# Third Quarter 2022 Earnings Teleconference Transcript

**Operator**

Greetings, and welcome to the Ambac Financial Group, Inc. Third Quarter 2022 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

**Charles Sebaski – Managing Director, Head of Investor Relations**

Thank you. Good morning and welcome to Ambac's third quarter 2022 call to discuss financial results.

Speaking today will be Claude LeBlanc, President and CEO, and David Trick, Chief Financial Officer.

They will discuss the financial results of our business and the current market environment, and after prepared remarks we will take your questions.

Our call today includes forward-looking statements. The company cautions investors that any forward-looking statements involve risks and uncertainties and are not a guarantee of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors.

These factors are described under the forward-looking statements in our earnings press release and our most recent 10-Q and 10-K filed with the SEC. We do not undertake any obligation to update forward-looking statements.

Also, in our prepared remarks or responses to questions, we may mention some non-GAAP financial measures. Reconciliations to those non-GAAP measures are included in our recent earnings press release, operating supplement or other materials available on the Investors Relations section of our website, ambac.com.

I would now like to turn the call over to Mr. Claude LeBlanc.

**Claude LeBlanc – President and CEO**

Thank you, Chuck, and welcome to everyone joining today's call.

This quarter represents a pivotal moment for Ambac, marked by the $1.84 billion settlement of our long-running RMBS litigations against Bank of America and the near-term resolution of our remaining Puerto Rico exposure—two of the largest outstanding obstacles impacting the pursuit of near- and long-term options to maximize value from our Legacy Financial Guarantee business. I am also very excited with the progress we continue to make in our core Specialty P&C business, which delivered material growth again this quarter.

For the quarter ending September 30, 2022, Ambac reported a net income of $340 million, or $7.41 per diluted share. Book value at quarter end was $1.00 billion and adjusted book value was $1.04 billion.

David will discuss our financial results in more detail shortly.

On October 6, we settled several RMBS litigations with Bank of America, for which we had been seeking recoveries for more than a decade. Ambac received proceeds from the settlement on October 19. Settlement of these RMBS litigations removed the single largest uncertainty from our balance sheet, marked by substantially all of last quarter's $1.5 billion rep & warranty subrogation receivable.

At its peak, the litigation recoverable was nearly twice the size of our adjusted book value, but today our remaining rep & warranty subrogation receivable is down to less than 10% of adjusted book value.

In addition, our significant de-risking accomplishments have supported the reduction of our insured par exposure from approximately $80 billion at the beginning of 2017 to $24 billion today. This, together with the expected near-term resolution of HTA (our last remaining un-restructured Puerto Rico exposure) and the Bank of America settlement, places Ambac in the strongest financial position since the great financial crisis.

In assessing de-risking and de-leveraging achievements relative to our adjusted book value since 2017, net loss reserves are down nearly 90%; adverse credit exposure is down 65%; net par outstanding is down 62%; and proforma debt leverage is down nearly 60%.

These achievements have progressed our legacy platform towards a stable run-off and materially improved the quality of our book value.

Having achieved this pivotal milestone, we can now accelerate our plans to crystalize value from our legacy business.

We continue to engage in active dialogue with our shareholders as we progress our legacy business strategy. In light of our recent achievements, we are now positioned to accelerate the timeline and strategy towards realizing value from the legacy business, for which there are a number of options we are actively pursuing. However, we also have to balance the desire for speed against (1) the existing regulatory constraints we are subject to; (2) market dynamics that inform value maximizing opportunities; and (3) the timing of any such options, in order to create maximum value for our shareholders.

It's important to remember that AAC remains subject to enhanced regulatory supervision under the 2018 Stipulation and Order and the 2010 Bank Settlement Agreement, which means that we continue to operate under contractual limitations and the Wisconsin Insurance Department has ultimate decision-making authority regarding any capital movements from AAC.

Since the settlement, AAC has repaid all outstanding Sitka Notes, representing approximately $1.21 billion of outstanding debt as well as $213 million of Tier 2 Notes. This, coupled with our de-risking accomplishments, paves the way for several critical next steps, including:

1. Actively working with our regulator towards a revised regulatory capital and operating framework for our legacy business
2. Actively continuing our asset recovery and de-risking initiatives
3. Opportunistically pursuing additional asset and liability management transactions, and
4. Accelerated expense management initiatives.

