Who's Holding the Bag?

Pershing Square Capital Management, L.P.
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Agenda

- Overview of credit market trends
- What is driving growth in easy credit?
- What has securitization wrought?
- Who’s holding the bag?
What’s Happening With the Credit Markets?

Freely Available Credit

- Relaxed lending standards
- Financial “innovation”
- CDO Demand

More Leverage / More Buyers

Increasing Asset Values

Decreasing defaults
Growth in higher-LTV loans fueled by lower verification standards

Documentation of Purchase First Liens with Simultaneous Seconds

12 to 23 months  24 months or more  None  Verbal verification

Source: Standard & Poor's
Interest-only products driving growth over last 3 years

Fixed vs. Hybrid ARMS (With and Without IO)

Source: Standard & Poor’s
Sub-Prime: More Leverage and More Buyers

Second liens have grown as % of total issuance

Total Issuance vs First Liens With Piggyback Issuance

Source: Standard & Poor's
Increasing Asset Values

Home Price Index is 15% above the 30-year trend-line

Source: Office of Federal Housing Enterprise and Oversight, Deutsche Bank
Data as of end of Third Quarter 2006
Who is Buying These Mortgages?
ABS Market Providing Liquidity for Originators

Source: Thompson Financial, Deutsche Bank
ABS Fueled by CDOs

ABS / MBS / CMBS purchased by CDOs ($bn)

<table>
<thead>
<tr>
<th>Year</th>
<th>Value ($)</th>
<th>% of total CDO Issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$19</td>
<td>23%</td>
</tr>
<tr>
<td>2002</td>
<td>$31</td>
<td>40%</td>
</tr>
<tr>
<td>2003</td>
<td>$27</td>
<td>33%</td>
</tr>
<tr>
<td>2004</td>
<td>$53</td>
<td>43%</td>
</tr>
<tr>
<td>2005</td>
<td>$98</td>
<td>52%</td>
</tr>
<tr>
<td>2006</td>
<td>$131</td>
<td>49%</td>
</tr>
</tbody>
</table>

Source: Bear Stearns
How Does a Securitization work?

Source: Deutsche Bank
How Does a CDO work?

**ABS Collateral Pool**

<table>
<thead>
<tr>
<th>Mortgage Loan #</th>
<th>5000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Loan Size</td>
<td>200,000</td>
</tr>
<tr>
<td>CLTV</td>
<td>85%</td>
</tr>
<tr>
<td>California Loan</td>
<td>30%</td>
</tr>
<tr>
<td>FICO</td>
<td>620</td>
</tr>
<tr>
<td>DTI</td>
<td>40%</td>
</tr>
<tr>
<td>Interest Only</td>
<td>20%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CDO Collateral Pool</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS bonds (mostly BBB or BBB-, 5-10% BB)</td>
</tr>
<tr>
<td>100 specific credits</td>
</tr>
</tbody>
</table>

**CDO Capital Structure**

<table>
<thead>
<tr>
<th>Tranche</th>
<th>Thickness</th>
<th>Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>80%</td>
<td>20%</td>
</tr>
<tr>
<td>AA</td>
<td>5%</td>
<td>15%</td>
</tr>
<tr>
<td>A</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>BBB+</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>BBB</td>
<td>1%</td>
<td>6%</td>
</tr>
<tr>
<td>BBB-</td>
<td>1%</td>
<td>5%</td>
</tr>
<tr>
<td>BB</td>
<td>1%</td>
<td>4%</td>
</tr>
<tr>
<td>O/C (Equity)</td>
<td>4%</td>
<td>0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tranche</th>
<th>Thickness</th>
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</tr>
<tr>
<td>BBB</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>O/C (Equity)</td>
<td>5%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Deutsche Bank
What’s Wrong with Rating Agency Models?

