Who’s Holding the Bag?

May 2007

Pershing Square Capital Management, L.P.

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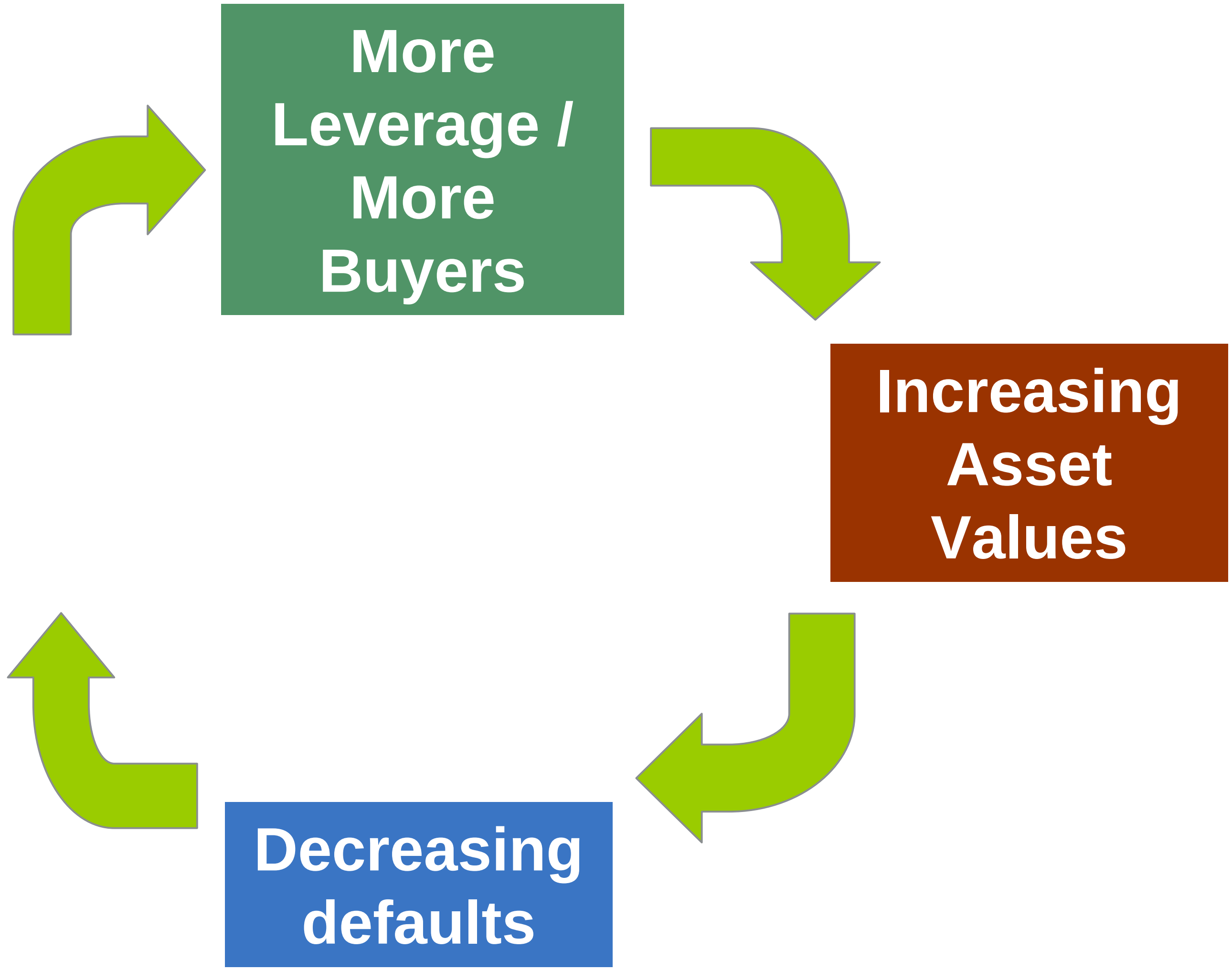
Agenda

- **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?

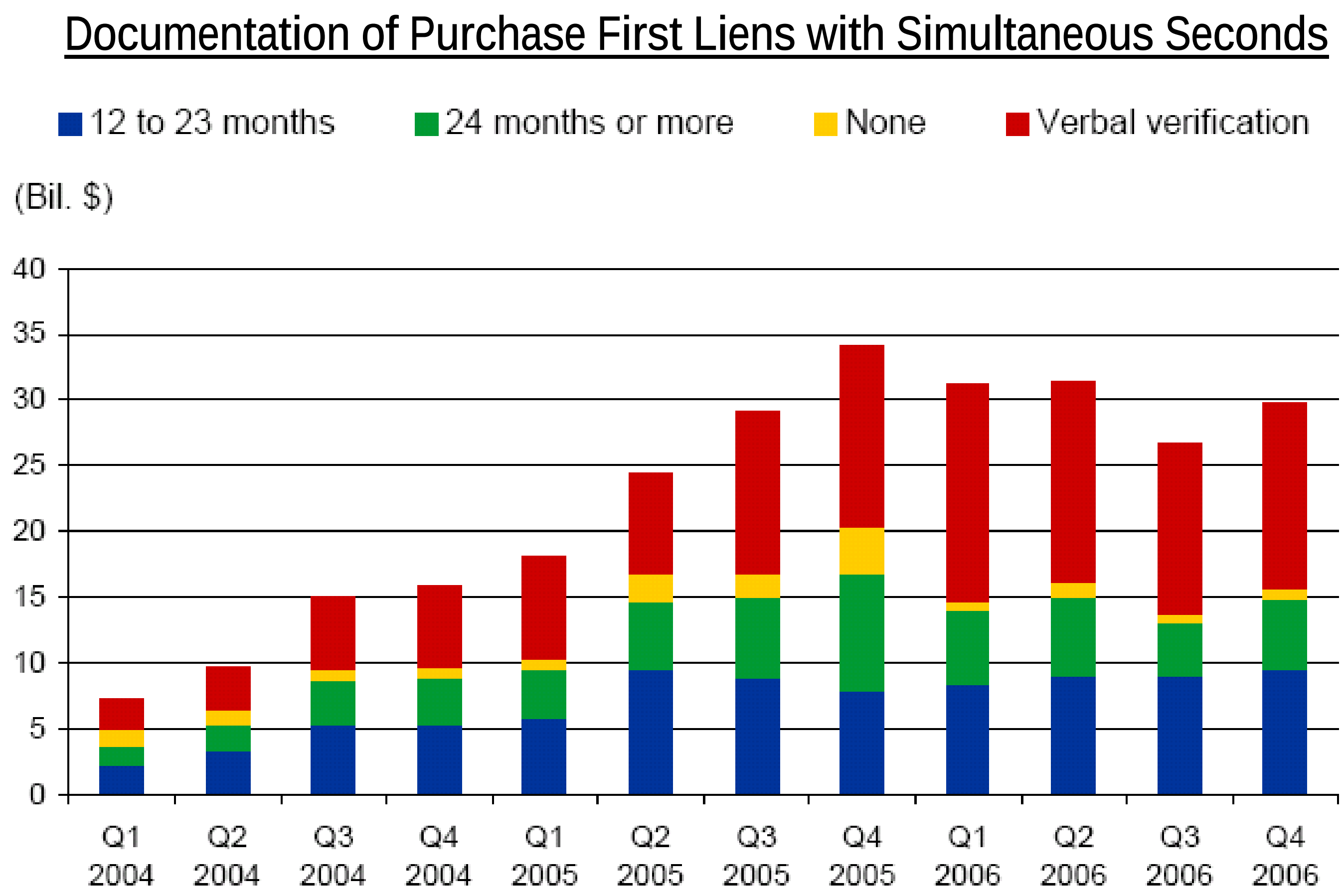
Freely Available Credit

- ✓ Relaxed lending standards
- ✓ Financial "innovation"
- ✓ CDO Demand



Sub-Prime: Relaxed Lending Standards

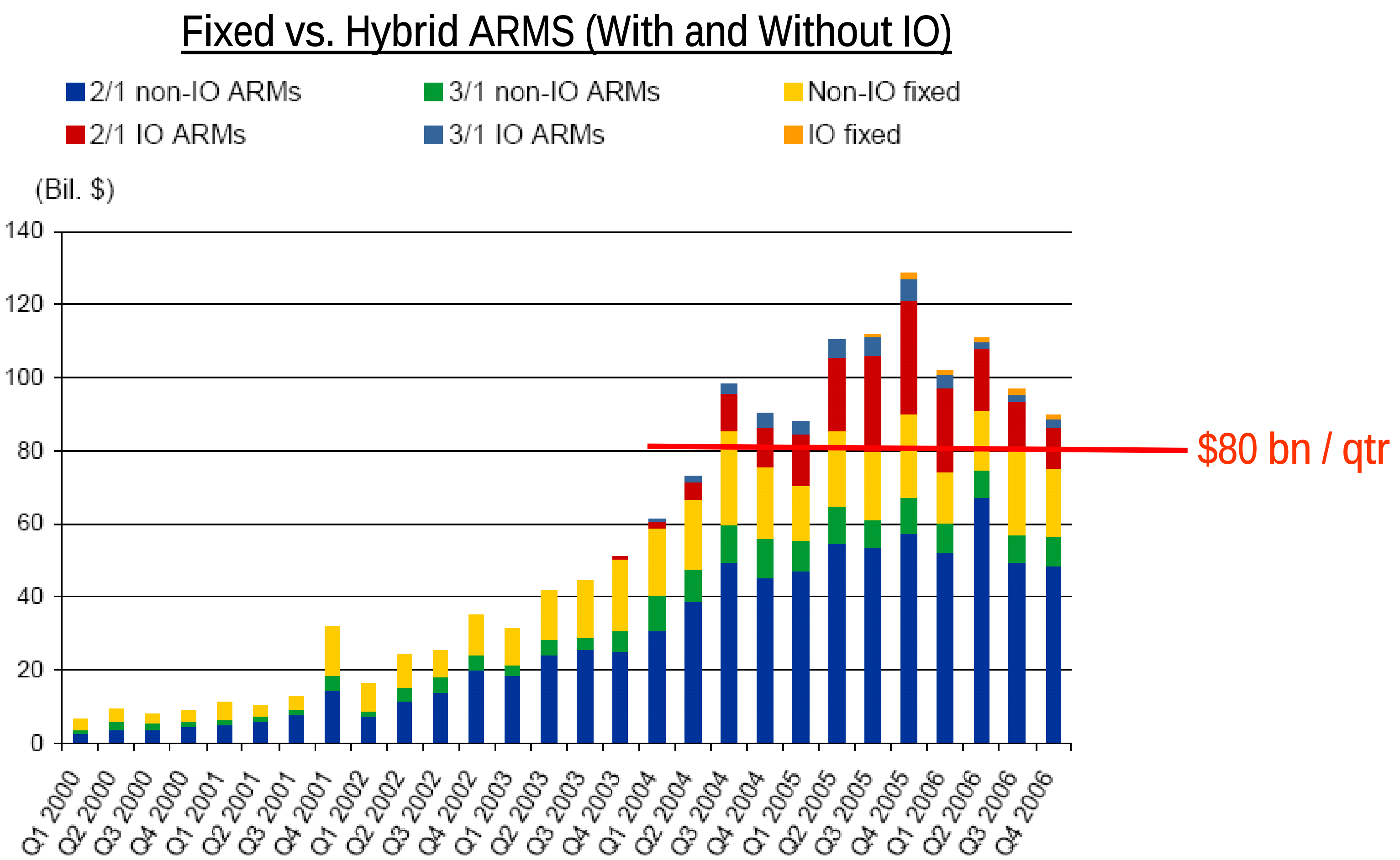
Growth in higher-LTV loans fueled by lower verification standards