Success in these near-term initiatives will inform all of the strategic options available to maximize value.

As we progress our initiatives to resolve other risks and position the company for a stable run-off, we do expect some continued volatility in earnings and ABV, which should dissipate over time.

As we look towards future steps, we are considering a number of broader strategic options, including:

1. The continued run-off of a profitable, accreting legacy business in a materially enhanced financial position
2. Strategic reinsurance transactions with the goal of further de-risking and freeing up regulatory capital
3. A partial or full sale of the legacy business

Shareholders should rest assured that we are aggressively pursuing these various initiatives in parallel, subject to existing constraints, in efforts to expeditiously generate value.

Now on to our core, strategic operating businesses.

Everspan Group, our Specialty P&C hybrid platform, had another strong quarter of growth, with gross premium written of $30 million, representing a six-fold increase from the prior year period. For the first nine months of the year, gross premiums written were $95 million, compared to $6 million for the same period last year.

Everspan continues to expand and diversify its MGA program partners, which currently stands at 13, up from 11 last quarter. The team remains focused on growth with strong, underwriting-focused program partners, backed by a leading panel of highly rated reinsurers

The operating environment for MGAs and specialty insurance remains robust and supportive of the strong pipeline of new programs Everspan continues to see, with a total of 43 submissions received this quarter. We believe that the events of Ian for cat-exposed property business—a category of risk for which Everspan has essentially no exposure—will have a spillover effect into the casualty markets, including changes to risk appetites and reinsurance availability, which will, in turn, pave the way for new program opportunities for strong balance sheet companies like Everspan.

In addition, commercial P&C pricing, while moderating in certain lines of business, is still increasing and remains above loss cost trends. These factors, along with the strength of Everspan's current programs, will provide us the opportunity and resources to support continued strong premium growth.

As we look forward, we expect Everspan to generate approximately $250 million of gross premium next year, growing to nearly $500 million in the 2024-2025 timeframe, subject to market conditions.

Turning now to Cirrata, our Insurance Distribution business.

We are very excited about our recent acquisition of two MGAs at Cirrata—All Trans Risk Solutions, a 30-year-old specialty transportation MGA, and Capacity Marine, a well-established marine and international risk wholesale broker—which together place approximately $60 million of premium.

This transaction will be immediately accretive and will expand our MGA footprint, diversification and network. Cirrata’s strategic positioning, including the value of its shared business services offering, has led to increasing opportunities to deploy capital at attractive returns.

On the de novo MGA front, in addition to our Human Services de novo team, led by Penny Parisoff, we are also seeing many attractive opportunities, which we are actively pursuing.

Year to date, Cirrata placed $97 million of premium, up over 7% from the corresponding period in 2021. On a combined, run-rate basis, with the addition of All Trans and Capacity Marine, Cirrata is on track to deliver $200 million of gross written premium in 2023, subject to market conditions.

I will now turn the call over to David to discuss our financial results for the quarter. David?

**David Trick – Chief Financial Officer**

Thank you, Claude, and good morning, everyone.

For the third quarter of 2022, Ambac reported net income of $340 million, or $7.41 per diluted share, compared to net income of $17 million, or $0.35 per diluted share, in the third quarter of 2021.

Adjusted earnings for the third quarter of 2022 were $338 million, or $7.37 per diluted share, compared to adjusted earnings of $25 million, or $0.53 per diluted share in the third quarter of 2021. The difference between adjusted earnings and GAAP net income for the third quarter of 2022 related to the exclusion of $5 million of insurance intangible amortization expense and $7 million of foreign exchange transaction gains.

The $323 million increase in net income for the third quarter 2022, compared to the third quarter 2021, was related to a $319 million net gain from the previously announced RMBS representation and warranty litigation settlement with Bank of America, and a $37 million gain on our macro interest rate hedge compared to a $5 million gain in the third quarter of 2021.

