Ambac

FINANCIAL PEACE OF MIND

1999 Annual Report

For safety, security and success make sure your deal is

Ambac Financial Group, Inc., headquartered in New York City, is a holding company whose affiliates provide financial guarantees and financial services to clients in both the public and private sectors around the world. The principal operating subsidiary, Ambac Assurance Corporation, a leading provider of financial guarantees for municipal and structured finance obligations, has been assigned triple-A ratings, the highest ratings available from Moody's Investors Services, Inc., Standard & Poor's Ratings Group, Fitch IBCA, Inc. and Japan Ratings and Investment Information, Inc. Ambac Assurance founded the municipal bond insurance industry in 1971 and continues to be an industry leader in innovation and client service. Ambac Financial Group, Inc., through its affiliates, also provides investment agreements, interest rate swaps and investment advisory and cash management services primarily to states, municipalities and municipal authorities. Ambac Financial Group, Inc. common stock is listed on the New York Stock Exchange (ticker symbol ABK).

In this Annual Report, we may make statements about our future results that are considered "forward-looking statements" under the Private Securities Litigation Reform Act of 1995. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report for further information regarding forward-looking statements, including factors that could cause materially different results.

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Ambac At a Glance

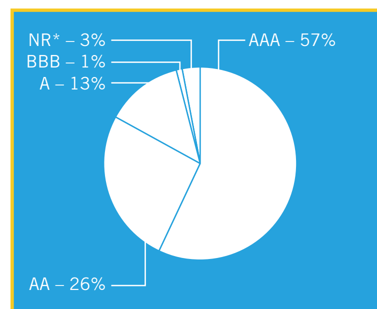
With its triple-A guarantee, Ambac helps public and private sector issuers around the world:

- Build and improve INFRASTRUCTURE AND EDUCATION facilities
- Finance HOSPITALS and healthcare entities
- Fund public and investor-owned UTILITIES
- Strengthen MORTGAGE AND HOME EQUITY LOAN-BACKED SECURITIES offerings
- Bolster complex STRUCTURED AND ASSET-BACKED SECURITIES
- Use financial resources more efficiently through municipal INVESTMENT AGREEMENTS and municipal INTEREST RATE SWAPS

TOTAL CLAIMS-PAYING RESOURCES*
(DOLLARS IN MILLIONS)

* Includes qualified statutory capital, unearned premiums, loss reserves, the present value of future installment premiums and third-party capital support.

FINANCIAL GUARANTEE INVESTMENT PORTFOLIO BY RATING* – $3.7 BILLION



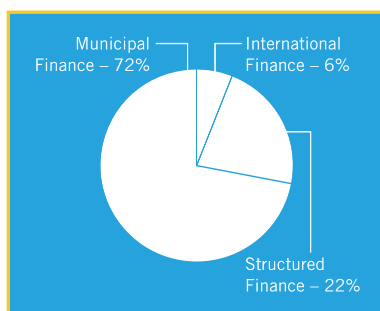
* Based upon Standard & Poor's ratings.

Ambac Guarantees the Timely Payment of Principal and Interest Due on Bonds

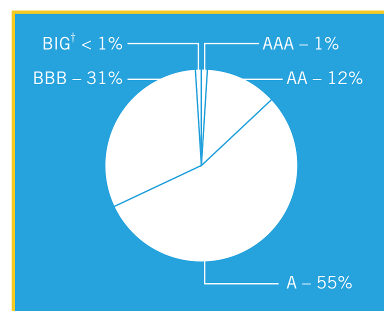
The financial resources and expertise backing Ambac's guarantee include:

- Over $5 BILLION in total CLAIMS-PAYING RESOURCES
- A HIGH QUALITY fixed income investment portfolio
- A strong and prudently DIVERSIFIED PORTFOLIO of guaranteed obligations
- A TRIPLE-A RATING by all the major rating agencies
- A tradition of INNOVATION and INDUSTRY LEADERSHIP since founding the municipal bond insurance industry in 1971
- A focus on comprehensive RISK MANAGEMENT

BOND TYPE DISTRIBUTION
OF GUARANTEED PORTFOLIO
$240.3 BILLION NET PAR OUTSTANDING



GUARANTEED PORTFOLIO BY RATING* –
$240.3 BILLION NET PAR OUTSTANDING



* Based upon Ambac internal ratings.
† Below Investment Grade.