- Data set limited by favorable recent year trends
  - Low interest rates
  - Improving liquidity
  - Rising home prices
  - Strong economic environment
  - Product innovation

- No payment shocks in existing data because borrowers have been able to refinance

- Performance of securitizations benefited from required and voluntary removal of troubled loans

- Rating Agencies assume limited historical correlation (20%-30% for sub-prime) will hold in the future

When the credit cycle turns, correlations could approach 100%
Liquidity for ABS depends on CDO Performance

$1 of equity invested in a Mezzanine CDO supports over $111 in sub-prime mortgages

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollars invested in BBB / Equity of Mezz CDO</td>
<td>1.0</td>
<td>10.0%</td>
</tr>
<tr>
<td>Senior Leverage in CDO</td>
<td>9.0</td>
<td>90.0%</td>
</tr>
<tr>
<td>Mezz CDO Assets</td>
<td>10.0</td>
<td>100.0%</td>
</tr>
<tr>
<td>BBB / Equity Tranche of ABS Securitization</td>
<td>10.0</td>
<td>9.0%</td>
</tr>
<tr>
<td>Senior Leverage in Securitization</td>
<td>101.1</td>
<td>91.0%</td>
</tr>
<tr>
<td>Total Collateral Purchased in Securitization</td>
<td>111.1</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Total Leverage on CDO Equity 110.1 x

Poor returns for BBB / Equity CDO investors will have over 100:1 impact on demand for securitizations of primary assets
What Has Securitization Wrought?
Mortgage Lending in the Old Days

Business Strategy: Lend & Hold

- Local S&L lends to local Home Owner
- Lender has direct knowledge of borrower
- Lender profits from performance of loan over time
- Borrower plans to pay down mortgage over time
- High transaction costs
Mortgage Lending Today: Lend & Securitize

**Originator**
- “Mortgage.com” or “1-800-MORTGAGE”
- Models-based issuance, questionable actuarial data

**ABS**
- Originator recognizes income upon loan sale or securitization
- Bank earns fee for underwriting ABS

**CDO**
- Rating Agency arbitrage allows CDO originator to book profit at closing
- CDO Manager makes nominal investment, receives recurring fees

**CDO Buyers / Insurers**
- Ultimate risk holder relies on ratings; minimal visibility to underlying credit
Moral Hazard: Everyone is paid up front, including the rating agencies, except for ultimate holder of risk.
Rating Agencies as De Facto “Regulator”

Source: Bear Stearns
Rating Agencies Are NOT Regulators

- Rating Agencies are for-profit businesses
  - Earn fees for writing opinions

- Rating Agencies have adverse incentives
  - Only paid if and when financing closes; ratings “shopping”
  - “Fairness opinion” where only paid if determined to be fair
  - More issuance = More fees
  - Structured Finance is over 40% of revenues with fees ~4x that of traditional debt ratings

- Rating Agencies have conflicts of interest
  - Concentrated customer base, sources of fees (Bond Insurers)
  - Guarantors offer lucrative career path for agency executives

- Rating Agencies have reputational risk with structured finance ratings
  - Slow to adjust credit opinions
Rating Agencies Claim No Liability for Being Wrong

Distinction “…between investment advisers with a fiduciary relationship to their clients and those who simply publish impersonal commentary on some aspect of a security…investors [might] mistakenly assume that a credit rating represented advice as to whether they should buy, sell or hold a security, or that they could rely on a credit rating agency as fiduciary, neither of which is true.”

Standard & Poor’s,
SEC Public Hearing, 2002
What Happens if the Rating Agencies Are Wrong?
Reduced Availability of Credit

Tighter lending standards
No more financial “innovation”
Reduced CDO Demand

The Cycle Also Works in Reverse

Catalyst: Unexpected Defaults

Decreasing Asset Values

Less Leverage / Fewer Buyers

Increasing Defaults and Reduced Recovery Rates

Reduced Availability of Credit
Already Happening in Sub-Prime

- Defaults have been higher than rating agency predictions
- Rating Agencies have begun to adjust models and downgrade tranches
  - Tighter standards for securitizations / CDOs
  - Acknowledging likelihood of higher than expected correlation
- Lack of new ABS CDOs dramatically reduces demand for new mortgages
- Banks pulling warehouse lines
- Originator bankruptcies / exiting business (~50 in last 15 months)
- Home price depreciation predicted by National Association of Realtors

**Upcoming payment shock will make things worse**
- Borrowers can’t refinance because of tighter standards
- Rising inventories and smaller pool of qualified buyers reduces value and liquidity of properties
Already Happening in Sub-Prime

More loans are experiencing early defaults

Source: Moody’s
Sub-Prime Fallout: It is Going to Get Worse...