Premiums earned were $10.8 million in the third quarter, slightly below the $11.2 million earned in the third quarter of 2021. For the quarter, Everspan's $4.0 million earned premium growth mostly offset the $4.4 million earned premium contraction in the Legacy Financial Guarantee portfolio, which earned $6.6 million. As Everspan continues to grow its premium base, growth in its earned premium will eventually more than offset the contraction in the Legacy Financial Guarantee earned premium. Active de-risking and organic run-off of the Legacy Financial Guarantee insured portfolio will continue to result in earned premium for this segment trending lower. This trend will be positively or negatively impacted by accelerated earned premiums resulting primarily from proactive de-risking of the insured portfolio. In the third quarter 2022 proactive de-risking resulted in net negative accelerated earned premiums of $1.7 million.

In addition, we would highlight that of the $30 million of Specialty P&C gross written premiums in the quarter, Everspan retained about 20% or $6 million. These premiums will earn in over the next year. Everspan's hybrid business model allows it to retain up to 30% of gross written premium.
Everspan also collected $1.2 million and earned approximately $900,000 of program fees in the quarter. As a reminder, program fees earn in over the course of a policy similar to how premium is earned. Therefore, as Everspan continues to add programs and grow gross written premium, both earned premium and program fees will grow significantly.

Cirrata, our distribution segment, also continues to grow both organically and strategically. While premiums placed of $28 million in the quarter were essentially flat with the prior year, year-to date-premiums placed are up 7% and EBITDA rose quarter over quarter. Insurance Distribution business revenue comes from commissions earned as a percentage of the premium placed. For the quarter gross commissions were $7 million, up 8% from the prior year period and total revenues were $7.3 million, up 12% from the prior year period.

The Insurance Distribution segment produced $1.3 million of EBITDA for the third quarter, up slightly from the $1.2 million produced in the third quarter 2021. Gross commissions and EBITDA were favorably impacted by changes in business mix, commission levels and the EBU renewal rights transaction.
The acquisition of All Trans and Capacity Marine were effective November 1st and therefore our fourth quarter results will include partial results from these new businesses, which are expected to be accretive to EBITDA.

Investment income for the third quarter was $11 million, down from $21 million in the third quarter of 2021, on account of broad macro changes across markets. More specifically, the decrease in investment income during the third quarter related to a net loss on fund investments of about $5 million compared to a $6 million gain in the third quarter of 2021. Allocations to alternative fund investments have been reduced by approximately $45 million year-to-date. Income from fixed income securities was up $2 million

compared to the same period last year due to higher average yields, particularly from floating rate securities.

Loss and loss expenses were a $353 million benefit in the third quarter of 2022 compared to a $55 million benefit in the third quarter of 2021.

The structured finance portfolio generated a benefit of $351 million this quarter compared to a benefit of $21 million in the third quarter of last year. The principal driver to this quarter's results was the recognition of a $319 million gain from the Bank of America settlement.

The total gain from the litigation settlement is approximately $397 million. The remaining $78 million will be recognized in the fourth quarter and includes a $126 million gain from the litigation itself and $5 million of investment gains, partially offset by $53 million of debt-related charges.

Net gains on derivative contracts, which are positioned as a partial economic hedge against the interest rate exposure in the financial guarantee and investment portfolios, were $37 million for the third quarter, compared to a gain of $5 million for the third quarter of 2021. During the quarter and year-to-date we have reduced the sensitivity of the macro hedge generally in line with the exposure we are hedging. Year to date into the fourth quarter we have reduced sensitivity to a DV01 of approximately $230,000 from over $500,000 at the beginning of the year.

Operating expenses were $37 million for the third quarter, up from $32 million in the third quarter 2021. The increase in operating expenses was due to higher net underwriting expenses for Specialty P&C associated with growth in the business, litigation expenses related to defensive litigation at AAC, higher compensation expenses resulting from increases in headcount for the Specialty P&C Platform and incentive plan costs partially offset by lower headcount at the Legacy Financial Guarantee business, and higher sub-producer commissions in the Insurance Distribution segment associated with growth and changes to the business mix.