AMBACKED

Financial Highlights

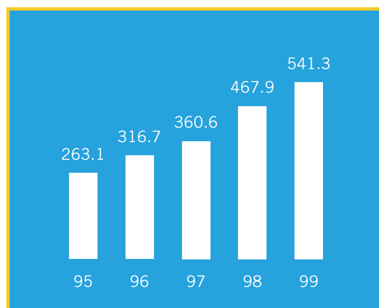
AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES	Years Ended December 31,				
(Dollars in millions, except share amounts)	1999	1998	1997	1996*	1995
STATEMENT OF OPERATIONS HIGHLIGHTS					
Gross premiums written	$445.2	$361.0	$286.2	$247.2	$193.3
Net premiums earned	264.4	212.7	154.0	136.6	111.8
Net investment income	209.3	186.2	159.7	144.9	131.0
Financial services net revenue	51.7	49.5	35.2	22.0	13.1
Total revenue	533.3	457.0	381.8	452.9	282.3
Losses and loss adjustment expenses	11.0	6.0	2.9	3.8	3.4
Financial guarantee underwriting and operating expenses	48.8	46.7	40.7	37.2	34.5
Financial services expenses	25.8	35.5	28.0	12.0	7.8
Interest expense	36.5	32.8	21.3	20.9	20.9
Net income	307.9	254.0	223.0	276.3	167.6
Net income per share	4.40	3.63	3.19	3.95	2.39
Net income per diluted share	4.31	3.56	3.13	3.91	2.37
Return on equity	15.0%	12.8%	12.8%	18.3%	13.8%
Cash dividends declared per common share	0.420	0.380	0.345	0.308	0.278

AMBAC FINANCIAL GROUP, INC. AND SUBSIDIARIES	As of December 31,				
(Dollars in millions)	1999	1998	1997	1996	1995
BALANCE SHEET HIGHLIGHTS					
Total investments, at fair value	$8,962.5	$ 8,748.4	$6,915.1	$5,200.5	$4,441.6
Prepaid reinsurance	218.0	199.9	183.5	168.8	153.4
Total assets	11,345.1	11,212.3	8,291.7	5,876.4	5,309.3
Unearned premiums	1,431.1	1,294.2	1,179.0	991.2	903.0
Losses and loss adjustment expenses	121.5	115.8	103.3	60.6	66.0
Obligations under investment agreements, investment repurchase agreements and payment agreements	6,140.3	5,956.8	4,321.0	2,754.6	2,426.9
Debentures	424.0	423.9	223.9	223.8	223.7
Total stockholders' equity	2,018.5	2,096.1	1,872.5	1,615.0	1,404.0

*1996 includes a one-time gain from the sale of a subsidiary equal to $155.6 million pretax and $100.6 million after tax.

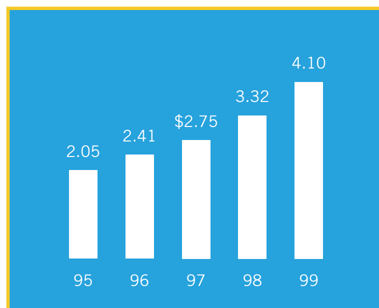
Five Year Highlights

TOTAL OPERATING REVENUES[1]
(DOLLARS IN MILLIONS)

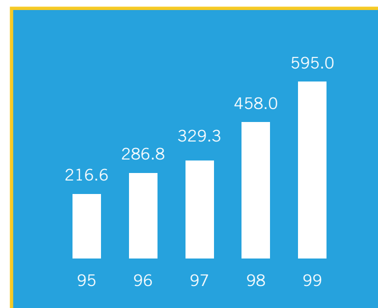


OPERATING EARNINGS PER DILUTED SHARE[2]
(DOLLARS)

CORE EARNINGS PER DILUTED SHARE[2]
(DOLLARS)



ADJUSTED GROSS PREMIUMS WRITTEN[3]
(DOLLARS IN MILLIONS)



1. Operating revenues exclude net realized gains and losses.

2 Core earnings and operating earnings are not substitutes for net income computed in accordance with Generally Accepted Accounting Principles (GAAP) but are important measures used by management, equity analysts and investors to measure financial results. Operating earnings exclude the effect on net income from net realized gains and losses and certain non-recurring items. Core earnings is defined as operating earnings less the effect on net income from insurance premiums earned from refundings and calls. The definitions of operating and core earnings used by Ambac Financial Group, Inc. may differ from definitions of operating and core earnings used by other public holding companies of financial guarantee insurers.

