

August 7, 2009

**Research Update:**

# Outlook On Ambac Assurance Corp. Credit Rating Revised To Negative

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## Research Update:

# Outlook On Ambac Assurance Corp. Credit Rating Revised To Negative

## Overview

- Ambac Assurance Corp. continues to experience adverse loss development in its insured book of business.
- We will view additional CDO of ABS commutations as distressed exchanges, and we believe that further losses and reserve additions and impairments could deplete policyholders' surplus to levels below the regulator-required minimums.
- We have revised our outlook on the counterparty credit rating to negative from developing, but the outlook on the financial strength rating remains developing.
- In addition, we have affirmed our 'CC' counterparty credit, financial strength, and financial enhancement ratings on Ambac.

## Rating Action

On Aug. 7, 2009, Standard & Poor's Ratings Services revised its outlook on its counterparty credit rating on Ambac Assurance Corp (Ambac) to negative from developing. The outlook on the financial strength rating remains developing. At the same time, Standard & Poor's affirmed its 'CC' counterparty credit, financial strength, and financial enhancement ratings on Ambac.

In addition, Standard & Poor's affirmed its 'CC' counterparty credit rating on Ambac Financial Group Inc. (Ambac Financial). The outlook on Ambac Financial remains negative.

## Rationale

Although Ambac has received regulatory approval to release contingency reserves to bolster surplus, the rating reflects our view that there could be additional commutations, which we will view as distressed exchanges. Once a distressed exchange has occurred, we will lower the counterparty credit rating on Ambac to 'SD'. Following the commutation, we will also complete a forward-looking review that takes into account whatever benefits the company realized from it as well as any other interim developments, and we will adjust the ratings as warranted.

The rating also reflects our view that further deterioration in Ambac's insured portfolio of nonprime residential mortgage-backed securities and related CDO of ABS exposure would require the company to strengthen reserves to account for higher projected claims. The additional reserves will hurt operating results significantly, which we believe could cause surplus to decline to below regulator-required minimums.

## Outlook

The negative outlook on the Ambac counterparty credit rating reflects the possibility that we could lower the rating to 'SD' upon the completion of additional commutations. The outlook on the Ambac financial strength rating is developing because we could raise the rating upon the completion of additional commutations that strengthen Ambac's financial position.

The negative outlook on Ambac Financial reflects the company's dependence on dividends from Ambac to pay its debt. We could lower the rating if Ambac were not able to provide sufficient cash to Ambac Financial to service this debt.

## Related Research

- "Bond Insurance Industry Overview And Analytical Focus," June 29, 2006, RatingsDirect.
- "Rating Implications Of Exchange Offers And Similar Restructurings, Update ," May 12, 2009.

## Ratings List

Ratings Affirmed; Outlook Action

	To	From
Ambac Assurance Corp. Connie Lee Insurance Co. Ambac Assurance U.K. Ltd. Counterparty Credit Rating Local Currency	CC/Negative/--	CC/Developing/--

Ratings Affirmed

Ambac Assurance Corp. Financial Strength Rating Local Currency	CC/Developing/--
Financial Enhancement Rating Local Currency	CC/--/--
Preferred Stock	C

Ambac Assurance U.K. Ltd. Financial Strength Rating Local Currency	CC/Developing/--
Financial Enhancement Rating Local Currency	CC/--/--

Connie Lee Insurance Co. Financial Strength Rating Local Currency	CC/Developing/--
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Ambac Financial Group, Inc.

*Research Update: Outlook On Ambac Assurance Corp. Credit Rating Revised To Negative*

Counterparty Credit Rating

Local Currency	CC/Negative/--
Senior Unsecured	CC
Subordinated	C

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