



Moody's Investors Service

Issuer Comment: **Moody's says Ambac's commutations boosted its regulatory capital, but no material changes to ratings given continued uncertainty of its capital and liquidity position**

Global Credit Research - 20 Nov 2009

On November 18, 2009, Ambac posted an \$856 million regulatory surplus for 3Q09. Ambac commuted four ABS CDOs for \$520 million with counterparties during the quarter, removing \$5 billion of notional risks from its insured book, and reversing a large amount of estimated losses related to CDOs. Also helping capital, Moody's noted, was \$311 million of reinsurance recaptures, which was partly offset by a capital reduction of \$280 million from the correction of an error in credit derivative estimations.

Previously, Ambac had also stated that it increased its expected recoveries from loan put-backs to about \$1.9 billion, reducing GAAP loss reserves for RMBS exposures to \$2.6 billion from a gross amount of \$4.5 billion. Ambac also indicated that it expects to record approximately \$440 million of tax-loss carry-back refunds during 4Q09 as a result of the "Worker Homeownership and Business Assistance Act of 2009".

Moody's currently rates Ambac Assurance Corporation (AAC) Caa2 for insurance financial strength, with a developing outlook; and rates Ambac Financial Group Inc.'s senior debt at Ca, with a negative outlook. We maintain our current ratings, as the third-quarter events, while generally positive for remaining counterparties, did not, in Moody's opinion, materially change the group's credit profile in light of the continued uncertainty related to its capital adequacy and holding company liquidity position.

Statutory capital position remains uncertain over the medium term. Despite the significant improvement in Ambac's statutory capital position in 3Q09, Moody's believes that the company will be challenged to consistently meet regulatory requirements over the medium term. We continue to believe there will be pressure on Ambac to improve and solidify its capital position.

The capital pressures that faced Ambac in 3Q2009 were largely alleviated by successful commutations with counterparties, including the reinsurance recapture. Commutations helped boost the Q3 statutory surplus to \$856 million. It is unclear if Ambac will be able to consistently commute on terms that would materially improve its capital position in the future.

In addition, gross statutory loss reserves can go up as troubled credits default, adversely affecting regulatory surplus. Ambac's statutory loss reserves only capture credits that are in default. As of the end of 3Q09, the non-CDO-related statutory loss reserves were about \$1.3 billion. This is 50% of Ambac's GAAP loss reserve for RMBS, which stood at \$2.6 billion net of remediation recoveries.

Realization of put-back recoveries could help ease capital pressure in the long run. Ambac expects \$1.9 billion in estimated RMBS remediation recoveries. This amounts to about 30% of its expected lifetime RMBS losses. Should the remediation strategy succeed, the company's ultimate loss could be significantly lower than our expectations, which would be positive from a capital adequacy prospective. That being said, mortgage-related exposures remain under stress and Ambac's high operating leverage means that relatively modest changes in loss estimates can have substantial effects on capital adequacy. Uncertainty about ultimate mortgage losses will continue to hinder industry recovery in the medium term.

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