3 Adjusted gross premiums written ("AGP") is not promulgated under GAAP. It includes gross up-front premiums written plus the present value of estimated future installment premiums written on insurance policies and structured credit derivatives issued in the period. Additionally, AGP is reduced for amounts ceded to MBIA under our international joint venture. The definition of adjusted gross premiums written used by Ambac Financial Group, Inc. may differ from definitions of adjusted gross premiums written used by other public holding companies of financial guarantee insurers.

Letter to Stockholders

DEAR FELLOW STOCKHOLDERS:

It is my pleasure to report that 1999 was the single best year in Ambac's history. We delivered outstanding financial results, and growth in our major businesses exceeded expectations. Providing financial guarantees for structured and asset-backed securities, as well as for financings outside the United States, proved particularly successful in 1999, with attractive growth ongoing.

In addition, throughout the year we strengthened and expanded our ability to serve municipal finance clients in the U.S. by applying new structures and financial techniques. To facilitate this growth, we selectively added professional staff in 1999 to further fortify Ambac's expertise and range of skills. Our high quality professional staff now encompasses a remarkable range of capabilities for assessing risk and executing complex transactions.

FINANCIAL RESULTS

Ambac's superb financial performance in 1999 included growth in core earnings and adjusted gross premiums written of 24 percent and 30 percent, respectively. Core earnings is an important measure we use to gauge the fundamental momentum of our business. Core earnings begins with net income and excludes the less predictable elements of income such as refundings of bonds in our insured portfolio and realized capital gains and losses in our investment portfolio. Adjusted gross premiums written is significant because it quantifies today the total premiums expected to be earned in the future. Adjusted gross premiums written includes both gross up-front premiums written and the present value of estimated future installment premiums written during the period. In addition, our strong financial performance enabled us to post a return on equity of 15.0 percent in 1999.

Ambac's outstanding financial results in 1999 were not reflected in its stock price as the equity market largely neglected financial and insurance stocks this past year. In fact, Ambac's stock actually declined 13% during the year.

This is disappointing to me personally and to all of us as shareholders. I remain convinced that the equity market will again take notice of Ambac's consistent attractive growth and compelling value and ascribe prices far more in line with other sectors in the market. It is worth noting that since going public eight years ago, Ambac has delivered a total return of 435%, far higher than the S&P 500 index of 359%.

RAISING THE BAR

The significant expansion and attractive profitability of our structured finance, asset-backed and international activities, as well as solid growth in our municipal finance business, underscores the ongoing success of our strategy: leveraging

Left to right: Frank J. Bivona, Executive Vice President & Chief Financial Officer; Phillip B. Lassiter, Chairman, President and Chief Executive Officer; David L. Boyle, Vice Chairman – Portfolio Risk Management Group; Robert J. Genader, Vice Chairman – Financial Insurance Business Group

core skills to broaden the range of products and services we offer to clients through meaningful relationships. As a leading force in financial guarantees, we combine our superior credit analysis, risk management and transaction structuring expertise with a triple-A claims-paying base to enhance clients' ability to access capital. When our unquestioned financial guarantee is attached to a transaction, we say that deal is "Ambacked." It's our way of noting that we're a partner in the safety, security and success of a financing.

The inherent strength and momentum of our business motivates us to reach even higher in 2000 and beyond. As previously announced, we increased our long-term targets for annual core earnings growth and return on equity to 15 percent and eight percent over the Treasury long bond rate, respectively.

Credit enhancement for all types of transactions is increasingly important in today's complex, global marketplace. As issuers pursue more efficient capital-raising solutions and reach out to new investors, frequently across borders, our structuring expertise and triple-A guarantee provide enhanced access to investors resulting in more efficient financing for the borrower.

We enjoyed a strong year in the municipal market, our most mature business segment. Pricing remained firm and actually strengthened during the year. Notably, we enjoyed robust growth in municipal structured finance transactions. This further validates our strategy to bring broadened capabilities to the municipal marketplace.

Complementary financial services, including interest rate swaps and investment agreements, help our clients achieve cost savings on borrowings. Growth in these areas is influenced by interest rate movements, but we anticipate continued attractive returns in the coming year. These services are valuable to our clients and are natural extensions of our financial guarantee business, particularly in the municipal marketplace.