~$800 Billion of sub-prime mortgages to reset

Sources: LoanPerformance, Deutsche Bank
Higher Losses due to Lower Home Appreciation

Annualized home price appreciation rates since 1999 and loss severity by MSA for loans originated between January 2000 and December 2004

Loss severity ratio since January 2004 vs. Annualized average growth rate since 1999 in home prices

- 60% at 3% HPA
- 32% at 5% HPA
- 5% at 10% HPA
- 1% at 15% HPA

HPA data as of end of third quarter 2006, mortgage data as of December 2006

Source: LoanPerformance, OFHEO, Deutsche Bank
# Leveraged Lending Mirrors Sub-Prime

<table>
<thead>
<tr>
<th><strong>Sub-Prime</strong></th>
<th><strong>LBOs</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>➤ Higher LTVs</td>
<td>➤ Higher Debt / EBITDA</td>
</tr>
<tr>
<td>➤ I/O, Negative amortizing loans</td>
<td>➤ Covenant lite &amp; PIK toggle notes</td>
</tr>
<tr>
<td>➤ Cash-out Re-fi</td>
<td>➤ Dividend Re-Cap</td>
</tr>
<tr>
<td>➤ “Liar” loans, limited documentation</td>
<td>➤ Credit for “pro forma” cost savings</td>
</tr>
<tr>
<td>➤ 0% down</td>
<td>➤ Lenders providing equity bridges</td>
</tr>
<tr>
<td>➤ Home Appreciation</td>
<td>➤ Purchase multiple expansion</td>
</tr>
</tbody>
</table>
Record buyout activity…

Source: JP Morgan
Buyout Leverage: Mirroring Sub-Prime Trends

...at higher purchase multiples...

Average EV / EBITDA

Source: JP Morgan
Buyout Leverage: Mirroring Sub-Prime Trends

...driven by more leverage....

Avg. Total Debt / EBITDA

Source: JP Morgan
Note: Represents top 20% of levered loans by Debt / EBITDA
Buyout Leverage: Mirroring Sub-Prime Trends

...supported by growth in CLOs

Leveraged Loan Arbitrage CLO Activity ($Bn)

Source: JP Morgan
Commercial Real Estate Mirrors Sub-Prime / LBO

- Loan-to-Values of > 100%
- Negative debt service coverage
- Non-recourse financing on projected NOI in years 5 & 6
- Dividend Yield on U.S. Real Estate Index declining from high of ~8.0% in September 2002 to 2.8% today
- Credit market supported by CMBS and CDO bid
Who’s Holding the Bag?
Who’s Holding the Bag?

First losses borne by BBB and equity investors in CDOs / securitizations

- Combined position represents only 5-10% of total collateral
- At ~9% losses, all capital through BBB is worth zero
  - Moody’s currently estimating 6-8% cumulative losses for 2006 sub-prime issuance—higher than initial expectations

Senior tranches typically guaranteed by Bond Insurers

- Bond Insurers sell credit protection on senior tranches of ABS & CDO securitizations
- Bond Insurers and CDO Buyers perceive low risk and accept nominal yield
Who's Holding the Bag?

Financial Guarantors are unique counterparties

- They don’t put up capital. They simply sign their name

- One of few counterparties in derivatives market not required to post collateral on decline in value of contract

- Only counterparties not required to post collateral even in the event of a downgrade in their credit rating
Who Are the Bond Insurers?

Financial Guarantors are inadequately capitalized to withstand a negative credit event.

<table>
<thead>
<tr>
<th>Face Value Bond Guarantees / Statutory Capital</th>
<th>Reserves / Guarantees</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBIA</td>
<td>3.15 bps</td>
</tr>
<tr>
<td>Ambac</td>
<td>3.93 bps</td>
</tr>
</tbody>
</table>
Ambac is exposed to Sub-Prime Losses

Ambac’s exposure to Sub-Prime mortgages, both direct and through CDO’s, is significant relative to book value and reserves

### ABK Sub-Prime Exposure

<table>
<thead>
<tr>
<th>($ billion)</th>
<th>$</th>
<th>% of Stat. Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sub-Prime Exposure</td>
<td>18.7</td>
<td>284.4%</td>
</tr>
<tr>
<td>Direct Sub-Prime Rated BBB</td>
<td>4.3</td>
<td>64.7%</td>
</tr>
<tr>
<td>Direct Sub-Prime Below-Investment-Grade</td>
<td>0.8</td>
<td>12.0%</td>
</tr>
<tr>
<td>Sub-Prime in High-Grade CDO's</td>
<td>7.8</td>
<td>118.7%</td>
</tr>
<tr>
<td>Sub-Prime in Mezz CDO's</td>
<td>1.0</td>
<td>14.9%</td>
</tr>
</tbody>
</table>
MBIA Structured Finance Guarantees as a % of total Guarantees have more than doubled over the past 10 Years.