Source: Standard & Poor's

Sub-Prime: Financial "Innovation"

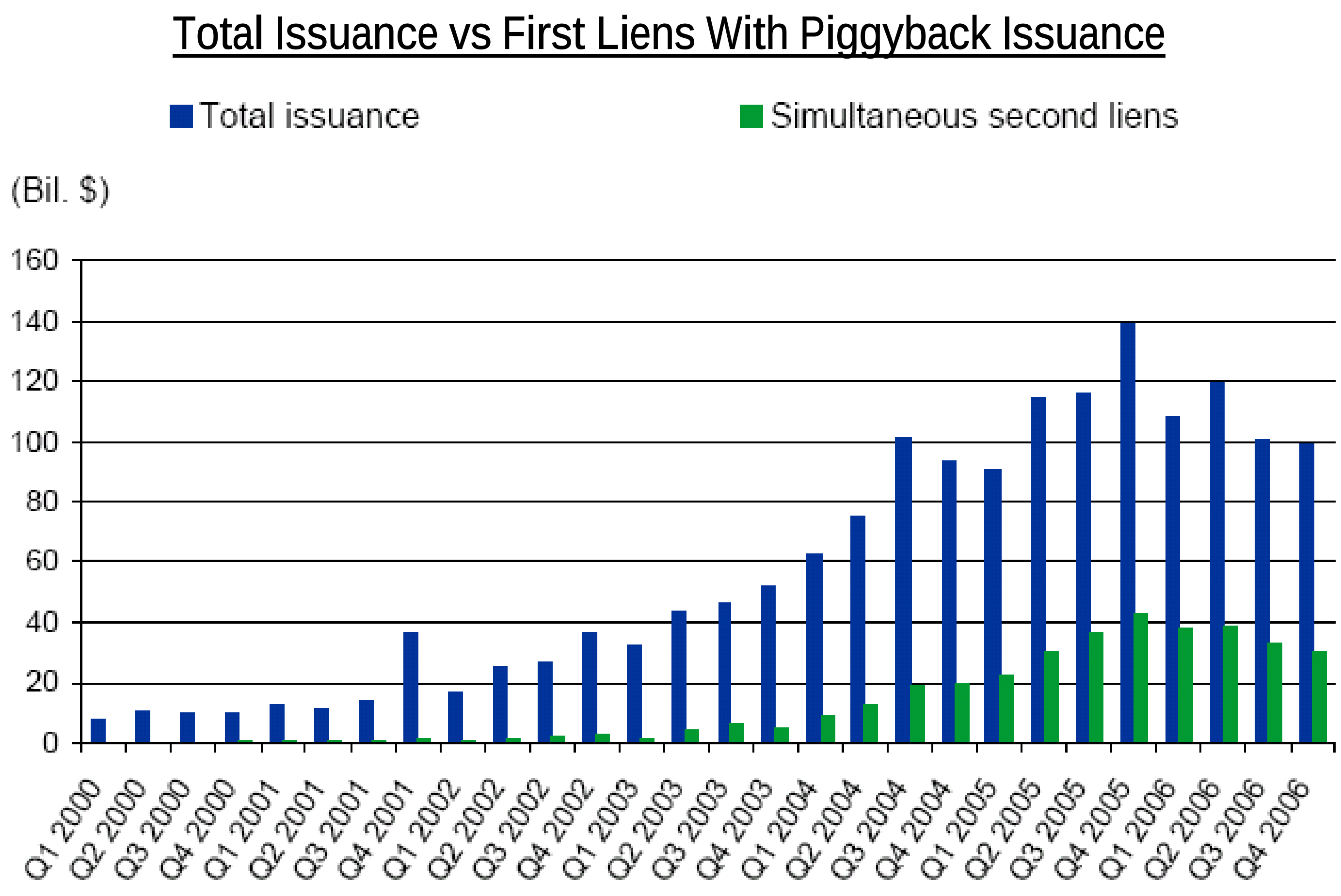
Interest-only products driving growth over last 3 years



Source: Standard & Poor's

Sub-Prime: More Leverage and More Buyers

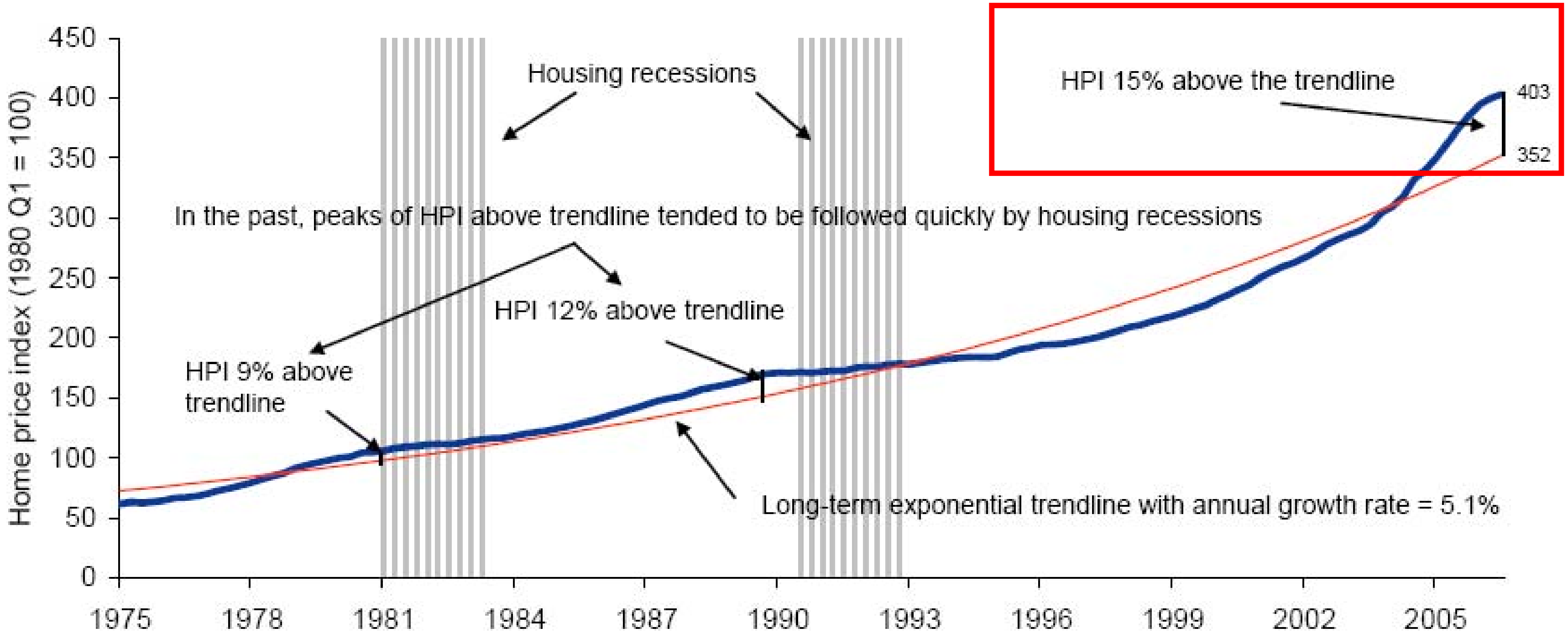
Second liens have grown as % of total issuance



Source: Standard & Poor's

Increasing Asset Values

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

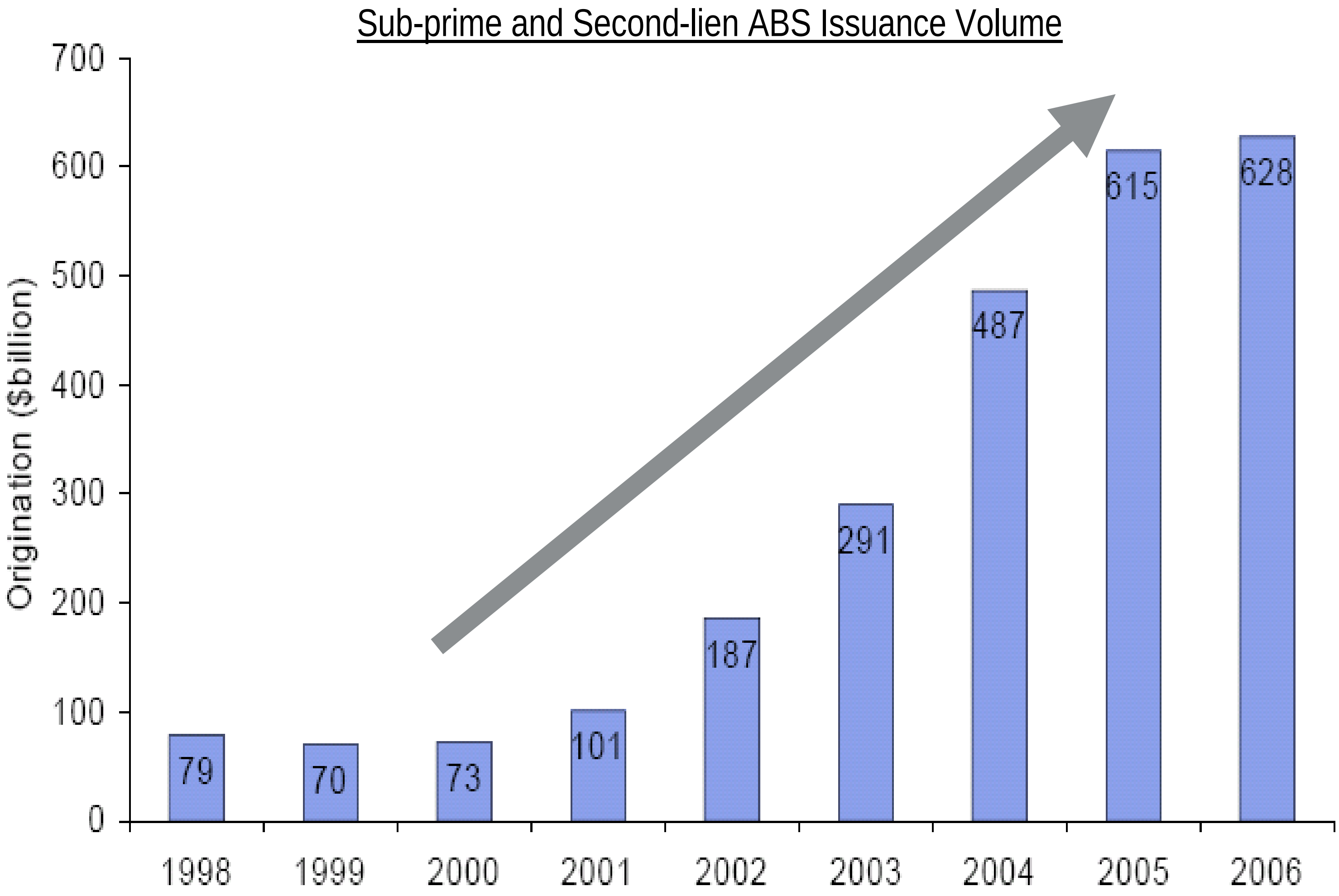


Source: Office of Federal Housing Enterprise and Oversight, Deutsche Bank

Data as of end of Third Quarter 2006

Who is Buying These Mortgages?

