

Credit Opinion: Ambac Assurance Corporation

Ambac Assurance Corporation

New York, New York, United States

Ratings

Category	Moody's Rating
Rating Outlook	DEV
Insurance Financial Strength	Ba3
Ambac Financial Group, Inc.	
Rating Outlook	DEV
Senior Unsecured	Caa1
Junior Subordinate	Caa2
Ambac Assurance UK Limited	
Rating Outlook	DEV
Insurance Financial Strength	Ba3

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Key Indicators

[1]

Ambac Assurance Corporation

	2008	2007	2006	2005	2004
Gross Par Written	\$ 11,298	\$ 125,977	\$ 124,457	\$ 125,278	\$ 118,106
Gross Premiums Written	\$ 537	\$ 1,031	\$ 997	\$ 1,096	\$ 1,048
Net Par Outstanding	\$ 434,310	\$ 524,025	\$ 519,043	\$ 479,085	\$ 459,432
Hard Capital (Statutory)	\$ 12,845	\$ 12,859	\$ 11,590	\$ 10,587	\$ 9,819
Net Income (GAAP)	\$ (5,609)	\$ (3,248)	\$ 876	\$ 751	\$ 725
Strategy & Franchise Value					
% of Industry Net Par Outstanding	18.4%	19.9%	22.3%	23.2%	24.0%
% of Industry Gross Par Written	8.2%	19.9%	21.7%	23.5%	25.1%
Portfolio Characteristics					
Credit Risk Ratio (bps)	248	81	47	42	45
Tail Risk Ratio (bps)	395	197	141	132	141
Capital Adequacy					
Aaa Hard Capital Ratio	0.80x	1.22x	1.57x	1.64x	1.51x
Aaa Total Capital Ratio	0.72x	1.13x	1.52x	1.58x	1.47x
Par Reinsured	12.8%	14.4%	8.6%	8.4%	8.6%
Profitability					
Adjusted Return on Equity [2]	nm	-0.6%	15.6%	14.4%	16.2%
Loss Ratio (SAP) [3]	528.2%	140.8%	6.0%	9.5%	12.2%
Expense Ratio (SAP)	29.1%	14.5%	15.0%	12.3%	11.1%
Financial Flexibility					
Earnings Coverage	nm	nm	16.9x	18.2x	18.5x
Cash Flow Coverage	0.0x	3.9x	4.9x	6.0x	5.9x
Adjusted Double Leverage	143.3%	119.0%	119.4%	122.4%	121.5%

[1] Dollar Amounts in Millions [2] Excludes after-tax impact of unrealized mark to market losses on derivatives [3] Adjusted for credit impairments on CDS contracts

Opinion

SUMMARY RATING RATIONALE

Ambac's Ba3 rating for insurance financial strength reflects primarily reflects weakened risk adjusted capitalization, as Moody's loss estimates on RMBS securities have increased significantly (particularly with respect to Alt-A transactions). These higher loss estimates increase the estimated capital required to support Ambac's sizable direct RMBS portfolio (including securities owned as well as securities guaranteed) and also the insurer's large portfolio of ABS CDO risks. Deterioration in other key rating factors as dislocation in financial markets - and in Ambac's situation - have persisted. These include, most notably, Ambac's weakened business position and very constrained financial flexibility. Taken together, Moody's believes that these factors limit Ambac's ability to effectively counter the company's weakened capital position.

Ambac writes financial guaranty insurance on public finance and structured finance obligations. Ambac's insurance provides an unconditional and irrevocable guaranty to pay scheduled interest and principal in the event of an issuer default.

Credit Strengths

Key credit strengths for the company include:

- Excluding mortgage-related exposures, well-diversified insured portfolio
- Significant value embedded in the firm's insured portfolio
- Strong cash flows and organic capital generation through portfolio amortization

Credit Challenges

Key credit challenges for the company include:

- RMBS and ABS CDO exposures have resulted in significant reserve and impairment charges, which could increase considerably under stress scenarios
- Sensitivity of insurance portfolio to credit cycle with some large single-name exposures
- Erosion of franchise and competitive position
- Holding company liquidity is strained due to lack of unrestricted dividend capacity during 2009
- Financial flexibility is impaired

Rating Outlook

On April 13, 2009, Moody's downgraded the insurance financial strength ratings of Ambac Assurance Corporation and Ambac Assurance UK Limited (together, "Ambac") to Ba3 from Baa1. Moody's stated that Ambac's developing outlook reflects the potential for further deterioration in the insured portfolio as asset performance develops over the intermediate (6-18 month) term. It also incorporates positive developments that could occur over that time including lower variability in mortgage-related asset performance, the possibility of commutations or terminations of certain ABS CDO exposures, and/or successful remediation efforts on poorly performing RMBS transactions.

What Could Change the Rating - Up

The following factors could result in an upgrade:

- Substantially reduced uncertainty regarding ultimate mortgage-related losses
- Capital adequacy ratios consistent with a higher rating level, with substantive cushion above target level

What Could Change the Rating - Down

The following factors could result in a downgrade:

- Failure of the company to maintain substantive cushion relative to all regulatory capital requirements
- Further deterioration in hard and total capital ratios
- Meaningful worsening of portfolio performance or expected performance, particularly in the US residential mortgage sector and other sectors susceptible to economic slowdown.

Recent Results and Developments

For the year ended December 31, 2008, Ambac Financial Group reported a GAAP net loss of \$5.6 billion, primarily due to substantial unrealized mark to market losses and credit-related impairments on credit derivatives and incurred losses in its direct RMBS portfolio. As of December 31, 2008, net par outstanding was approximately \$434 billion.