1996

- Public Finance: 86%
- Structured Finance: 14%

2006

- Public Finance: 68%
- Structured Finance: 32%
Growing Structured Finance Exposure

MBIA has increased exposure to Structured Finance during period of rapid innovation and lower lending standards

MBIA: Net Par Insured

<table>
<thead>
<tr>
<th>Year</th>
<th>$ Insured (bn)</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>42.1</td>
<td>38.7%</td>
</tr>
<tr>
<td>2004</td>
<td>47.6</td>
<td>44.3%</td>
</tr>
<tr>
<td>2005</td>
<td>46.7</td>
<td>42.1%</td>
</tr>
<tr>
<td>2006</td>
<td>59.5</td>
<td>53.0%</td>
</tr>
<tr>
<td>Q1 '07</td>
<td>25.2</td>
<td>66.5%</td>
</tr>
</tbody>
</table>
## MBIA Compared to Citigroup

<table>
<thead>
<tr>
<th></th>
<th>MBIA</th>
<th>Citigroup</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit Rating</strong></td>
<td>Aaa, AAA</td>
<td>Aaa, AA+</td>
</tr>
<tr>
<td><strong>Regulator</strong></td>
<td>NYS Insurance Dept</td>
<td>Federal Reserve, OCC, FDIC</td>
</tr>
<tr>
<td><strong>Leverage</strong></td>
<td>94:1 (Net Par / Capital)</td>
<td>12:1 (Risk Adj. Assets / Tier 1 Capital)</td>
</tr>
<tr>
<td><strong>Credit Exposure</strong></td>
<td>$635 billion</td>
<td>$1,107 billion</td>
</tr>
<tr>
<td><strong>Capital</strong></td>
<td>$6.8 billion</td>
<td>$127.0 billion</td>
</tr>
<tr>
<td><strong>Reserves / Credit Exposure</strong></td>
<td>3 bps</td>
<td>96 bps</td>
</tr>
</tbody>
</table>
### Minimal Losses Will Impair MBIA’s Capital Base

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Guaranteed Portfolio</td>
<td>$635.2 Billion</td>
</tr>
<tr>
<td>Public Finance</td>
<td>421.8</td>
</tr>
<tr>
<td>Structured Finance</td>
<td>$213.4 Billion</td>
</tr>
<tr>
<td>CDO Exposure</td>
<td>108.6</td>
</tr>
<tr>
<td>Mortgage Exposure</td>
<td>52.0</td>
</tr>
<tr>
<td>Other ABS Exposure</td>
<td>26.9</td>
</tr>
<tr>
<td>Direct and Pooled Corporate Exposure</td>
<td>25.9</td>
</tr>
<tr>
<td>Total Structured Finance Exposure</td>
<td>$213.4 Billion</td>
</tr>
</tbody>
</table>

| Estimated "Excess" Capital over AAA\(^{(1)}\) | $0.5 Billion |
| Losses to eliminate excess capital         | 23 bps       |

| Total Statutory Capital Base              | $6.8 Billion |
| SF Losses to eliminate all capital        | 316 bps      |

\(^{(1)}\) Excess Capital estimate assumes $1.5B of excess capital at 12/06 reduced by two $500M dividends in 12/06 & 4/07.
## MBIA: Significant CDO Exposure

CDO Exposure (Net of Reinsurance):

<table>
<thead>
<tr>
<th>Collateral Type</th>
<th>Net Par Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Grade</td>
<td>$ 50.7</td>
</tr>
<tr>
<td>High Yield</td>
<td>12.2</td>
</tr>
<tr>
<td>Multi-Sector</td>
<td>22.7</td>
</tr>
<tr>
<td>CMBS</td>
<td>23.0</td>
</tr>
<tr>
<td>Emerging Market</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$108.8</td>
</tr>
</tbody>
</table>

$ Value of Mezz CDO Exposure (12/31) $ 5.0
Mezz CDO as % of Statutory Capital 73.5%

Large exposure to mezzanine CDOs with underlying collateral rated BBB or worse
Mezzanine CDO Spreads Widening Significantly

Spreads for AAA tranches of Sub-Prime CDO Index

Source: Morgan Stanley

TABX.HE.07-1.06-2 BBB & BBB-

Source: Morgan Stanley
**MBIA: “Excess” Capital?**

Is ~$500M a sufficient cushion to the minimum capital required to maintain AAA rating?