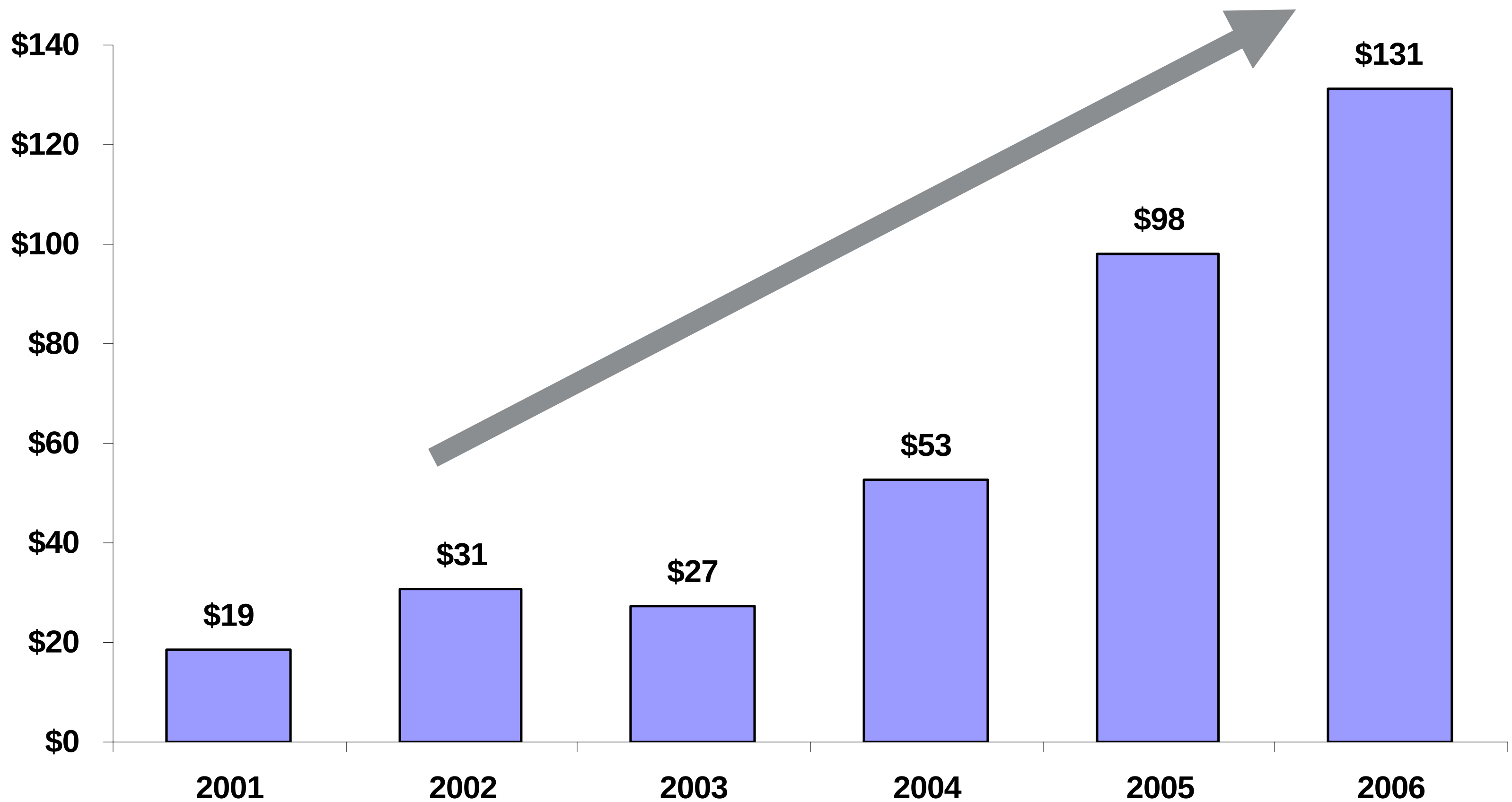
ABS Market Providing Liquidity for Originators



Source: Thompson Financial, Deutsche Bank

ABS Fueled by CDOs

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



% of total CDO Issuance	23%	40%	33%	43%	52%	49%

Source: Bear Stearns

How Does a Securitization work?

ABS Collateral Pool	
Mortgage Loan #	5000
Average Loan Size	200,000
CLTV	85%
California Loan	30%
FICO	620
DTI	40%
Interest Only	20%

ABS Capital Structure

Tranche	Thickness	Support
AAA	80%	20%
AA	5%	15%
A	6%	9%
BBB+	2%	7%
BBB	1%	6%
BBB-	1%	5%
BB	1%	4%
O/C (Equity)	4%	0%

Source: Deutsche Bank

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CDO Collateral Pool	
ABS bonds (mostly BBB or BBB-, 5-10% BB)	100 specific credits

CDO Capital Structure

Tranche	Thickness	Support
AAA	80%	20%
AA	10%	10%
BBB	5%	5%
O/C (Equity)	5%	0%

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

	$	%
Dollars invested in BBB / Equity of Mezz CDO	$ 1.0	10.0%
Senior Leverage in CDO	$ 9.0	90.0%
Mezz CDO Assets	$ 10.0	100.0%
BBB / Equity Tranche of ABS Securitization	$ 10.0	9.0%
Senior Leverage in Securitization	$ 101.1	91.0%
Total Collateral Purchased in Securitization	$ 111.1	100.0%
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

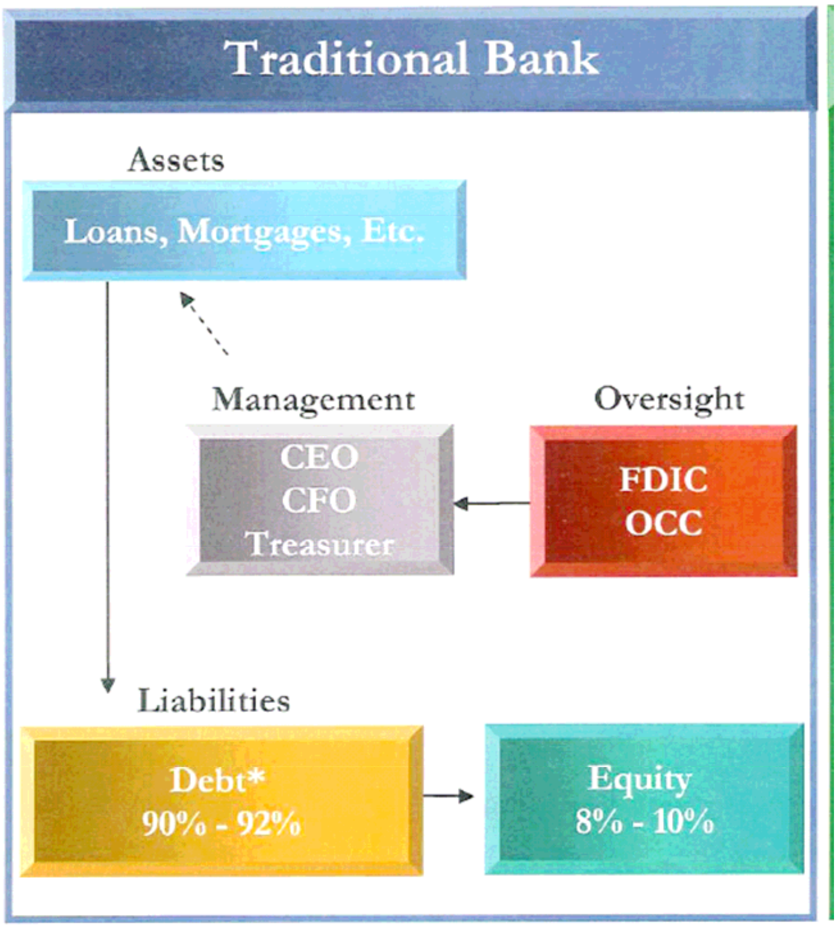
CDO Buyers / Insurers

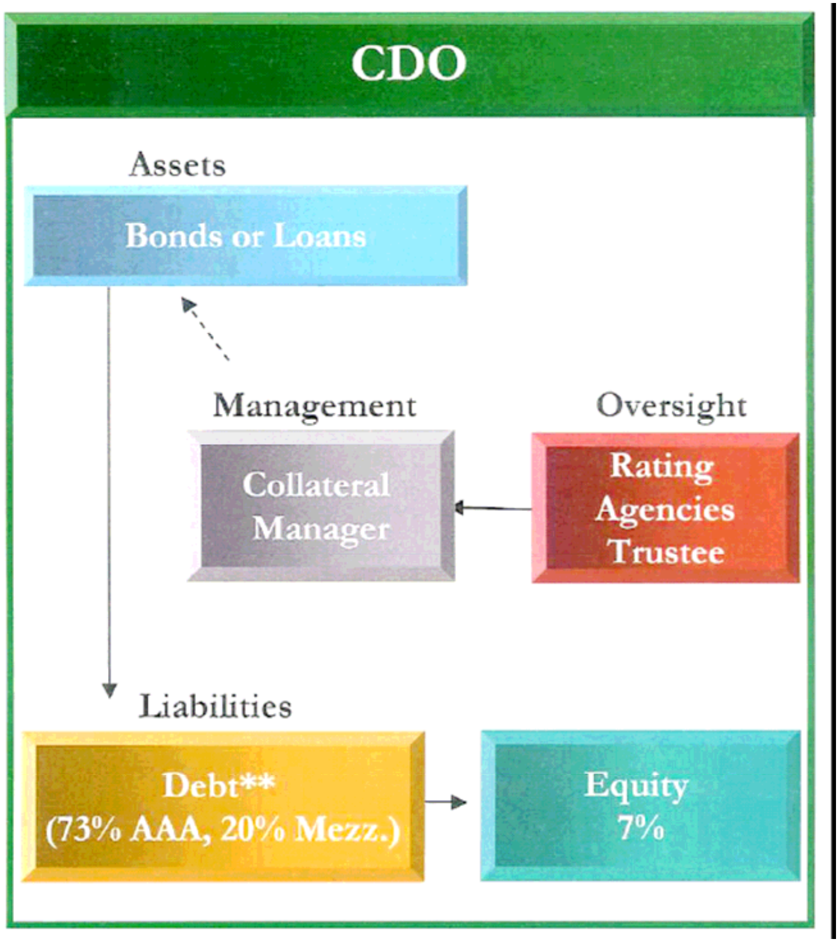
- ✓ Ultimate risk holder relies on ratings; minimal visibility to underlying credit

