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Mr. Russell G. Golden, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116



File Reference No. 1620-100

Ambac

Dear Mr. Golden,

LETTER OF COMMENT NO. 37

This letter is submitted on behalf of Ambac Financial Group, Inc. ("*Ambac*" or "*we*") to comment on the Proposed Statement of Financial Accounting Standards, *Amendments to FASB Interpretation No. 46(R)* ("Exposure Draft"). Ambac is primarily engaged in the regulated business of financial guarantee ("FG") insurance. Ambac provides credit enhancement for a wide variety of domestic and international transactions, with our business generally including public finance (municipal) and asset-backed security transactions which involve variable interest entities. In a traditional FG transaction, Ambac guarantees scheduled payments on a bond or other debt security ("insured obligation") in exchange for payment of an insurance premium. Use of the guarantee generally attaches the insurer's credit rating to the insured obligation, generally allowing the insured obligation to bear a lower interest rate than it would otherwise require.

Ambac supports FASB's efforts to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. However, we do not believe that the changes proposed in the Exposure Draft entirely meet those objectives.

We have provided comments to FASB's questions 1, 4, 5 and 9 in the attached **Appendix A**.

We appreciate the opportunity to express our views on the Exposure Draft. We are available to discuss our comments and observations at your convenience.

Sincerely,

Sean Leonard
Senior Vice President and
Chief Financial Officer

Appendix A:

The specific questions posed by the FASB in the Exposure Draft and our responses follow:

Question 1: Will the proposed Statement meet the project's objectives to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements?

Ambac supports the FASB's efforts to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. However, Ambac believes the changes in the Exposure Draft might have unintended consequences that may distort the financial condition of financial guarantors. It is our business to provide financial guarantees to financial obligations that might be issued by variable interest entities. The current accounting model for financial guarantee enterprises requires that we establish loss reserves when applicable, which we believe adequately reflects our risk exposure to the financial guarantee contracts. The consolidation model under the Exposure Draft would confuse users of our financial statements in scenarios where the financial guarantor might be required to consolidate the VIE. For example, the financial guarantor might have certain control rights in the event of default of the insured obligations. Such control rights would enable the guarantor to declare acceleration of the repayment of the insured obligation or foreclose on the underlying collateral held in the VIE, which might require consolidation of the VIE at that point in time. These are defensive rights and in many cases might not be economically feasible to exercise. We believe the existing accounting model for financial guarantees is more reflective of the economics of the financial guarantor's involvement in the VIE as a service provider and are more understandable to users of our financial statements. As such, we would request a scope exemption from FIN 46(R) for providers of financial guarantees to VIEs which are currently subject to the accounting requirements of SFAS 60, *Accounting and Reporting by Insurance Enterprises*, and SFAS 163, *Accounting for Financial Guarantee Insurance Contracts*.

Question 4: The Board concluded that it would be helpful to provide examples of the application of the principles in this proposed Statement. Do you believe that the examples in Appendix A clearly indicate how the principles in paragraphs 14-14B of Interpretation FIN 46(R), as amended by this proposed Statement would be applied? If not, please articulate what additional information or guidance is necessary, considering the basis for the Board's conclusions.

The examples in Appendix A are helpful in assisting certain constituents to apply the principles in paragraphs 14-14B of Interpretation FIN 46(R), as amended by this Exposure Draft. However, we do not believe these examples address all of the interpretational questions that a financial guarantor will likely face in practice when attempting to identify the primary beneficiary of a VIE at inception and as part of its continuous assessment. To the extent the Board does not wish to scope out financial guarantors from FIN 46(R) as suggested in our response to Question 1, we believe there are two fundamental issues that the Appendix A examples should address which relate to the appropriate interpretation of paragraph 14A(a): i) how contingently exercisable rights a financial guarantor typically has should be evaluated at the inception of the guarantor's involvement with a VIE and on an ongoing basis, and ii) whether certain financial guarantor rights should be viewed as significantly impacting the activities of a VIE, including activities that impact the VIE's economic performance. As noted in our response to Question 1, a financial guarantor which insures the obligation of a VIE may have certain control rights in the VIE that are contingent upon an event of default of the insured obligations. We believe these contingently exercisable control rights should only be considered when evaluating a VIE for potential consolidation under the Exposure Draft when the triggering event, i.e. an event of default, has actually occurred. Additionally, we do not believe certain control rights a guarantor has that are either currently or contingently exercisable

significantly impact the activities of a VIE. As such, we would like the FASB to consider the following examples and provide additional guidance to clarify these issues:

Examples:	Non-contingent exercisable rights	Contingently exercisable rights upon an event of default	Economic effects of non-contingent and contingent rights
<p>A. Assume a VIE issues notes to investors and use the proceeds to acquire a pool of home equity lines of credit ("HELOCs"). Cash collected from the collateral is used to issue new loans during the reinvestment period. A financial guarantor provides a financial guarantee policy to the note holders of the VIE.</p>	<p>The financial guarantor has consent rights that are shared with the beneficiaries (i.e. note holders) of the financial guarantee policy for any action that would modify or compromise the rights of the note holders in the VIE that is initiated by a third party servicer.</p>	<p>In an event of default of the notes, the financial guarantor has the unilateral right to declare acceleration of the notes (effectively terminating any reinvestment period).</p>	<p><u>Non-contingent rights</u> – consent rights are shared with note holders and thus the guarantor does not have the power to direct matters of the VIE.</p> <p><u>Contingent rights</u> - The guarantor's unilateral (controlling) rights to declare acceleration allow the financial guarantor to alter the potential cash flows or economic performance of the VIE during the reinvestment period.</p>
<p>B. Assume same scenario as Example A.</p>	<p>The financial guarantor has 100% of the consent rights for any action that would modify or compromise the rights of the note holders in the VIE that is initiated by a third party servicer.</p>	<p>In an event of default of the notes, the financial guarantor has the unilateral right to declare acceleration of the notes (effectively terminating any reinvestment period).</p>	<p><u>Non-contingent rights</u> – although consent rights are not shared, the guarantor does not have the power to initiate or unilaterally direct matters of the VIE.</p> <p><u>Contingent rights</u> - The guarantor's unilateral (controlling) rights to declare acceleration allow the financial guarantor to alter the potential cash flows or economic performance of the VIE during the reinvestment period.</p>
<p>C. Assume the same scenario as in Example A, except that the collateral is a static pool of residential mortgages without any reinvestment period.</p>	<p>The financial guarantor has 100% of the consent rights for any action that would modify or compromise the rights of the note holders in the VIE that is initiated by a third party servicer.</p>	<p>In an event of default of the notes, the financial guarantor has the unilateral right to declare acceleration of the notes.</p>	<p><u>Non-contingent rights</u> – although consent rights are not shared, the guarantor does not have the power to initiate or unilaterally direct matters of the VIE.</p> <p><u>Contingent rights</u> The financial guarantor has the unilateral (controlling) right to accelerate the payment of the notes. However, the total cash flows provided by the collateral would not change as a result of the financial guarantor exercising the acceleration right and would not affect the financial guarantor's risk exposure or other variable interest holders' economic exposure (if any, i.e. subordinated tranches).</p>

Question 5: This proposed Statement retains the quantitative analysis for situations in which an enterprise cannot determine whether it is the primary beneficiary through the qualitative analysis in paragraph 14A of Interpretation 46(R), as amended by this proposed Statement. In Appendix A, each example either identifies a primary beneficiary or concludes that no primary beneficiary exists through a qualitative analysis. The Board may consider removing the quantitative analysis for determining whether an enterprise is the primary beneficiary of a variable interest entity. Do you believe that the quantitative analysis is necessary based on the proposed amended guidance for determining the primary beneficiary? Do you believe that the quantitative analysis would be performed in many situations? Why or why not?

As we are moving toward a more principles-based approach in our accounting model with an emphasis on international convergence, keeping the quantitative analysis within this consolidation framework would defeat that purpose. We believe the qualitative analysis alone would serve the purpose of identifying the primary beneficiary in practice. We believe including the quantitative analysis will lead to its overuse as a fallback evaluation in less plain-vanilla transactions and is likely to lead to unnecessary confusion and potential conflict between preparers and their auditors. Therefore, we support the FASB's qualitative approach under proposed paragraphs 14A and 14B and request that FASB eliminate the quantitative analysis in paragraph 14C.

Question 9: Should the elements of a consolidated variable interest entity be required or permitted to be classified separately from other elements in an enterprise's financial statements?

Yes. We believe the existing accounting model for financial guarantees is more reflective of the economics of the financial guarantor's involvement in the VIE and more transparent as discussed in our response to Question 1. However, to the extent the Board approves the Exposure Draft in its current form we would support allowing preparers to separately classify the elements of a consolidated variable interest entity, which would clearly indicate which assets are segregated to support which liabilities. Furthermore, we believe that a serious consideration of the linked presentation model by the Board would be worthwhile.