<table>
<thead>
<tr>
<th>High-Risk Credit Exposures:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>($ billion)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>Excess Capital as %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct and Indirect Sub-Prime Exposure</td>
<td>$7.8</td>
<td>6.4%</td>
</tr>
<tr>
<td>Below-Investment-Grade Exposure</td>
<td>11.9</td>
<td>4.2%</td>
</tr>
<tr>
<td>Mezzanine CDO Exposure (12/31)</td>
<td>5.0</td>
<td>10.0%</td>
</tr>
<tr>
<td><strong>High-Risk Credit Exposure</strong></td>
<td><strong>$24.7</strong></td>
<td><strong>2.0%</strong></td>
</tr>
<tr>
<td>Remaining Exposure to Other Guarantees</td>
<td>$610.6</td>
<td></td>
</tr>
</tbody>
</table>
How Does MBIA Account for Wider Spreads?

- Supposed to mark to market any losses on derivatives
  - MBIA provides protection by selling CDS on CDO tranches
- MBIA’s CDO guarantees are held to maturity and do not trade
- With no market price, MBIA “marks to model”
- MBIA’s internal model incorporates rating agency inputs
- Rating Agencies have not downgraded senior tranches, therefore MBIA has not recognized any MTM losses
## Wider CDO Spreads Will Impair Capital Base

<table>
<thead>
<tr>
<th>Eliminates</th>
<th>Eliminates All Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Excess&quot; Capital (bps)</td>
<td>(bps)</td>
</tr>
<tr>
<td>$108.8 Billion 9 125</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CDO Exposure</th>
<th>$108.8 Billion 9 125</th>
</tr>
</thead>
<tbody>
<tr>
<td>Est. &quot;Excess&quot; Capital over AAA</td>
<td>$0.5 Billion</td>
</tr>
<tr>
<td>Total Statutory Capital Base</td>
<td>$6.8 Billion</td>
</tr>
</tbody>
</table>

Note: Assumes 5-yr avg. life of credit protection

If exposures were marked to market, slight movements in credit spreads would impair or eliminate MBIA's capital base.
Wait, There’s More...
MBIA Is One of the Most Profitable US Companies?

“We have the highest profit margin of any financial company in the Forbes 500 with over a billion in sales.”

--Joseph W. Brown, Chairman of MBIA

Net Income Margins of Several Highly Profitable Companies

Source: Company reports, Pershing estimates (MBI adjusted for one-time expenses).
Decreasing Unallocated Reserves

MBIA’s unallocated reserves, expressed in bps of net par outstanding, have dwindled to only 3.2 basis points of total exposure (as of 3/31/07)
MBIA’s current methodology accelerates revenue recognition and inflates book value

- MBIA recognizes deferred premium revenue on an accelerated basis
  - Company claims that the appropriate method for recognizing deferred premium revenue is in proportion to “the expiration of related risk”

- MBIA insures discrete, not continuous risks
  - MBIA effectively guarantees a stream of payments. Therefore, risk expires only when payments are made

New FASB Proposal, dated 4/18, requires MBIA to recognize revenue in proportion to risk expiration (scheduled payments), not the passage of time
### Example 1:
5-year $500mm, 5% coupon debt issuance, amortizing 20% annually.

<table>
<thead>
<tr>
<th>Year</th>
<th>Proposed Methology</th>
<th>Current Methodology</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>21.7%</td>
<td>45.7%</td>
<td>-23.9%</td>
</tr>
<tr>
<td>2</td>
<td>20.9%</td>
<td>25.7%</td>
<td>-4.8%</td>
</tr>
<tr>
<td>3</td>
<td>20.0%</td>
<td>15.7%</td>
<td>4.3%</td>
</tr>
<tr>
<td>4</td>
<td>19.1%</td>
<td>9.0%</td>
<td>10.1%</td>
</tr>
<tr>
<td>5</td>
<td>18.3%</td>
<td>4.0%</td>
<td>14.3%</td>
</tr>
</tbody>
</table>
Impact of FASB’s Revenue Recognition Decision

- Cumulative write-down of book value
- Increased leverage ratios and lower ROE
- Reduced earnings power
- Reduced earnings growth rate
  - Adverse impact on contribution of new business
- Higher P/E and book value multiples at current price
“…would result in a significant deceleration of the earnings pattern typically seen among guarantors under existing accounting policies, and reduce shareholders' equity due to the cumulative effect adjustment necessary at adoption … the accounting change could result in a reduction of shareholders' equity in excess of 10% for some firms, with a similarly significant impact on GAAP net income.”