Interest expense in the third quarter was approximately $49 million, up from $44 million in the third quarter of 2021.Approximately $25 million or 52% of this quarter's interest expense related to $1.4 billion of debt that was repaid on October 29th from the proceeds from the Bank of America settlement. As a result of this redemption AAC has been significantly de-levered with remaining debt as of October 31st consisting of approximately $143 million of Tier 2 debt and $1.4 billion of surplus notes, inclusive of accrued and unpaid interest.

Shareholder's equity increased $4.99 per share to $22.43 per share, or $1.0 billion at September 30, 2022 from the end of the second quarter. The increase was primarily due to the $319 million settlement gain somewhat off-set by unrealized losses on available-for-sale investments of $59 million and foreign exchange translation losses related to AUK and the weakening of the Pound of $58 million.
Adjusted book value increased to $1,040 million or $23.13 per share at September 30, 2022, from $773 million or $17.20 per share at June 30, 2022.

This $5.93 per share increase is due to the $319 million settlement gain partially offset by the adverse effect of foreign exchange translation losses and higher discount rates on the PV of Financial Guarantee installment premiums.

I will now turn the call back to Claude for some brief closing remarks.

**Claude LeBlanc – President and Chief Executive Officer**

Thank you, David.

This quarter marked another milestone for Ambac's legacy business, and we believe the company is in a stronger financial position today than at any point over the last decade. Combined with our growing core Specialty P&C insurance business, we believe Ambac is well positioned to deliver material long-term value for our shareholders.

Our plan is to continue to aggressively pursue our strategic initiatives, including:

1. Pursuing strong growth in our Specialty P&C platform organically and through select M&A transactions and de novo MGA build outs; and
2. Pursuing strategic options for our Legacy Financial Guarantee business in order to create both short- and longer-term economic value.

As we evaluate the options available for us to deploy capital, we always measure such options against the return of capital to our shareholders, as well as considerations relative to the protection of our significant tax assets, in order to preserve our ability to unlock future value from our NOLs. We continue to evaluate alternate options to mitigate NOL risk associated with share buybacks and currently have $21 million in authorized capital available for our program.

Now that we have achieved a level of stability and growth in our Legacy Financial Guarantee and core P&C business, we are now actively seeking to broaden our investor base as we continue to transform the company.

We look forward to updating you on our various initiatives in the upcoming quarter.

Operator, please open the call for questions.

**Operator**

The first question comes from Dennis Chua from Repertoire Partners.

**Dennis Chua – Repertoire Partners**

Claude, congrats on the settlement. It's great that you're providing details on the various segments, particularly the potential scenarios to unlock value at AAC and the attractive opportunity to grow the specialty P&C platform.

On the topic of capital allocation, I think you briefly touched on this, but there are various competing considerations. Obviously, a buyback at these prices is a straightforward value-accretive move. But on the other hand, we have billions of dollars of NOLs that the company has done a great job protecting, and we don't want to trip Section 382. And in addition, by investing to grow our earnings, we get to utilize these NOLs. Can you give us maybe a little bit more detail in how you're thinking about the balance between buybacks and investing to grow earnings in the near term?

**Claude LeBlanc – President and Chief Executive Officer**

Sure. I'll let David handle this one.

**David Trick – Chief Financial Officer**

Thanks, Dennis.

As we stated in the past, our primary consideration when we're deploying capital at AFG is return on capital. And we believe our stock remains really undervalued. As you know, there's a balance to be

struck. And we see tremendous opportunities in the market to deploy capital in new businesses accretively with attractive returns on capital that will create long-term shareholder value. But that's not to say we're not wanting to buy back stock. As a reminder, we purchased over 1.6 million shares or approximately 3.5% of our outstanding shares at the time in the second quarter at an average price of $8.83.

At the same time, we have to respect the constraints that we operate under to protect our NOLs, which we believe are a very valuable asset, including, but not limited to, the regulatory requirements, explicit regulatory requirements, we have to preserve and to protect the NOLs. Therefore, we've been exploring ways in which we can affect buybacks while, at the same time, protecting the value of those NOLs. And we've been diligent, as you note, to maintain and protect them because they are so valuable for both our new and our legacy businesses. And we believe this value has been validated by our own views, but also by third parties that have expressed interest in this asset.

