparing this response, we have reviewed ACA's Capital Model and ACA's Liquidity Plan, both of which have been updated with June 30, 2020, actual results and were presented to the Maryland Insurance Administration ("Administration") on October 16, 2020, in support of the January 15, 2020, and July 13, 2020, requests.

As discussed below, we have determined that it is appropriate for ACA to make a one-time release of contingency reserves of $38,300,000, and to make a one-time payment of $11,000,000 to surplus note holders. The Administration hereby authorizes this one-time release of contingency reserves and this one-time payment to surplus note holders. No additional releases or payments are authorized without the explicit future authorization of the Administration. Additionally, while we provide our rationale for our decisions below, this should not be considered as setting a precedent for our responses to any future requests from the Company.

ACA bases its request to release contingency reserves on the amount by which the Company's recorded contingency reserve exceeds the contingency reserve that would be computed under SSAP 60. However, as we have communicated previously, the Administration believes that

SSAP 60 was written for financial guaranty insurers which are going concerns, and that SSAP 60 is not appropriate in the case of an insurer that is in supervised run-off, is no longer contributing to contingency reserves, and has no ability to raise additional capital. Accordingly, we have determined what we believe to be an appropriate contingency reserve as discussed below.

In determining an appropriate balance for ACA's contingency reserve, and an appropriate payment to the surplus note holders, we considered the following:

1. ACA discontinued contributions to its contingency reserves in the fourth quarter of 2014 and maintained its contingency reserve balance at $95.9 million until 2019. On June 17, 2019, the Administration approved a release of $32.0 million of contingency reserves. ACA's requested release of an additional $59.5 million of contingency reserves at this time would result in the release of 93% of the existing $63.9 million contingency reserve.

[redacted]

3. ACA's recorded loss reserves include loss recoveries (i.e., reductions of the recorded loss reserves) projected to occur after the end of run-off in 2037. As we have communicated to you previously, the Administration does not believe that loss recoveries which will occur after the end of run off represent a claims paying resource, since the funds will not become available until after the date that the claims will need to be paid. Accordingly, when considering ACA's request to release contingency reserves, the Administration added back to the recorded loss reserves the amount of recorded loss recoveries which are projected to occur after 2037.

4. We recognize that ACA has worked very diligently and successfully to reduce the size of the portfolio of insured credits. In addition, management has developed a model to determine its estimate of what the Company considers to be "excess" capital. We applaud management's efforts and results, and we believe that these actions and results are appropriate and that they indicate that the Company has been managed well throughout its run-off. However, significant risk and uncertainties remain, due in part to the significant judgement involved in estimating the amount and timing of claims payments and recoveries, many of which may occur well out in the future and may not be under management's control.

Accordingly, ACA's contingency reserve should, at a minimum, provide for (i) the excess of the Capital Model severe stress-level loss reserves over posted loss reserves, plus (ii) loss recovery amounts reflected in the Capital Model that occur beyond the end of run-off, plus (iii) any off-balance sheet losses (the result being the "Minimum"). We believe that the difference between the Minimum amount and ACA's posted contingency reserves may be considered for release at this time.

[redacted]

The release of $38.3 million of contingency reserves would bring ACA's surplus at June 30, 2020 to $109.3 million (i.e., $71.0 million plus $38.3 million). At this time, we believe that it is appropriate to authorize a payment to surplus noteholders of 10% of surplus as adjusted for the contingency reserve release. Rounded to the nearest million, this results in a payment to surplus note holders of $11,000,000.

We have given this matter a great deal of consideration, we believe that the conclusions we have come to are very reasonable, and we have set forth our thinking on the matter above. Nonetheless, if you would like to discuss this matter further, please contact Lynn Beckner at lynn.beckner@maryland.gov or me at vincent.ogrady@maryland.gov.

Sincerely,

/s/ Vincent P. O'Grady

Vincent P. O'Grady
Associate Commissioner
Examination & Audit

cc: Kathleen A. Birrane, Insurance Commissioner
Lynn Beckner, Chief Financial Analyst
Matthew Kozak, Investment Specialist