Mortgage Lending Today: Lend & Securitize

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

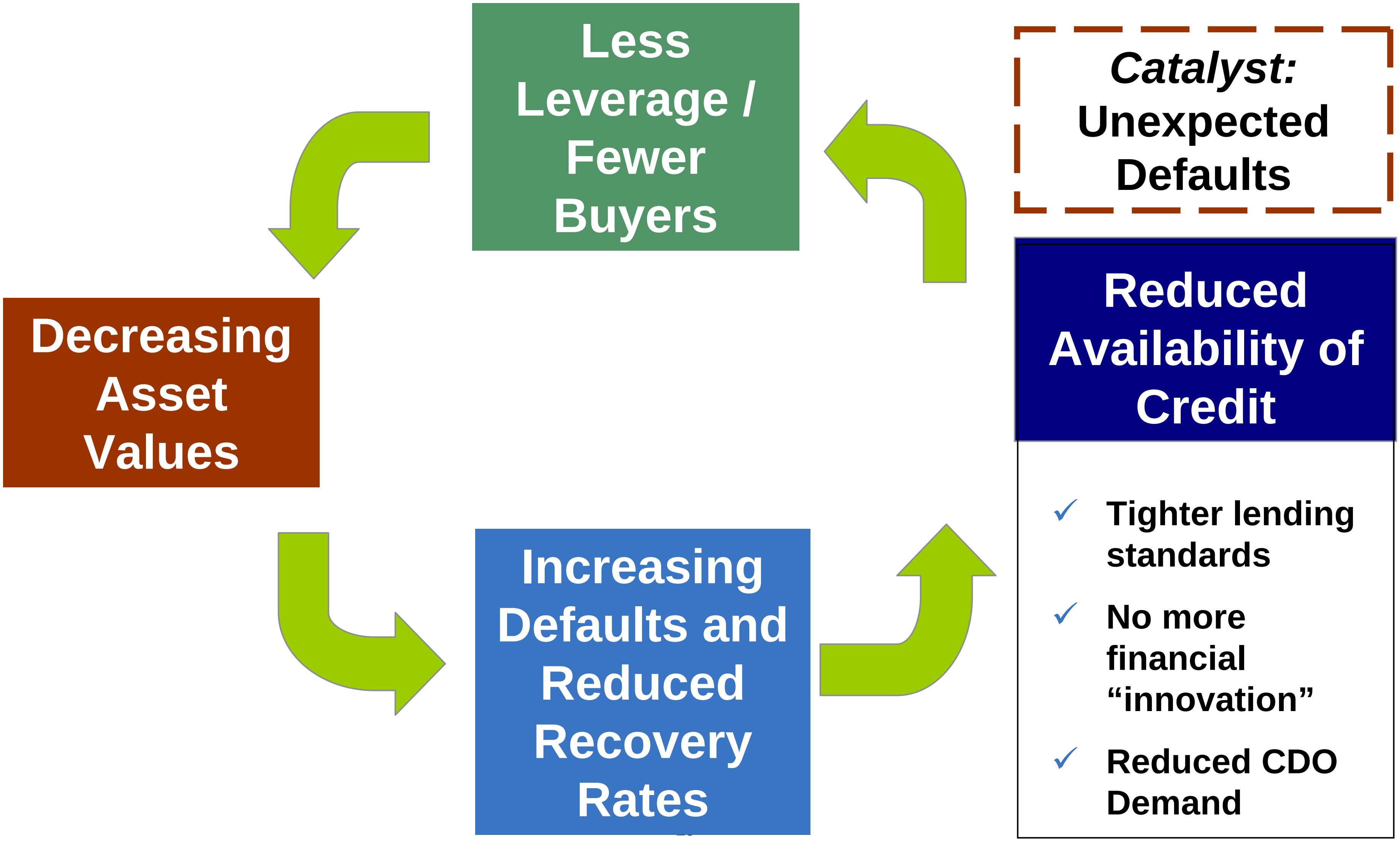
Rating Agencies Claim No Liability for Being Wrong

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?

The Cycle Also Works in Reverse



Already Happening in Sub-Prime

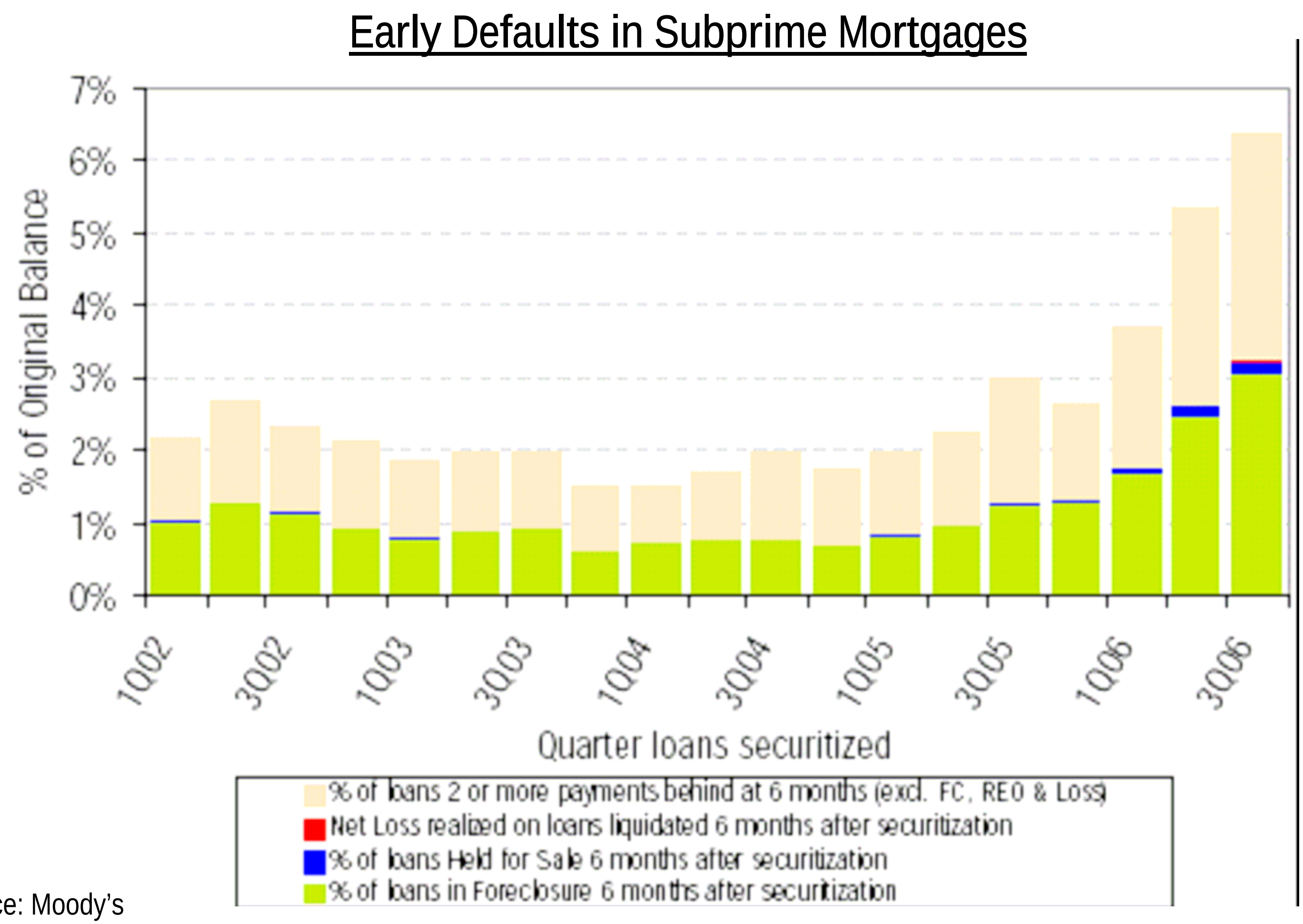
- **Defaults have been higher than rating agency predictions**
- **Rating Agencies have begun to adjust models and downgrade tranches**
  - Tighter standards for securitizations / CDOs
  - Acknowledging likelihood of higher than expected correlation
- **Lack of new ABS CDOs dramatically reduces demand 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

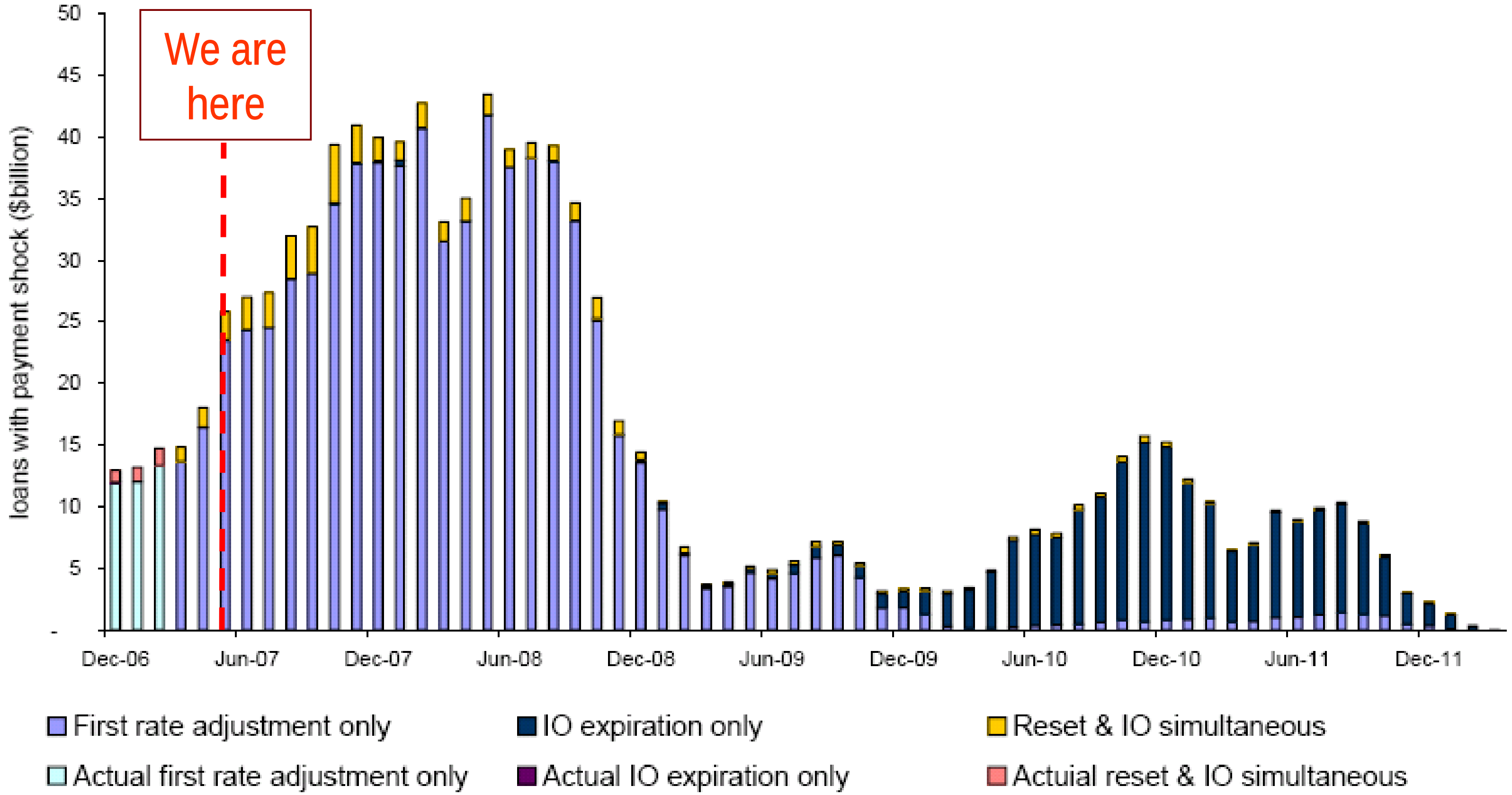
More loans are experiencing early defaults



