

August 28, 2008

Summary:
Ambac Assurance Corp.

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Summary:

Ambac Assurance Corp.

Local Currency

Credit Rating: AA/Negative/--

Rationale

On Aug. 14, 2008, Standard & Poor's Ratings Services affirmed its 'AA' financial strength rating on Ambac Assurance Corp. (Ambac) and removed it from CreditWatch Negative. The outlook is negative.

The negative outlook reflects our view that Ambac's exposure to domestic nonprime mortgages and related exposures to collateralized debt obligations of asset-backed securities (CDO of ABS) has likely damaged its franchise and that the company faces diminished new business flow. Removal of the negative outlook will be dependent on, among other factors, clarification of ultimate potential losses as well as future business prospects, the outcome of strategic business decisions, and potential regulatory developments.

The rating affirmation reflects our assessment of Ambac's:

- Capital position, which we believe to be satisfactory when measured against conservative projections of potential losses;
- Generally successful ongoing efforts to remediate the outstanding mortgage-related exposure; and
- Broad refocusing of the business and risk management intended to position the company to take advantage of any new business opportunities and to meaningfully participate in the credit enhancement industry as quickly as possible, including retaining the necessary management and staff to support these initiatives.

When stressed in Standard & Poor's capital adequacy model, Ambac's existing capital resources, future earnings, and cash flow generated a margin of safety in the 1.1x-1.2x range. The result was adjusted for the \$1.3 billion capital infusion in the first quarter of 2008 and incorporates current loss assumptions for the residential mortgage-backed securities (RMBS) and CDO of ABS exposures. The margin of safety expresses the relationship between theoretical losses generated in the capital adequacy model and capital remaining at the end of a theoretical depression. Ambac's margin of safety in the model exceeds Standard & Poor's minimum requirement of 1.0x for a 'AA' rated company.

We believe Ambac's remediation efforts are starting to bear fruit. The company announced the commutation of a \$1.4 billion ABS CDO ("AA Bespoke") at a cost of \$850 million. This resulted in a gain under GAAP accounting versus the associated mark-to-market charges, as well as a reduction in projected losses under various rating agency capital adequacy models. In our view, completing the transaction also eliminated the potential for future adverse loss development.

Ambac has also been actively pursuing representation and warranty claims against transaction sponsors. Loss reserves at June 30, 2008, reflect more than \$260 million of estimated recoveries on these claims. It is our understanding that the company will remain active in its remediation efforts.

In light of the damage to Ambac's business franchise, the revised business focus appears designed to allow the

company to maximize revenue generation, seek opportunities to regain investor acceptance, and begin writing a meaningful amount of new business. To generate revenue, the company is pursuing reinsurance opportunities, continuing to insure transactions from time to time, and seeking opportunities to provide fee-based services. To regain investor acceptance and generate new business, the company has proposed to increase the capital of a now-dormant subsidiary and enter the global municipal and infrastructure credit enhancement markets. Ambac has been generally successful in retaining managers and staff to support these initiatives.

Outlook

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