STAYING THE COURSE TO SUCCESS

To further capitalize on our growth opportunities, we strengthened our organization during the past year deepening our transaction structuring and financial engineering skills. These competencies are essential in our specialized finance activities and are increasingly valued by our municipal finance clients as well.

During the year we added to our product array and expanded the client groups we serve. Over the past year we established Ambac as a leader in structuring and insuring credit derivatives. Strategic investments in people and systems now ensure that we can execute similar risks efficiently in either the traditional financial insurance markets, or in the expanding credit derivatives arena. In 1999, we extended coverage to equipment finance and leasing and quickly

established Ambac as a leading player in credit-enhancing securitizations in that market.

Clients outside the United States benefit from our structuring expertise and financial strength through our joint venture, MBIA•AMBAC International. This combination of the leading providers of financial guarantees continues to surpass our expectations for growth and profitability. We expect that to continue. Expanding opportunities necessitate ongoing investment in professional talent and expertise across these markets.

Throughout the international developed markets, the joint venture provides credit enhancement for a wide range of transactions, from government privatization transactions to highly structured securitizations. Continued development of European financial markets is increasing the need for quality credit enhancement. The growth prospects are very attractive.

Our activity in Japan increased in 1999 and we foresee substantial opportunity as the Japanese capital markets broaden and deepen in the years ahead. Through the joint venture, we also focus selectively on opportunities in various developing markets. In these markets, we utilize financial structures that mitigate the currency risks and volatility normally associated with these economies.

VIGILANT EYE ON RISK

In all of our transactions, international or U.S.-based, analyzing and controlling risk is paramount: for our issuing clients, for investors who purchase the securities, and, importantly, for Ambac's own portfolio.

This emphasis on risk management starts at the top of our organization: My role as Chief Risk Officer of Ambac is my most important responsibility. Our Portfolio Risk Management Committee, comprised of our most senior professionals contributing expertise across a wide spectrum of risk, constantly monitors the risk exposure of each individual sector as well as Ambac as a whole. To underscore the value we place on these activities, we recently restructured our organization to establish Portfolio Risk Management as a stand-alone group headed by one of our most senior executives.

Significantly, the drive to continuously refine and improve our risk management capabilities permeates Ambac's culture. As our business becomes increasingly diverse, we believe this dedication to risk management excellence strengthens Ambac and enables us to better serve clients.

Serving clients is what the people of Ambac have been doing well since our founding of the industry in 1971. Our superior ability to analyze credits, develop and structure innovative financial solutions and execute transactions smoothly, continue to distinguish our professionals as among the best in the financial services industry. We are not resting on our laurels, however. We constantly strive to improve and expand our expertise and sharpen our skills.

We use these superior capabilities to serve our clients – bringing them creative, realistic and cost-effective ways to access capital – while we expertly manage risk. This, along with our commitment to our Premier Values, has been the key to Ambac's success for nearly 30 years and will remain our guiding principle as we continue to build our business and create shareholder value.

Sincerely,

Phil Lassiter

Premier Values

PEOPLE

Our greatest asset is the individuals who serve our constituencies. We demonstrate by our behavior and actions that our people, their skills, development and motivation "make the difference" to give us a competitive advantage in the marketplace.

REPUTATION

We maintain an environment where integrity and honesty are fundamental principles of conduct. We know that our reputation is a franchise that must never be compromised.

EXCELLENCE

We understand that success means earning client respect and exceeding client expectations. We strive to achieve excellence in every task.

MERITOCRACY

We seek out and retain the best talent, providing our people with opportunities to grow and share in our success.

INNOVATION

We welcome new insights, new ideas, fresh perspectives – we value strategic thinking and are not afraid of change, recognizing that innovation is an essential success element for all companies in all industries.

EARNINGS/RETURNS

We understand that long-term earnings growth and attractive returns on capital are of vital importance to our stockholders and other constituents.

RISK MANAGEMENT

We recognize that excellence in managing risk is central to our business and evidence that commitment through exacting standards and professionalism in all aspects of the risk management process.

Left to right: *Kevin Doyle, General Counsel; Kate McDonough, Public Finance – West; Howard Pfeffer, Public Finance; Steve Dymant, Financial Services.*

Ambac helps create and strengthen partnerships to finance economic development projects

Ambac helps structure and provides insurance for bond offerings that finance infrastructure improvements. Ambac-insured financings including many projects undertaken in partnership with private sector interests, such as air cargo facilities, specifically focused on fostering a region's economic development.