Source: Moody's

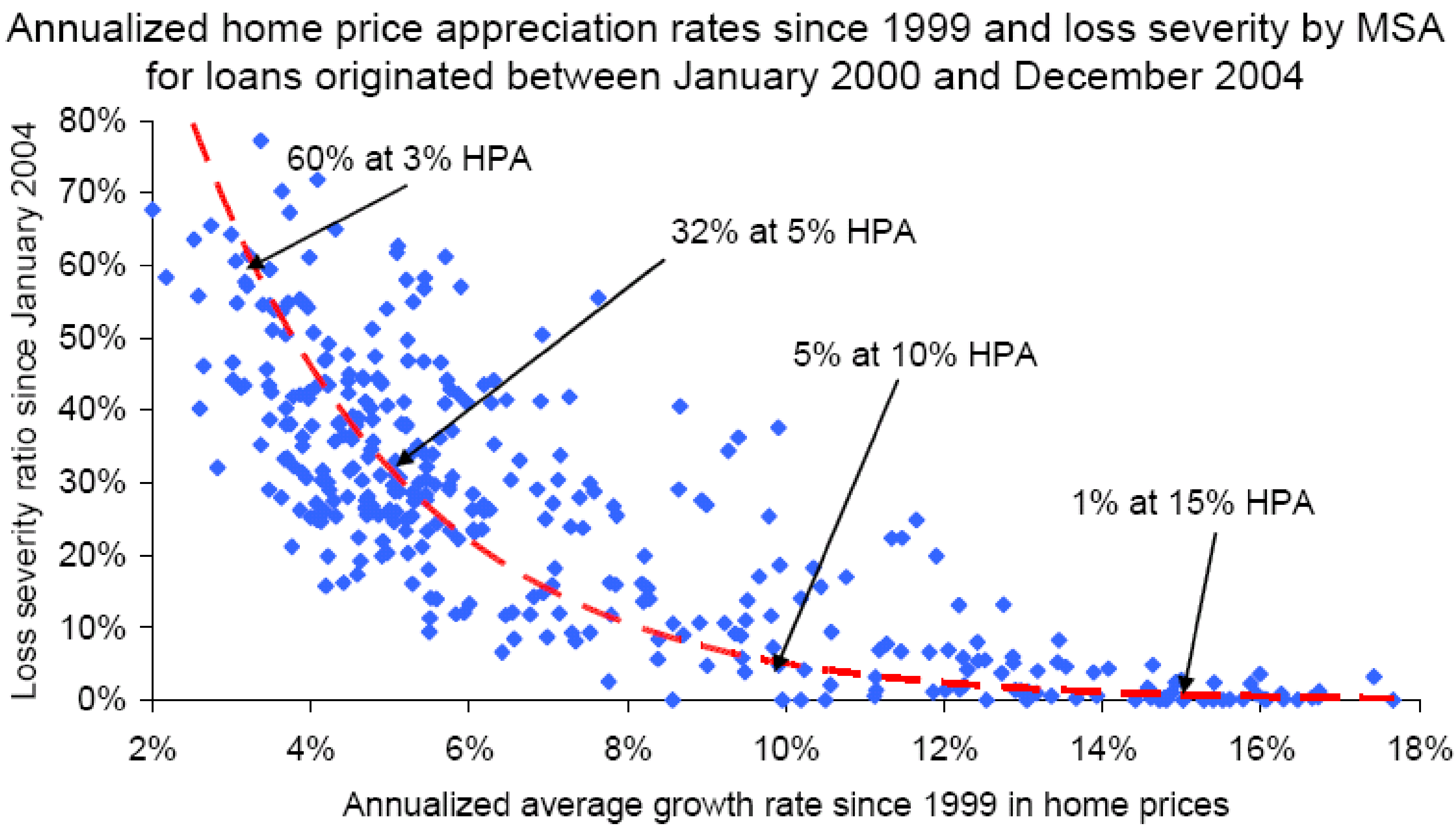
Sub-Prime Fallout: It is Going to Get Worse…

~$800 Billion of sub-prime mortgages to reset



Sources: LoanPerformance, Deutsche Bank

Higher Losses due to Lower Home Appreciation



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

Sub-Prime	LBOs
Higher LTVs	Higher Debt / EBITDA
I/O, Negative amortizing loans	Covenant lite & PIK toggle notes
Cash-out Re-fi	Dividend Re-Cap
“Liar” loans, limited documentation	Credit for “pro forma” cost savings
0% down	Lenders providing equity bridges
Home Appreciation	Purchase multiple expansion

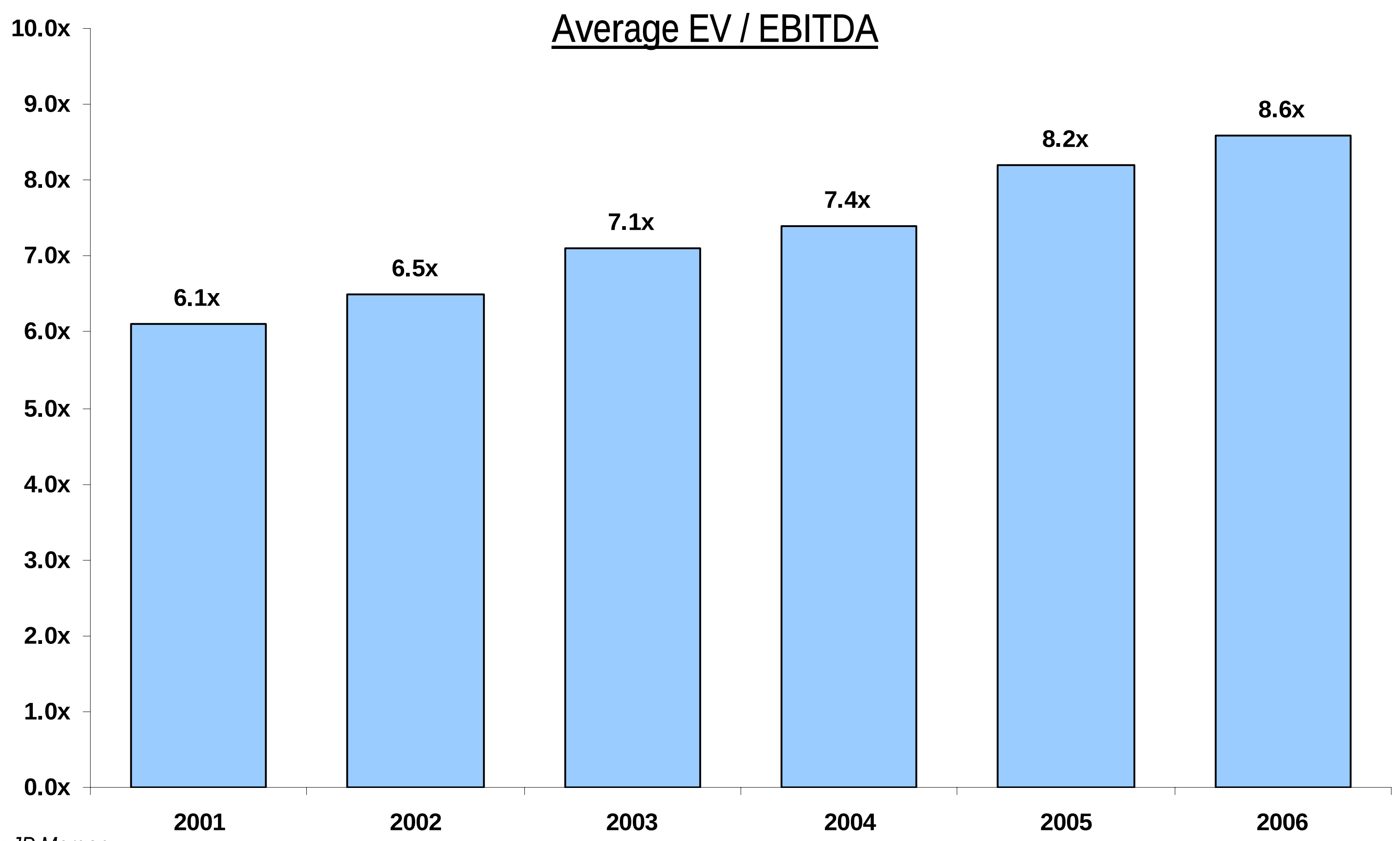
Buyout Leverage: Mirroring Sub-Prime Trends

