



**TESTIMONY OF MICHAEL CALLEN**

**CHAIRMAN AND INTERIM CHIEF EXECUTIVE OFFICER OF**  
**AMBAC FINANCIAL GROUP**  
**BEFORE THE**

**ASSEMBLY STANDING COMMITTEE ON INSURANCE**

**March 14, 2008**

Good morning Mr. Chairman and members of the Committee. I am Michael Callen, Chairman and interim CEO of Ambac Financial Group. Thank you for inviting me to speak to you today on the state of the bond insurance industry.

Ambac and other bond insurers inhabit a vital but usually obscure corner of the modern financial system. We are crucial to the financing of municipal governments, school districts, and other public sector entities, helping them to get the capital they need at the lowest possible cost. We play a similar role in consumer finance, where Ambac-insured bonds have lowered the cost of financing for homes, education and automobiles.

Ambac has been in the financial guarantee insurance business for 37 years. Almost a quarter of insured municipal bonds are guaranteed by Ambac. Over the past three and a half decades, Ambac and the industry have successfully survived many cycles and challenges including Hurricane Katrina, 9/11, Orange County and multiple recessions. Even during periods of such distress, no holder of an Ambac insured security has ever missed a single interest or principal payment. Today, with claims-paying resources of over \$16 billion, Ambac has the ability to meet all expected future claims with capital to spare. Even under extremely stressful scenarios well beyond expectations, we believe Ambac meets all obligations.

Nevertheless, we are facing an historic disruption in credit markets. Financing, so readily available in prior years, has become scarce. Lenders are not lending, borrowers are finding it difficult to obtain credit. The Federal Reserve has lowered benchmark interest rates and injected billions of dollars into the economy to address the fact that banks are hesitant to lend to their clients, or even to each other.

The cost of borrowing is up across the board. This reflects the basic supply and demand equation. Fewer sources of credit result in higher costs for credit.

The bond insurers are a component of the current trough in the credit cycle. We did not cause it. We are not driving it. But we are very much mired in it. We are, after all, risk-taking institutions so this should be expected.

Today's challenging market conditions are a result of many factors including the collapse of the housing bubble, years of easing credit standards and loss of faith in the validity of credit ratings. These are not challenges that are caused by regulatory actions or inactions.

The truth is Ambac, along with many global financial institutions, took credit risks that we now wish we had not. Ambac guaranteed what in hindsight were complex securities by the name of CDO squareds, which are largely backed by sub-prime mortgage securitizations. We did four such transactions. In retrospect, the structure of these deals has ended up magnifying, not minimizing, the risks involved. As a result, Ambac announced that we expect to pay \$1.1 billion in claims in the future on three of these CDO squareds, and on one CDO. We are not happy about that.

But with every mistake comes the silver lining of lessons learned. Ambac has raised additional capital, refocused our business and tightened credit standards.

Earlier this week Ambac raised \$1.5 billion with the goal of maintaining our triple-A ratings from Moody's and Standard & Poor's. We completed this transaction during very difficult market conditions. This money comes from sophisticated institutions who, after extensive due diligence of our business and the opportunities, decided to invest in our company and in the industry.

Ambac is not the only company to have attracted capital from large and experienced investors. Wilbur Ross, Warren Buffet and Warburg Pincus have also invested in this industry alongside Cerberus, which invested in Ambac. What do these investors have in common? They all see a viable future in the bond insurance business.

In addition to the capital raise, Ambac has announced that we will stop writing new structured finance business for 6 months. This will have the impact of further raising our capital by \$600 million.

Ambac will continue to focus on opportunities in the municipal market. In order to do so, we must work on restoring our credibility with the investor base. Having maintained our triple-A ratings from Moody's and S&P following the capital raise, we are in a position now to reestablish our history as a guarantor of municipal debt.

We know that demand for the product continues to exist. Our competitors with stable ratings are writing attractive business. Berkshire Hathaway, a new entrant into this field, has successfully been building its municipal exposure. We look forward to reentering the market and promoting the healthy competition that has served this country's states and municipalities so well over the past 37 years.

At this point, Ambac has decided against splitting its book of business. We have instead decided to focus our new business generation on lower risk and lower volatility lines, particularly municipal business, as well as utilities, infrastructure and healthcare. We believe that this is the best way of maintaining our Moody's and S&P triple-A ratings and of restoring market confidence in our business.

We do not anticipate that investors in Ambac-wrapped bonds will lose a penny of interest or principal. In the long run this will validate the business model and increase the value of financial guarantees. But we cannot wait, and are not waiting, to restore confidence.

Since confidence is largely a product of education, we greatly appreciate the opportunity to discuss these issues here today. All efforts to educate investors and issuers are useful steps in moving toward a more normalized market. We are grateful, once again, to this Committee for the attention given to our industry.

Thank you.