Infrastructure is critical to an area's sustainable economic vibrancy. Ambac helps state and local governments access the capital they need for infrastructure projects that encourage local economic health. Increasingly, governments are concluding that private development can be a more cost-efficient way to build, improve or maintain needed infrastructure without increasing general tax levies. The challenge lies in merging the needs of the public sector with the interests of private developers. Ambac is at the forefront of this accelerating trend to forge public/private cooperation for a community's benefit. We actively partner with local governments and their agencies bringing private companies the benefits of tax-exempt financing to achieve public sector goals.

For example, to help fund expansion and improvement at major airports, Ambac develops innovative transaction structures, often in partnership with airlines or airport operating companies. To strengthen the financing and lower overall financing costs for issuers of airport debt, we back those bonds with Ambac's triple-A-rated guarantee. We put our expertise to work for airport issuers both in the U.S. and in select markets around the world.

To help clients achieve fiscal goals after a successful bond offering, Ambac provides additional financial services, such as investment agreements. Backed by the Ambac guarantee, investment agreements enable issuers to invest bond proceeds to meet specific rate of return goals and a customized schedule for use of funds.

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Left to right: John Uhlein, International; Eric Rosenweig; Lori Evangel, MBIA representatives to MBIA · AMBAC International; Tim Travers, Utilities; David Wallis, International

Ambac brings the benefits of credit enhancement to international issuers through its MBIA · AMBAC International joint venture. Corporate and government issuers in Europe, Australia, Japan and select emerging markets strengthen their financings using Ambac's innovative ideas, structuring expertise and solid financial guarantee.

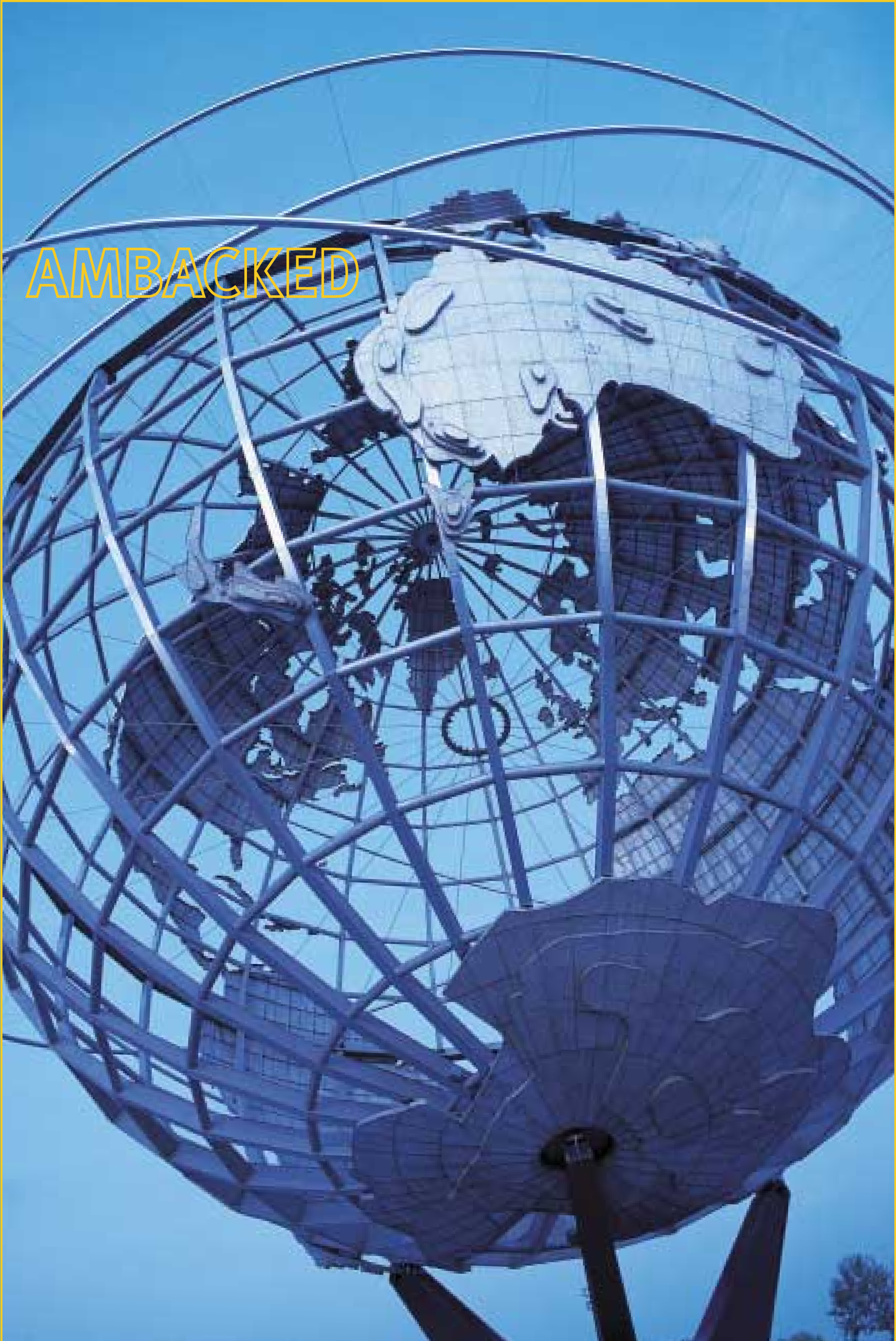
Capital markets outside the United States continue to present a wealth of opportunity for Ambac to expand its financial guarantee business. Through a joint venture, MBIA·AMBAC International, we bring financial strength, structuring expertise and an ability to efficiently execute transactions for a wide range of clients throughout Europe, Australia, Japan and in carefully selected developing markets. Transaction types span a wide range, including infrastructure financings; securitization transactions; university, housing and hospital deals; and a number of collateralized bond and loan obligations. By combining the expertise and resources of Ambac and MBIA, the joint venture, now in its sixth year, brings clients an unmatched level of talent and experience as well as more than $13.7 billion in claims-paying ability.