Record buyout activity…

Source: JP Morgan

Buyout Leverage: Mirroring Sub-Prime Trends

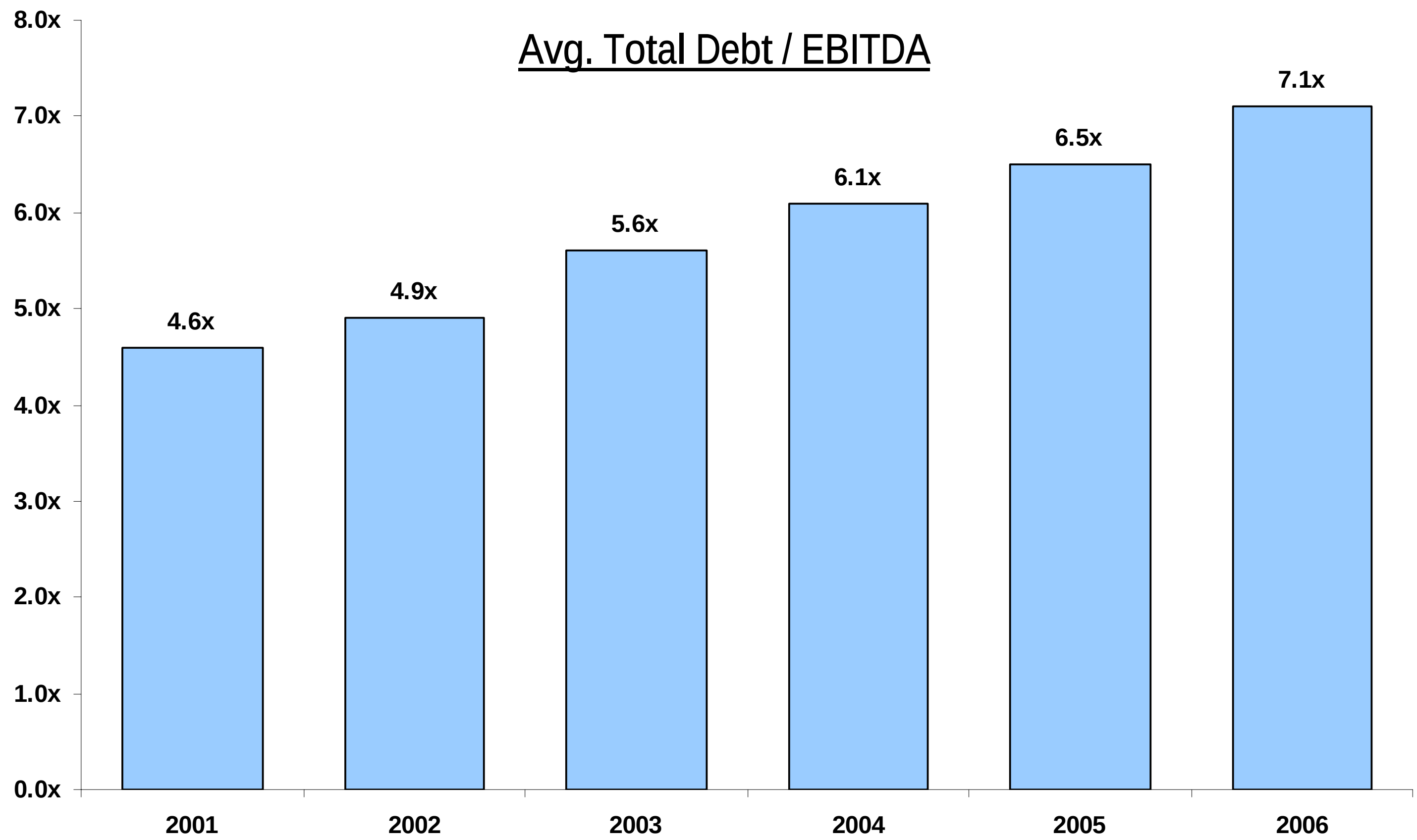
…at higher purchase multiples…



Source: JP Morgan

Buyout Leverage: Mirroring Sub-Prime Trends

…driven by more leverage….

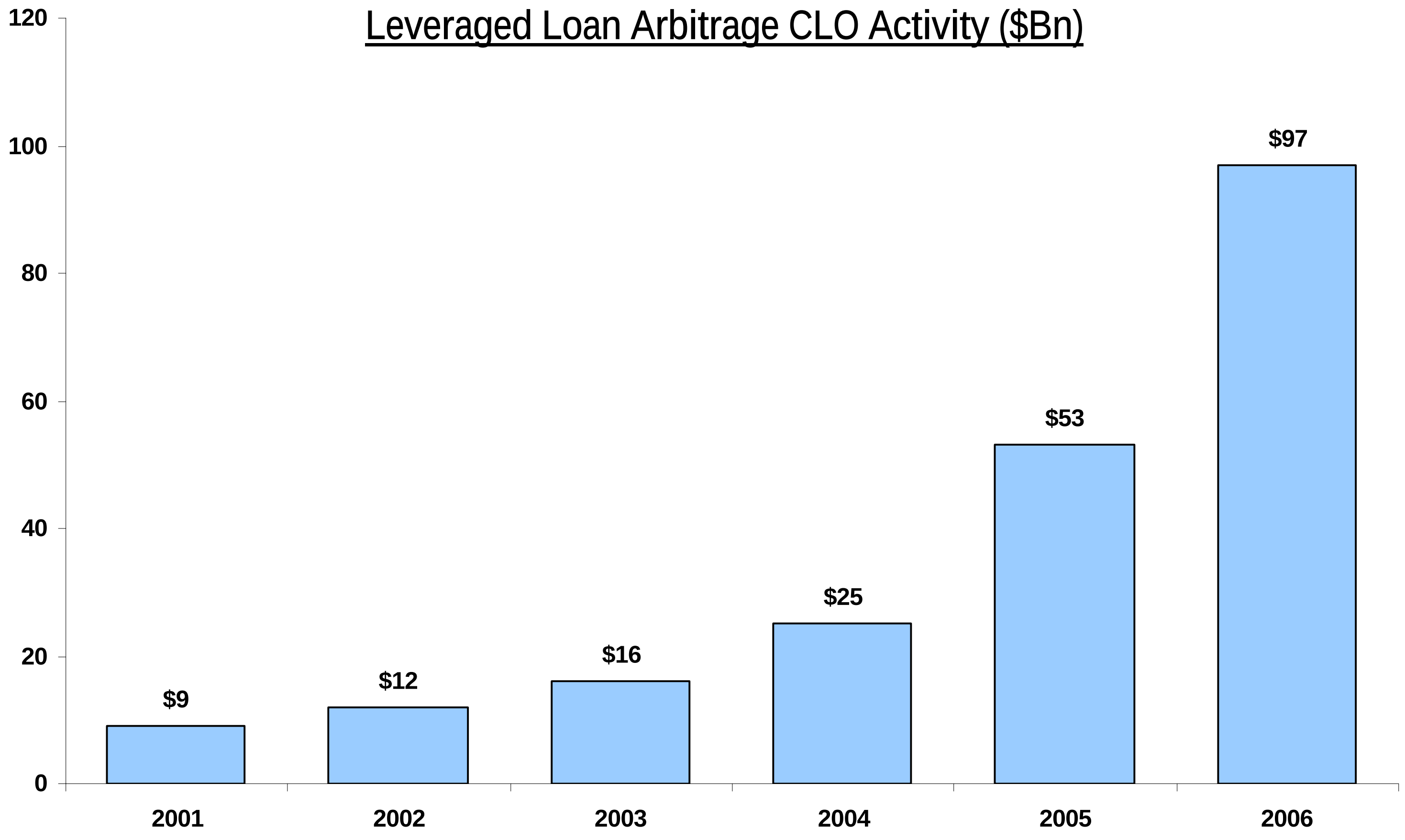


Source: JP Morgan

Note: Represents top 20% of levered loans by Debt / EBITDA

Buyout Leverage: Mirroring Sub-Prime Trends

…supported by growth in CLOs



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

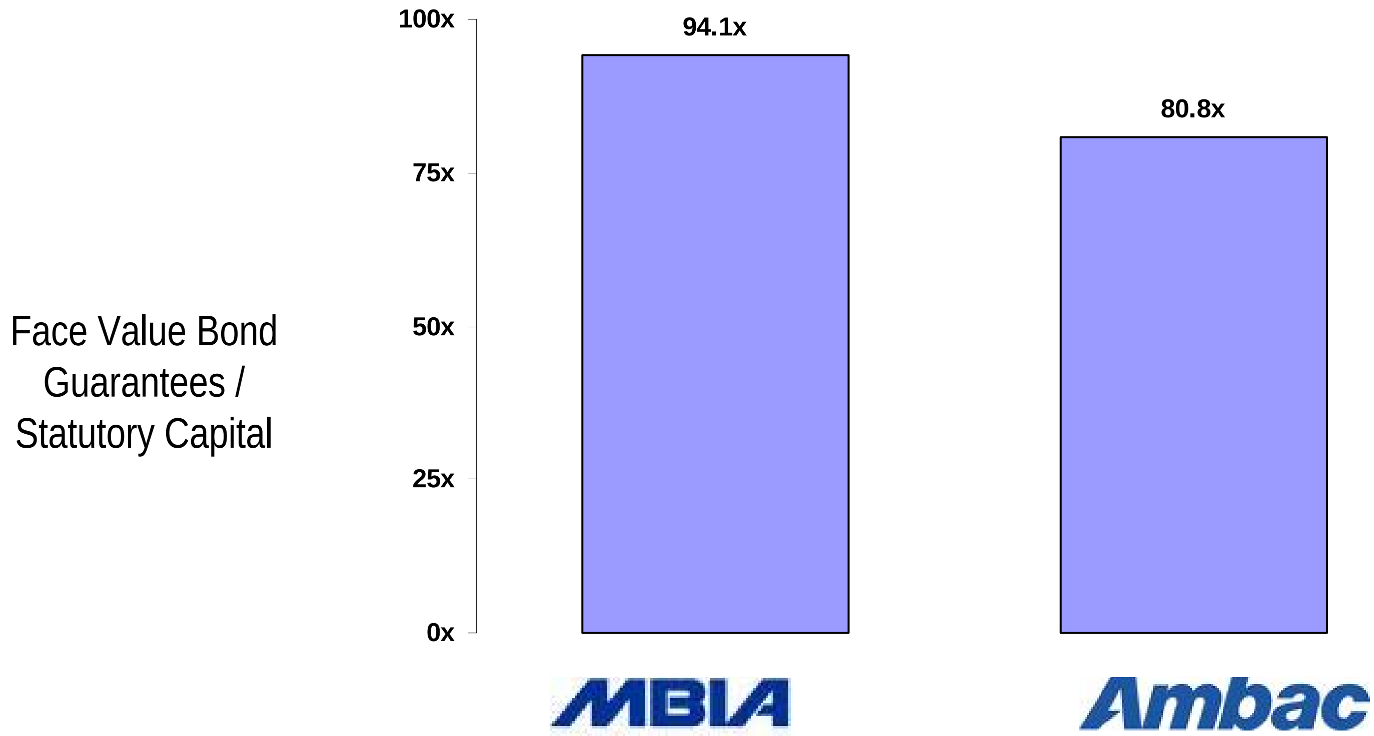
Who's Holding the Bag?