So as a result, further to Claude's earlier comments, we believe the NOLs will contribute significantly to the value that we ultimately realize from AAC under any other strategic options he laid out.

Does that address your question?

**Dennis Chua – Repertoire Partners**

Yes. Sorry, I was on mute.

**Operator**

The next question comes from Richard Burns, who is a private investor.

**Richard Burns – Private Investor**

This question is on foreign exposure. Can you discuss your exposure to foreign exchange? Also, what is your exposure to European risk through your AUK international insured portfolio?

**David Trick – Chief Financial Officer**

Sure, Rich. Thanks.

I'll address the question on foreign exchange, and then Claude will touch on the exposure to European risk. But our main exposure to foreign exchange lies with the assets and liabilities of Ambac UK. Ambac UK has invested assets of about GBP 492 million and about GBP 76 million of premiums receivable. About 1/3 of the invested assets in the UK are held in dollars, which leaves about a GBP 300 million of exposure to the British pound, and we have a small exposure as well to euros.

On the insured portfolio side, the British pound exposure is about $7 billion of insured exposure, and we have about another EUR 1 billion exposure and against those relatively modest reserves. So the long story is our primary exposure to foreign currency is the British pound, and that lies with the UK operation.

**Claude LeBlanc – President and Chief Executive Officer**

And as far as our UK exposure goes, we've done a significant de-risking over the last number of years, and our main areas of exposure today are really the UK PFI, regulated entities and some corporate securitizations, but the bulk really being with the PFI and regulated entity sectors where we believe there's significant resilience. And we believe that our guarantee and our credit support underlying those guarantees remains very strong.

With the increasing rate environment as well on some of our index-linked exposures, which tend to increase in the inflationary environment, when rates go up, we also are better able to capture more premium as the premiums adjust to the value of the index-linked exposures, which also helps out on our Solvency II capital. So as we sit today, we feel very comfortable with our exposures, and we believe that strong resilience exists for AUK based on the projected economic trend currently in the UK and Europe.

**Operator**

The next question comes from Giuliano Bologna from Compass Point.

**Giuliano Bologna – Compass Point Research & Trading, LLC, Research Division**

Congrats on resolving the Countrywide litigation after many years.

I think you're giving a little bit to some of the actions you guys took over the past couple of quarters. You guys bought some Surplus notes and some Tier II Notes. I think that there's something in the presentation footnote about fair value of $69 million for the -- on surplus notes. I'm curious, are both of those securities mark-to-market as of September 30? And then I guess the follow-on to that is, have you sold any of those after quarter end? And then how should we think about the market obviously be mark-to-market again in the fourth quarter, assuming higher prices competing moved after quarter end? Is that the right way to think about that?

**David Trick – Chief Financial Officer**

Yes. Thanks, Giuliano. So, the $69 million of surplus notes we hold at the holding company are mark-to-market. That's a market number as of 9/30. I believe they were marked probably around $0.57 on a $1 or so at that time. So, they'll be remarked obviously at the -- for the fourth quarter.

In terms of other buybacks, we haven't bought Tier II Notes. We did have an investment in the Sitka Notes at AAC. So, we held about $91 million of par of Sitka Notes at AAC. And some of it as a result of the redemption of those notes, we'll be booking what it should be about a $5.5 million gain due to the discount we bought them at plus the 3% call premium.

**Giuliano Bologna – Compass Point Research & Trading, LLC, Research Division**

That's great and very helpful.

So obviously, remarking notes to the market on the next quarter, but you also have a little bit of additional settlement-related gains that you'll recognize next quarter. But taking on a go-forward basis, if I go through just the mechanics of the settlement amount and the payoffs, you guys will have a few hundred million of additional cash that will be coming in kind of on a net basis from the settlement proceeds. What do you think about the best use of that capital? Is it investing it to generate more investment income? Or are there other opportunities to use that capital more strategically to help accelerate some of the acceleration of the value creation at AAC to kind of enhance value in a quicker way there?

