

August 14, 2008

Research Update:

Ambac Assurance Corp. 'AA' Ratings Affirmed And Taken Off Watch Neg; Outlook Is Negative

Primary Credit Analyst:

Dick P Smith, New York (1) 212-438-2095;dick_smith@standardandpoors.com

Secondary Credit Analyst:

David Veno, New York (1) 212-438-2108;david_veno@standardandpoors.com

Table Of Contents

Rationale

Outlook

Ratings List

Research Update:

Ambac Assurance Corp. 'AA' Ratings Affirmed And Taken Off Watch Neg; Outlook Is 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.

At the same time, Standard & Poor's affirmed its ratings on holding company Ambac Financial Group Inc.'s senior debt and hybrid security at 'A' and 'BBB+', respectively. In addition, Standard & Poor's affirmed its ratings on preferred stock issued by Anchorage Finance Sub-Trusts I, II, III, and IV and Dutch Harbor Finance Sub-Trusts I, II, III, and IV (committed capital facilities supported by, and for the benefit of, Ambac) at 'A'. All these ratings were also removed from CreditWatch and assigned negative outlooks where appropriate.

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:

- Satisfactory capital position, measured against conservative projections of potential losses;
- Successful ongoing efforts to remediate the outstanding mortgage-related exposure; and
- Broad refocusing of the business and risk management 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 (based on year-end 2007 data) in the 1.1x-1.2x range. The 2007 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 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 the 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 successful in retaining managers and staff to support these initiatives.

Outlook

The negative outlook reflects our view that Ambac's exposure to domestic nonprime mortgages and related exposures to 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.

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Ambac Assurance Corp.		
Connie Lee Insurance Co.		
Ambac Assurance U.K. Ltd.		
Issuer Credit Rating		
Local Currency	AA/Negative/--	AA/Watch Neg/--
Financial Strength Rating		
Local Currency	AA/Negative/--	AA/Watch Neg/--
Ambac Assurance Corp.		
Ambac Assurance U.K. Ltd.		
Financial Enhancement Rating		
Local Currency	AA/--	AA/Watch Neg/--
Ambac Financial Group, Inc.		

Research Update: Ambac Assurance Corp. 'AA' Ratings Affirmed And Taken Off Watch Neg; Outlook Is Negative

Issuer Credit Rating		
Local Currency	A/Negative/--	A/Watch Neg/--
Ambac Financial Group, Inc.		
Senior Unsecured (5 issues)	A	A/Watch Neg
Subordinated (1 issue)	BBB+	BBB+/Watch Neg
Dutch Harbor Fin Sub-Trust II		
Preferred Stock (1 issue)	A	A/Watch Neg
Anchorage Fin Sub-Trust II		
Preferred Stock (1 issue)	A	A/Watch Neg
Anchorage Fin Sub-Trust I		
Preferred Stock (1 issue)	A	A/Watch Neg
Anchorage Fin Sub-Trust III		
Preferred Stock (1 issue)	A	A/Watch Neg
Anchorage Fin Sub-Trust IV		
Preferred Stock (1 issue)	A	A/Watch Neg
Dutch Harbor Fin Sub-Trust I		
Preferred Stock (1 issue)	A	A/Watch Neg
Dutch Harbor Fin Sub-Trust III		
Preferred Stock (1 issue)	A	A/Watch Neg
Dutch Harbor Fin Sub-Trust IV		
Preferred Stock (1 issue)	A	A/Watch Neg

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; select your preferred country or region, then Ratings in the left navigation bar, followed by Credit Ratings Search.

Copyright © 2008 Standard & Poor's, a division of The McGraw-Hill Companies, Inc. (S&P). S&P and/or its third party licensors have exclusive proprietary rights in the data or information provided herein. This data/information may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of this data/information in any form is strictly prohibited except with the prior written permission of S&P. Because of the possibility of human or mechanical error by S&P, its affiliates or its third party licensors, S&P, its affiliates and its third party licensors do not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates and its third party licensors be liable for any direct, indirect, special or consequential damages in connection with subscriber's or others use of the data/information contained herein. Access to the data or information contained herein is subject to termination in the event any agreement with a third-party of information or software is terminated.

Analytic services provided by Standard & Poor's Ratings Services (Ratings Services) are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. The credit ratings and observations contained herein are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1)212.438.9823 or by e-mail to: research_request@standardandpoors.com.