DETAILED RATING CONSIDERATIONS

Moody's currently rates Ambac Ba3 for insurance financial strength, which is 5 notches below the Baa1 rating produced by Moody's unadjusted rating scorecard (for additional details, please refer to the "other considerations" section, below).

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

Factor 1 - Franchise Value and Strategy: < Baa

Moody's adjusts Ambac's franchise value and strategy score downwards to non-investment grade from Aa due to the company's significantly diminished franchise and competitive position in the current environment. Ambac remains among the largest financial guarantors as measured by net par outstanding, though the company's primary gross par written market share has fallen precipitously in 2008 due to the overhang associated with the company's mortgage-related exposures. The company is likely to remain in a state of "hibernation" until this overhang dissipates. Ambac has strong embedded earnings from approximately \$5.4 billion of unearned premium reserves and future installment premiums. Finally, the company's significant reserve charges and impairments arising from direct RMBS and ABS CDOs indicates that risk management controls failed to identify and avoid potential risks in these segments of the portfolio, resulting in a management, governance and risk management oversight assessment consistent with a single-A rating.

Factor 2 - Portfolio Characteristics: Baa

Ambac's 4Q2008 credit risk and tail risk ratios were 248 basis points and 395 basis points, respectively, up significantly compared to a year ago, reflecting downward credit rating migration in the insured portfolio, particularly among mortgage-related exposures. These exposures, including direct RMBS and ABS CDO transactions, have been subject to considerable pressure in our analysis as Moody's cumulative loss expectations for subprime and Alt-A RMBS have meaningfully increased in recent months. While the company is exposed to large single risks in its portfolio, Ambac's large and diverse portfolio, as well as its sizable capital base, serve as important mitigants against single risk concentrations.

Factor 3 - Capital Adequacy: < Baa

Ambac's 4Q2008 total capital ratio is consistent with a Ba rating, reflecting meaningful increases in Moody's estimates of stress case losses among direct RMBS and ABS CDO exposures, as well as some downward credit rating migration among sectors susceptible to economic slowdowns, such as private student loans and consumer and corporate ABS. At 4Q2008, 12.8% of gross par outstanding was reinsured, though this figure is likely to decrease as the company has executed commutation agreements with some of its reinsurance providers, a trend that is likely to continue as the company looks to reduce its counterparty risk exposure and increase its claims paying resources through the recapture of unearned premiums.

Factor 4 - Profitability: < Baa

While Ambac has historically achieved the highest returns on equity in the financial guaranty industry, the company has recorded significant loss reserves and credit related impairments on its credit derivative portfolio during the past five quarters. Longer term, core profitability is likely to trend downward as the company deleverages and holds increased amounts of capital to cover the potential for stress losses in its RMBS and ABS CDO portfolios. During 2008, Ambac reported large operating losses. Moody's expects continued volatility in Ambac's results for the next several quarters.

Factor 5 - Financial Flexibility: < Baa

In Moody's opinion, Ambac's financial flexibility is impaired. The company's depressed current stock price and wide credit spreads on its bonds may make it difficult for the company to economically raise additional capital. The company's heavy incurred losses have resulted in the inability to upstream dividends to the holding company during 2009 without approval of the regulator. At 4Q2008, the company had approximately \$233 million of cash and inter-company loans at the holding company, enough to cover about 1.8 years of interest expense and holding company expenses. Liquidity at Ambac's financial services businesses has been enhanced through the use of various inter-company agreements designed to allow Ambac Assurance to provide liquidity support to Ambac's GIC and swaps operations, including up to \$3 billion in asset purchases from the GIC business, a \$1.6 billion unsecured revolving credit facility to the GIC business and a \$750 million unsecured revolving credit facility for the interest rate/currency swaps business.

Other Considerations

Ambac's Ba3 insurance financial strength rating is 5 notches below the Baa1 stand alone rating produced for Ambac by Moody's unadjusted rating scorecard. The difference is primarily driven by a lower assessments with respect to franchise value and strategy (to < Baa) portfolio characteristics (to Baa) and profitability (to < Baa).

Rating Factors

Ambac Assurance Corporation

Financial Strength Rating Scorecard [1]	Aaa	Aa	A	Baa		Score	[2]Adjusted Score
Factor 1: Strategy & Franchise Value (25%)						Aa	< Baa
% of Industry Net Par Outstanding	18.4%						
% of Industry Gross Par Written		8.2%					
Moody's Adjusted Book Value/Book Value	2.46x						
Client Concentration	x						
Management, Governance & Risk Management Oversight			x				
Factor 2: Portfolio Characteristics (20%)						A	Baa
Credit Risk Ratio					248		
Tail Risk Ratio				395			
% Below Investment Grade				10.2%			
S (WCL > 10% of HC) / HC	0.0%						
Factor 3: Capital Adequacy (30%)							< Baa
Hard Capital Ratio					x		
Total Capital Ratio					x		
Par Reinsured		12.8%					
Factor 4: Profitability (15%)						Baa	< Baa
Return on Equity - 3 year average					-35.1%		
Loss Ratio (SAP) - 3-year average					225.0%		
Expense Ratio (SAP) - 3-year average	19.5%						
Factor 5: Financial Flexibility (10%)							< Baa
Earnings Coverage					0.0x		
Cash Flow Coverage					0.0x		
Adjusted Double Leverage				143.3%			
Ease of Access to Capital					x		
Aggregate Profile						Baa1	Ba3

[1] Metrics as of December 31, 2008 (unless noted) [2] The scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.

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