**David Trick – Chief Financial Officer**

Yes. I think you know we've talked about in the past, Giuliano, we are continually reviewing our capitalization against the opportunities that we have for deploying that capital. And in particular, we have to think about that in context of our evolving regulatory capital framework and make decisions based on both our expectations for risk-adjusted returns as well as the new capital requirements. So it's a great question and something that is a key focus of ours and is certainly an evolving situation.

**Giuliano Bologna – Compass Point Research & Trading, LLC, Research Division**

And one last one in around the strategic considerations. I'd be curious if you guys would consider some sort of spin-off transaction related to AAC or using AAC equity as a currency to help results in securities or things like that to separate kind of the value of the run-off business from the growth businesses?

And related to that, you guys obviously have an NOL, you have a platform and the bottom of market is actually coming back given the higher rate environment. I realized a couple of quarters doesn't make a trend. But whatever would make sense as a scenario as complicated as it may be to try and separate AAC, obviously retaining as much without impacting the NOLs and essentially when they might be able to turn back on or roll up other platforms in the industry to scale back up.

**Claude LeBlanc – President and Chief Executive Officer**

Yes. Thanks, Giuliano.

As I mentioned earlier, we are considering a broad range of strategic options for AAC and certainly a transaction involving a partial sale or full sale of the platform is in that category. We believe there are transactions that can be completed in the category of partial sale where the NOLs would be preserved for the benefit of a buyer, and that's something that we'll be carefully looking at.

But as I indicated, there's also potentially other opportunities through other types of transactions, including reinsurance transactions and capital redeployment transactions that could also prove to be very valuable and accretive to our investors. We're not looking currently at any transactions involving other financial guarantee companies or any transactions involving other investments by AAC into other financial guarantee platforms.

Our new business activity is really limited to what's going on at the holding company. And clearly, to the extent we can bring capital up to the holding company, either through a distribution or a partial sale or sale, we will then evaluate how to deploy that capital, as we currently do, looking at both opportunities on the strategic side in terms of acquisitions, other capital deployment initiatives, but also return of capital to shareholders. And that's really the focus of our AAC strategy in the near term and longer term.

**Operator**

The next question comes from Paul Devine from C. Devine and Associates.

**Paul Devine– C. Devine and Associates**

Congratulations on getting the settlement called. It certainly was a journey for everybody involved.

Two questions for you. First, do you anticipate Everspan is going to require more capital to support its growth as you look out over the next year or so?

And then the second, and you referenced this, the acquisition and your first Enova launch in your distribution segment, how do you see that playing out? Is it going to be more de novo? Or do you see more M&A? And maybe just if you could give us some thoughts about how much capital you might be willing to deploy.

**Claude LeBlanc – President and Chief Executive Officer**

Let me take the second question, and I'll pass the first one back to David. On the acquisition side, we are seeing a number of very attractive opportunities to deploy capital in our new business segments. The market has been very competitive, as you're probably aware, on the insurance distribution front. However, in the small- to mid-sized segment of the market, we are seeing very attractive opportunities. And our offering is different than what's out there in the market. We are not looking to do outright acquisitions. We look to make acquisitions where we have a controlling stake, and we would have a management role in the interest.

So, it's really a model where we partner with existing teams who are running MGAs. Through our controlled transaction, we then make available to them our business services infrastructure to allow them to further enhance their operating flexibility and enhance our growth. And that model has proven to be very attractive and has really brought teams to us and MGAs to us that we have been able to consider, and we believe have been able to attract very attractive valuations in the market.

The de novo side is obviously very accretive, very limited investment upfront, but they do take longer to grow and scale. But we believe that a blend of the two is really the right mix. We have a slight bias towards de novo potentially given the capital deployment requirements for acquisitions. But I believe a blend of the two is likely the model that we will continue to utilize going forward, and really looking for those opportunities that are highly accretive for the benefit of our shareholders longer term is driving the opportunities that we will focus on.