Wallace Enman
Moody's Senior Accounting Analyst
4/19/2007
Enhanced uniformity in reporting may nevertheless result in some guarantors' reported financial statements appearing stronger or weaker relative to peers than under current reporting standards. The implementation of the proposed guidance would alter reported financial leverage, coverage ratios and profitability metrics going forward, and as a result, Moody's may adjust certain rating metrics to recognize the effect of these accounting changes on its overall methodology.

Moody’s Press Release
4/19/2007
Ongoing Fraud Investigation

Independent Investigator reviewing improper transfers of value from MBIA Insurance to Holding Company

- In search of growth, MBIA aggressively expanded into non-traditional, high-risk asset classes such as defaulted property tax liens

- As the value of the tax-lien portfolio deteriorated, the Holding Company advanced capital to meet margin calls and avoid recognizing losses

- Holding Company improperly transferred losses to Insurance Subsidiary by causing it to guarantee bonds backed by tax liens at inflated valuations

MBIA has led the market to believe that investigations are behind them. Independent Investigator will release initial findings this summer.
Is MBIA Prepared?

How is MBIA preparing for the deterioration in credit markets?

- **December 2006:** Received permission from NYSID and paid $500M special dividend from Insurance Subsidiary to Holding Company

- **February 2007:** Announced largest share repurchase program in company history ($1 Billion)

- **April 2007:** Received permission from NYSID and paid yet another $500M special dividend from Insurance Subsidiary to Holding Company

- **May 2007:** Disclosed share repurchases of ~$300M in Q1 equal to 3.4% of total shares outstanding
Is MBIA Prepared?

What is MBIA management doing to prepare for the upcoming deluge?

- Resigned (5/30/06): Nicholas Ferreri, Chief Financial Officer
- Retiring (1/11/07): Jay Brown, Chairman of Board of Directors
- Resigned (2/16/07): Neil Budnick, President of MBIA Insurance Co.
- Resigned (2/16/07): Mark Zucker, Head of Global Structured Finance
Risk is Hidden in Guarantor Portfolios

- Moral Hazard in the Structured Finance process combined with a flawed Rating Agency function has overstated credit quality for hundreds of billions of dollars of guaranteed bonds

- Guarantors have no margin for error
  - Massive on- and off-balance sheet leverage
  - Exposure to risky, untested categories
  - Negligible reserves
  - Aggressive and fraudulent accounting

- Credit Market participants believe they have transferred risk to AAA-rated Financial Guarantors

- Guarantors’ counterparties are unsecured and have no right to collateral even in the event of a downgrade

When losses hit, these guarantees will have no value, and counterparties are left holding the bag
Our Recommendations

**Insurance Subsidiaries are effectively insolvent in our view and need to be recapitalized**
- Holding Companies must fund capital shortfall at subsidiaries
- Dividends from subsidiaries to holding companies should be terminated

**Removal of Executives Responsible for Fraudulent Activity**
- Current CEO of MBIA supervised failed investment in tax lien business and subsequent scheme to hide losses
- Executives appear to have made false and misleading statements to analysts and investors

**MBIA Insurance subsidiary needs independent Board of Directors**
- Conflict of Interests: Holding company is extracting capital from insurance subsidiary to fund share repurchases and special dividends
- Independent Board is needed to ensure that transactions between holding company and insurance company are done on arms’ length basis
Risk vs. Reward: What’s the downside?

Financial Guarantors are trading near or above their reported Adjusted Book Values.
What Is Our Interest In This?

- We believe that capital must be returned to the insurance subsidiary in order to protect policy holders from future losses.

- Our interests are aligned with bondholders and the capital markets generally.

- We are short the common stock and own credit protection for MBIA, Inc. and Ambac Financial Group, Inc., the holding companies of the bond insurance companies.
What Are We Doing About This?

- We are in the process of identifying additional violations of NYS Insurance Laws. Stay Tuned

- We are meeting with the relevant congressional and regulatory authorities to focus attention on the problem