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



Reserves / Guarantees	3.15 bps	3.93 bps

Ambac is exposed to Sub-Prime Losses

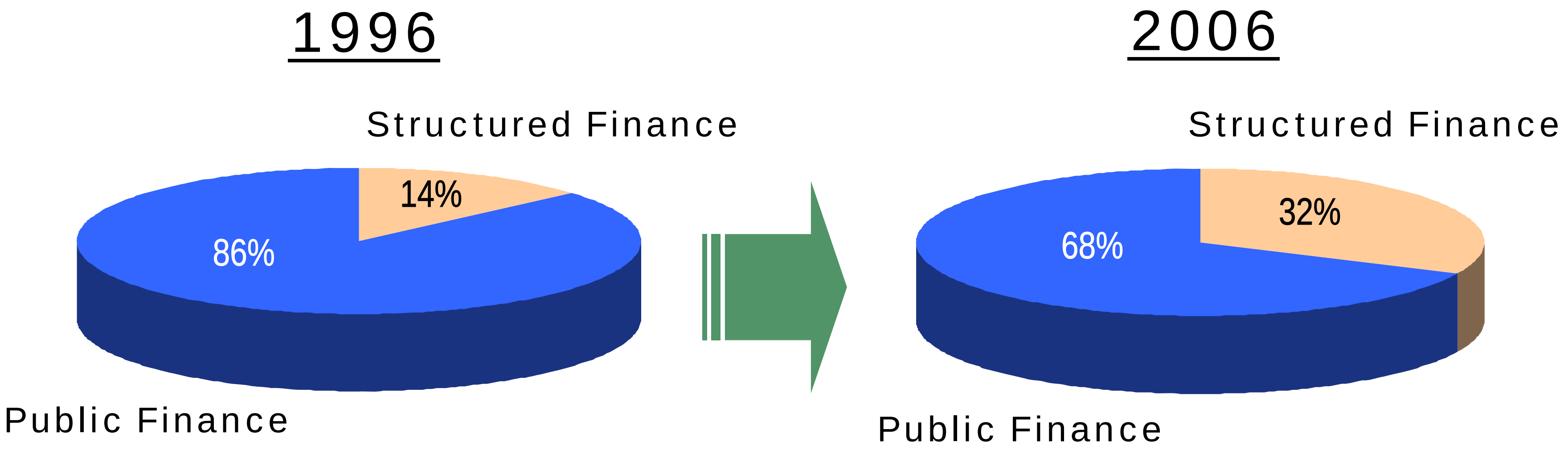
Ambac's exposure to Sub-Prime mortgages, both direct and through CDO's, is significant relative to book value and reserves

ABK Sub-Prime Exposure
($ billion)

	$	% of Stat. Capital
Total Sub-Prime Exposure	$ 18.7	284.4%
Direct Sub-Prime Rated BBB	4.3	64.7%
Direct Sub-Prime Below-Investment-Grade	0.8	12.0%
Sub-Prime in High-Grade CDO's	7.8	118.7%
Sub-Prime in Mezz CDO's	1.0	14.9%

Growing Structured Finance Exposure

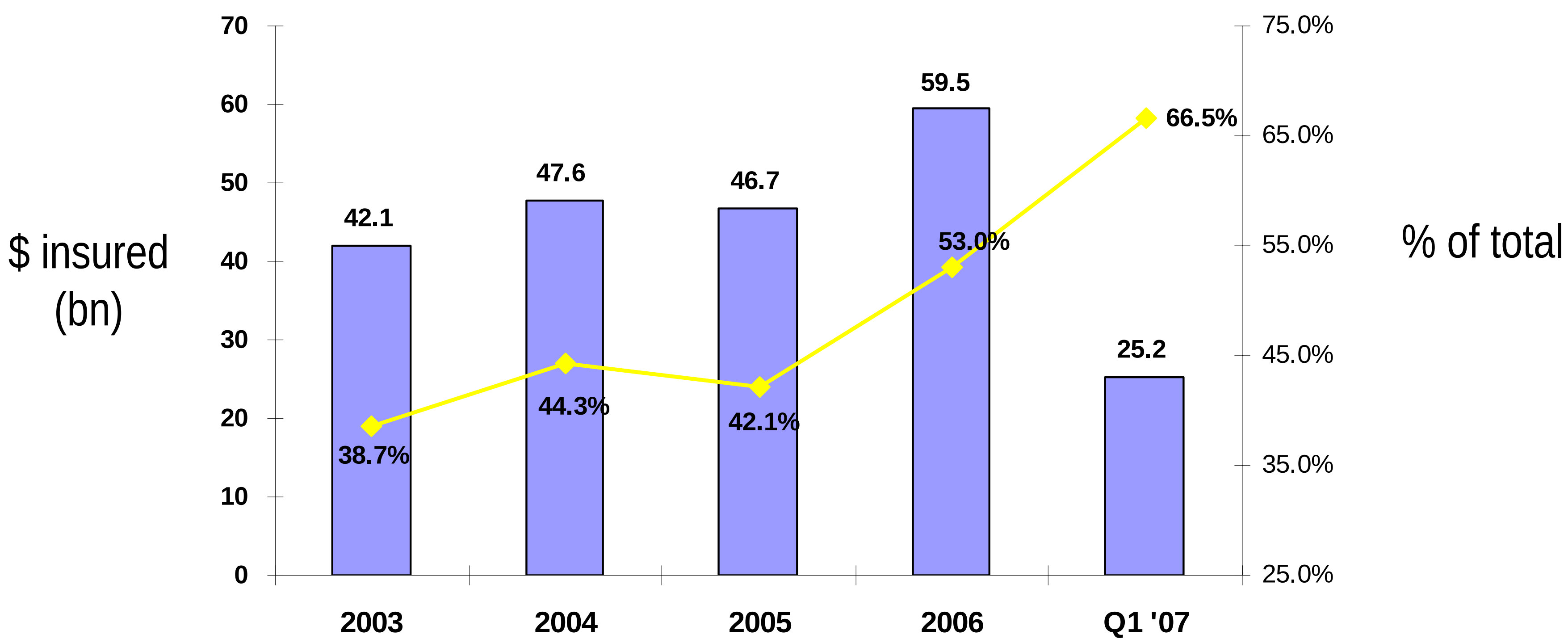
MBIA Structured Finance Guarantees as a % of total Guarantees have more than doubled over the past 10 Years



Growing Structured Finance Exposure

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

MBIA: Net Par Insured



MBIA Compared to Citigroup

	MBIA	citigroup
Credit Rating	Aaa, AAA	Aaa, AA+
Regulator	NYS Insurance Dept	Federal Reserve, OCC, FDIC
Leverage	94:1 (Net Par / Capital)	12:1 (Risk Adj. Assets / Tier 1 Capital)
Credit Exposure	$635 billion	$1,107 billion
Capital	$6.8 billion	$127.0 billion
Reserves / Credit Exposure	3 bps	96 bps

Minimal Losses Will Impair MBIA's Capital Base

Total Guaranteed Portfolio	$635.2	Billion
Public Finance	421.8	
Structured Finance	$ 213.4	Billion
CDO Exposure	108.6	
Mortgage Exposure	52.0	
Other ABS Exposure	26.9	
Direct and Pooled Corporate Exposure	25.9	
Total Structured Finance Exposure	$ 213.4	Billion

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

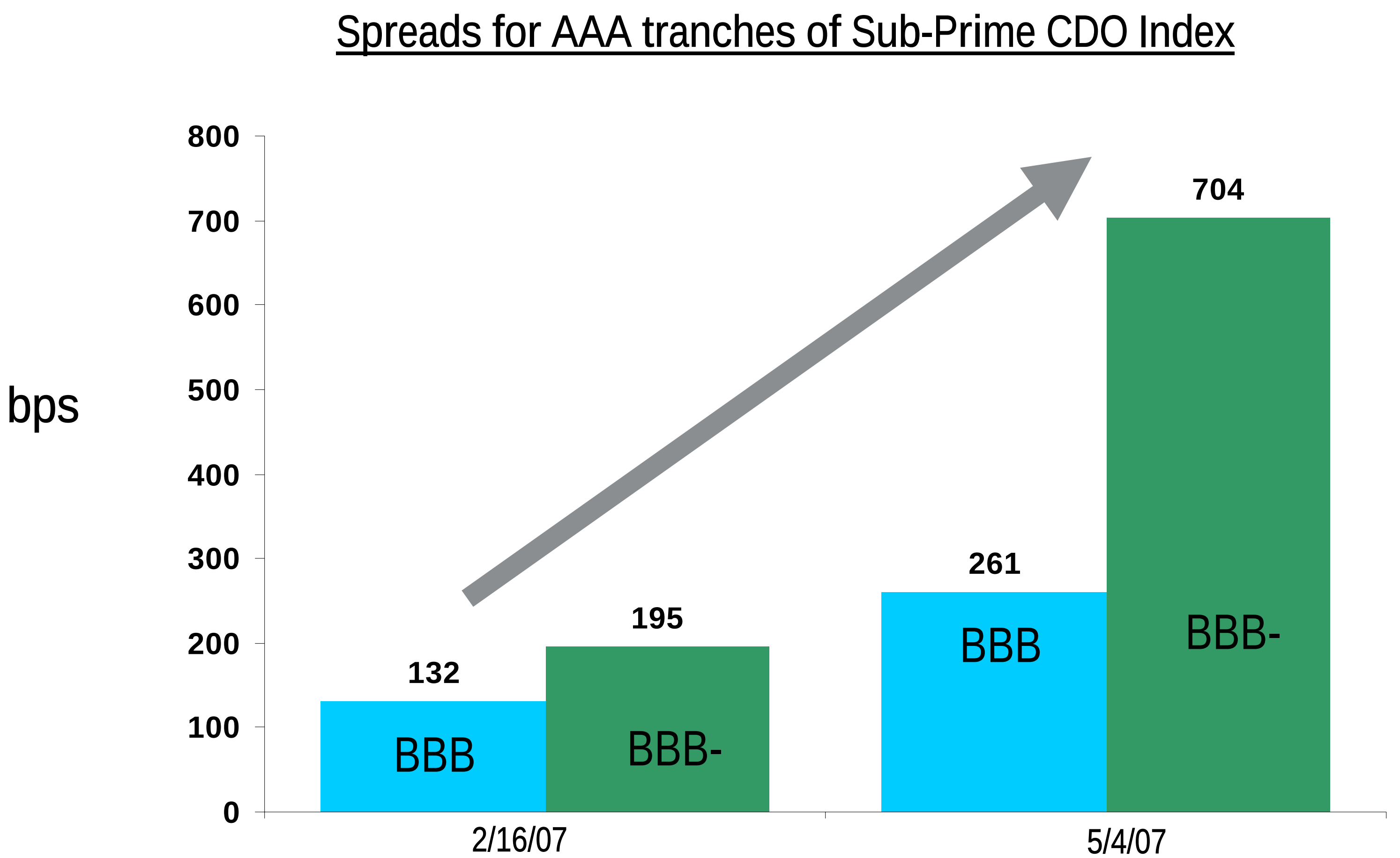
CDO Exposure (Net of Reinsurance):

Collateral Type	Net Par Outstanding
Investment Grade	$ 50.7
High Yield	12.2
Multi-Sector	22.7
CMBS	23.0
Emerging Market	0.2
Total	$ 108.8

$ 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



Source: Morgan Stanley

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

MBIA: "Excess" Capital?