**David Trick – Chief Financial Officer**

And with regards to Everspan, we still anticipate Everspan will break even sometime around mid-next year. So, we don't anticipate there will be material additional capital requirements for Everspan, maybe a few small dollars to true up. And given their capital levels in general, that business can be leveraged five to six time So we believe it's capitalized in the right way for long-term -- very long-term profitable growth.

**Operator**

The next question comes from Geoffrey Dunn from Dowling & Partners.

**Geoffrey Dunn – Dowling & Partners**

David, can you elaborate on maybe two areas. First of all, with respect to expense levels in the financial guarantee legacy business with Countrywide now behind you, I think you said you're looking at an accelerated expense initiative there. Are you in a position now to get that run rate below $20 million on a run rate quarterly basis going forward?

**David Trick – Chief Financial Officer**

Thanks, Geoff.

So, I would generally put the expenses into three categories: one is obviously interest expense; two, there's LAE; and then there's operating expenses. So obviously, as I said in my prepared remarks, we'll see a substantial reduction in interest expense over 50% going forward on a quarterly basis.

In addition to that, LAE, it was something that was running in the last year, about $7 million a quarter. Most of that related to the Bank of America trial preparations and related expenses. That will be going away. And then in terms of core operating expenses, yes, definitely a focus of ours is to continue to bring down the OpEx at the legacy business. We're doing that and approaching that through multiple different channels and ways.

One of the things we also hope and expect and are working on with our regulator is bringing down some of the regulatory costs, as an example, given now that we've resolved this major sort of risk to the balance sheet. So, our focus clearly is on reducing the expenses. We're going through our budget season now and spending a lot of time focusing on efficiency of the business.

And as, again, noted in terms of expenses generally for the quarter, there will be some volatility there. We do still have some defensive litigation, which has proven not to be cheap to defend. And also, with regard to the new businesses, as those businesses grow, of course, those expense bases will grow with. But it's definitely a focus of ours to continue to bring down the cost of managing the business.

**Geoffrey Dunn – Dowling & Partners**

Okay. And then with respect to Wisconsin, and I know this is a sensitive area, so I understand the comments could be limited, but what are some of the restraints you're currently under that you might explore changing? Or what are the areas of the capital model that you could try to work with Wisconsin to lighten up?

**David Trick – Chief Financial Officer**

Yes. So historically, the last number of years, even post the Segregated Account exit from rehab, we haven't really had a very, I'll call it, transparent capital regime put in place with the regulator. And as you know, most traditional P&C companies operate under a risk-based capital model, and the guarantors have never had that type of regime.

And so, we very much welcome the process that we're embarking upon with the regulator in terms of getting more transparency and more definition around the capital requirements that are needed to manage the run-off business. And I think probably a big focus of that, of course, is going to be how much capital do you need for the risk that remains in the insured portfolio, which is again something we very much welcome because, as you know, we've been very focused on the quality of the insured portfolio and proactively de-risking that book.

When you sort of look at the remaining risk within the insured portfolio, it is very well contained. So, we think that's a process that will be an efficient one. And then, of course, the regulator, I'm sure we'll be looking at asset risk and other types of operating risk as well in assigning charges to that. So, it's something we will do our best to work with the regulator very closely and actively. At the end of the day, the regulator, of course, as in all these situations, has the ultimate decision-making authority there. But we will be very much actively working to get the best possible outcome from that exercise that we can get.

**Geoffrey Dunn – Dowling & Partners**

Okay. Historically, the rating agencies have been kind of the de facto regulators for capital. Does the state regulators effectively defer to the rating agencies historically? So, this might be a longer process for them to get their hands around it?

**David Trick – Chief Financial Officer**

I mean I would say from my own biased experience, pre-2008, I would say that was certainly an issue with the rating agencies. But since then, I think the regulators have become much more proactive in terms of the capital management of the insurance industry. But at the same time, I think there's opportunities to borrow some of the methods the rating agencies have and publicly disclose.

**Operator**

This concludes our question-and-answer session. I'd now like to hand the call over to Claude LeBlanc for closing remarks. Thank you.

**Claude LeBlanc – President and Chief Executive Officer**

Thank you. This concludes our call. Thank you, everyone.