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

High-Risk Credit Exposures: ($ billion)	$	Excess Capital as %
Direct and Indirect Sub-Prime Exposure	$ 7.8	6.4%
Below-Investment-Grade Exposure	11.9	4.2%
Mezzanine CDO Exposure (12/31)	5.0	10.0%
High-Risk Credit Exposure	**$ 24.7**	**2.0%**
Remaining Exposure to Other Guarantees	$ 610.6	

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

			Eliminates "Excess" Capital (bps)	Eliminates All Capital (bps)
CDO Exposure	**$108.8**	**Billion**	**9**	**125**
Est. "Excess" Capital over AAA	$ 0.5	Billion		
Total Statutory Capital Base	$ 6.8	Billion		

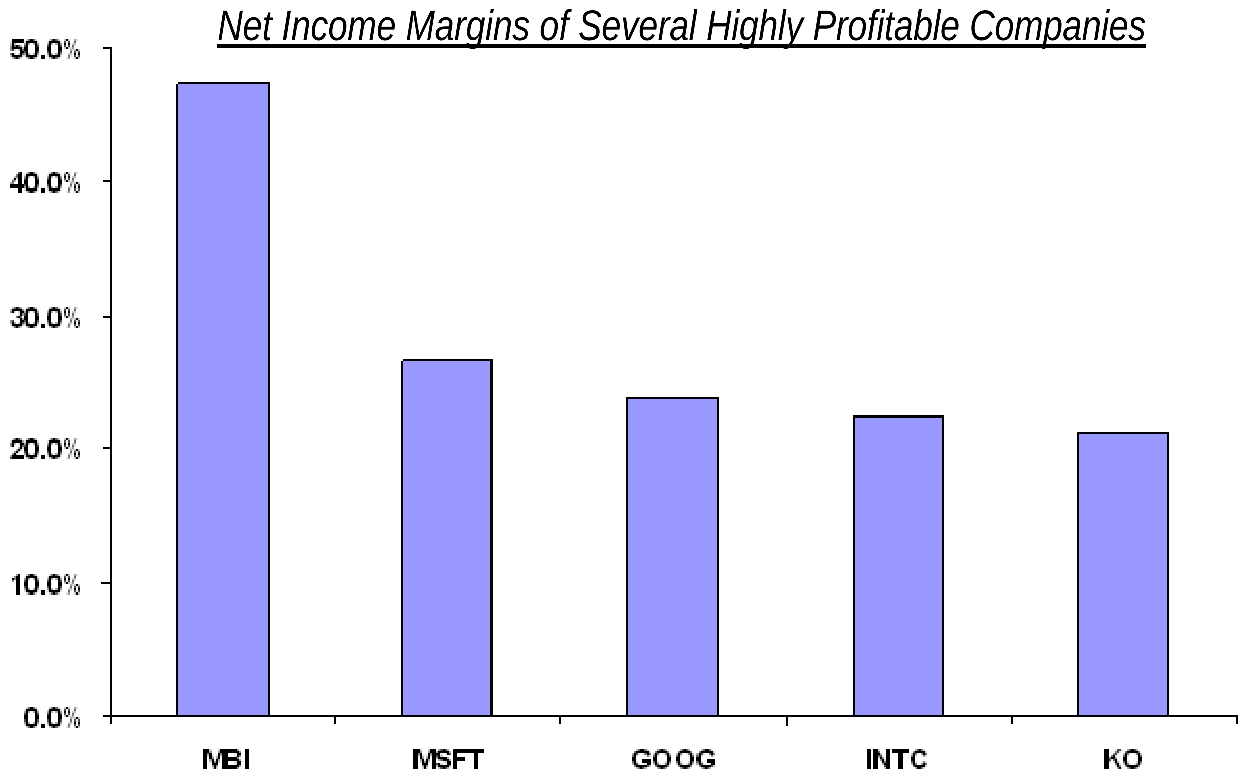
Note: Assumes 5-yr avg. life of credit protection

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

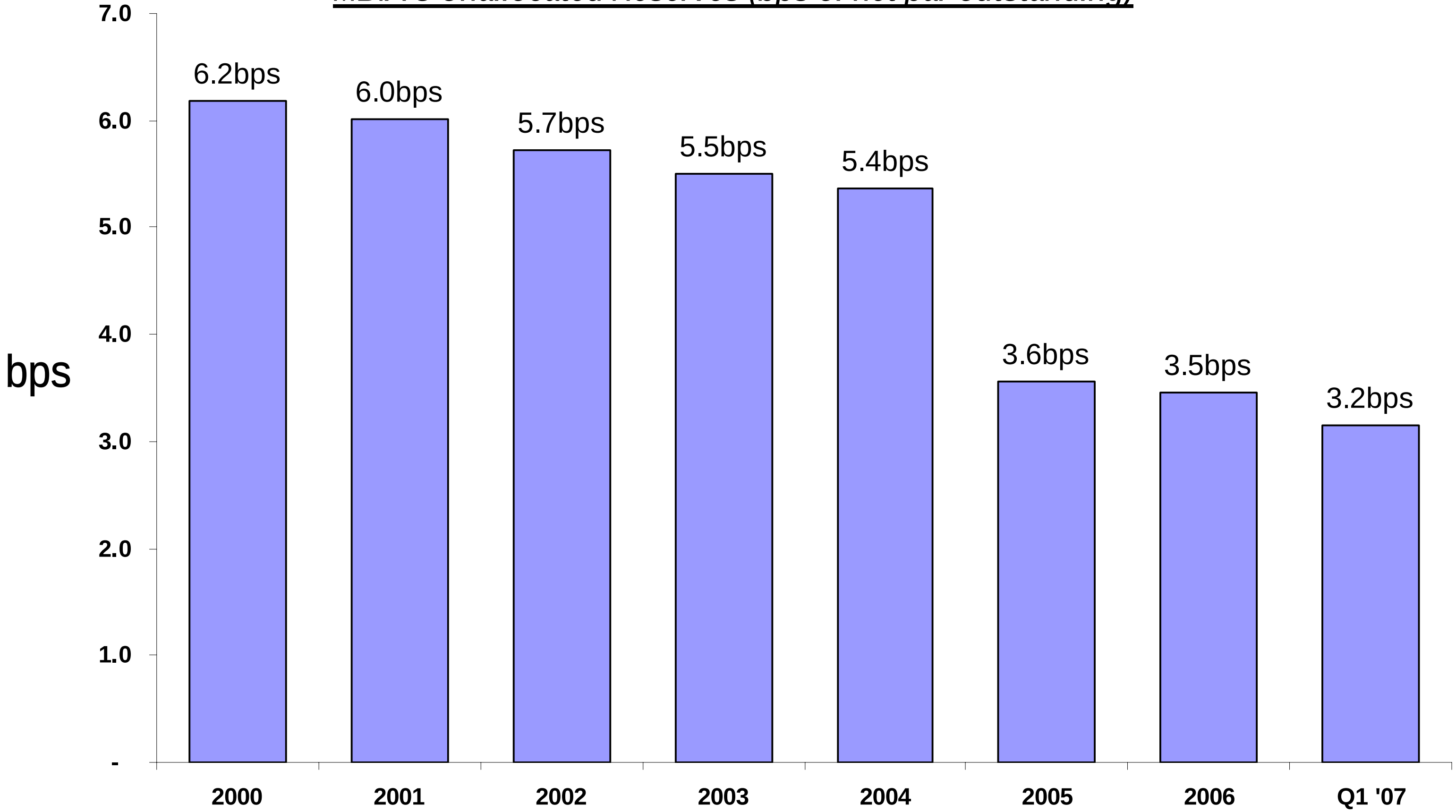


Source: Company reports, Pershing estimates (MBI adjusted for one-time expenses).

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 Unallocated Reserves (bps of net par outstanding)



Accelerated Revenue Recognition

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

MBIA Current Methodology vs. FASB Approach

Example 1: **5-year $500mm, 5% coupon debt issuance, amortizing 20% annually.**

	Allocation of Premium by Year				
	Year 1	Year 2	Year 3	Year 4	Year 5
Premium Revenue Recognized as % of Total					
Proposed Methology	21.7%	20.9%	20.0%	19.1%	18.3%
Current Methodology	45.7%	25.7%	15.7%	9.0%	4.0%
Difference	**-23.9%**	**-4.8%**	**4.3%**	**10.1%**	**14.3%**

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**

Moody’s Interpretation of FASB Change

“…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

Moving the Goal Post

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

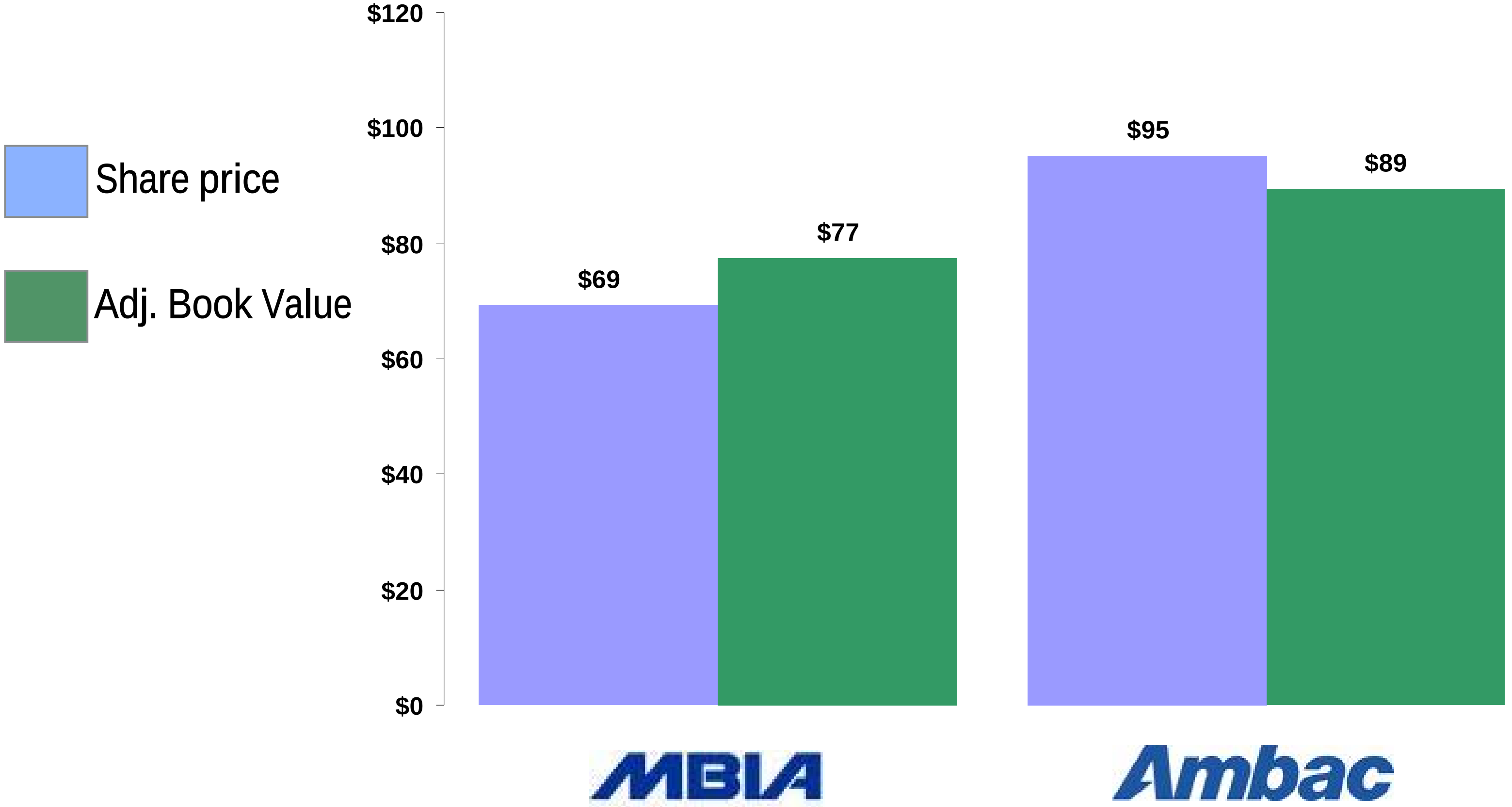
- **Current CEO of MBIA supervised failed investment in tax lien business and subsequent scheme to hide losses**
- **Executives appear to have made false and misleading statements to analysts and investors**

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**