In Europe, monetary union and the ongoing development of a European market for public securities increases the value of financial guarantees. As investors seek out higher yielding securities from markets outside their home country, or from less-familiar issuers, the attachment of a triple-A rated guarantee provides an important endorsement of safety and reliability. International issuers appreciate the ability of financial guarantees to enhance investor access to their securities efficiently and cost-effectively. In addition, more complex financing techniques, such as securitization of a wide range of asset types, continue to grow in popularity. In these efforts, issuers are increasingly reaping rewards from the extensive financial engineering skills the joint venture brings to the market.

During 1999, the joint venture was active in Europe and Australia in providing insurance for a range of infrastructure financings. These included a number of transactions executed as part of the United Kingdom's Private Finance Initiative (PFI), municipal financings for government entities in France and utility financings in Australia.

In Japan, the joint venture's alliance with two major domestic insurance providers will enable us to quickly capitalize on continuing opportunities to structure and guarantee deals. While activity in the Japanese capital markets was dampened during 1999, ongoing change and the increasing openness of the Japanese financial markets hold strong potential for further growth of our business in this dynamic market.

Through a joint venture, Ambac brings the advantages of credit enhancement to international issuers



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Left to right: Warren Tong, Jeffrey Nabi, Thomas Adams, Iain Bruce, Donna Troia, Mortgage-Backed Securities – Consumer Asset-Backed Group

Ambac's market knowledge and structuring expertise benefit leading mortgage and asset-backed issuers

Ambac works actively with leading issuers of mortgage-backed securities to improve the strength and marketability of their mortgage-backed and home equity loan securities. Ambac's market knowledge and financial strength help these issuers access the capital and liquidity they need, even during difficult market conditions.

Securitization of receiveables and other assets, including mortgage and home equity loan portfolios, continues to play an important role for lenders, financial institutions and corporations seeking efficient ways to manage their capital and lending resources. Ambac's robust business in providing financial guarantees for mortgage- and home equity-backed securities continued to grow in 1999 despite a decline in total issuance in these markets.

We have established strong relationships with major mortgage securities issuers by combining our unmatched level of market knowledge and structuring expertise with a focus on efficient, effective execution. Consistently delivering for our high quality clients enables Ambac to reap rewards from the ongoing growth of these leading issuers. As their business expands, our business grows accordingly.

Solid skills and experience in analyzing and structuring securitization issues opens other avenues for Ambac in the consumer asset-backed securities sector. Issuers increasingly seek innovative ways to manage exposures and use capital efficiently. Our ability to develop unique solutions, fortified by Ambac's triple-A-rated guarantee, will continue to provide opportunities for growth in the coming year.

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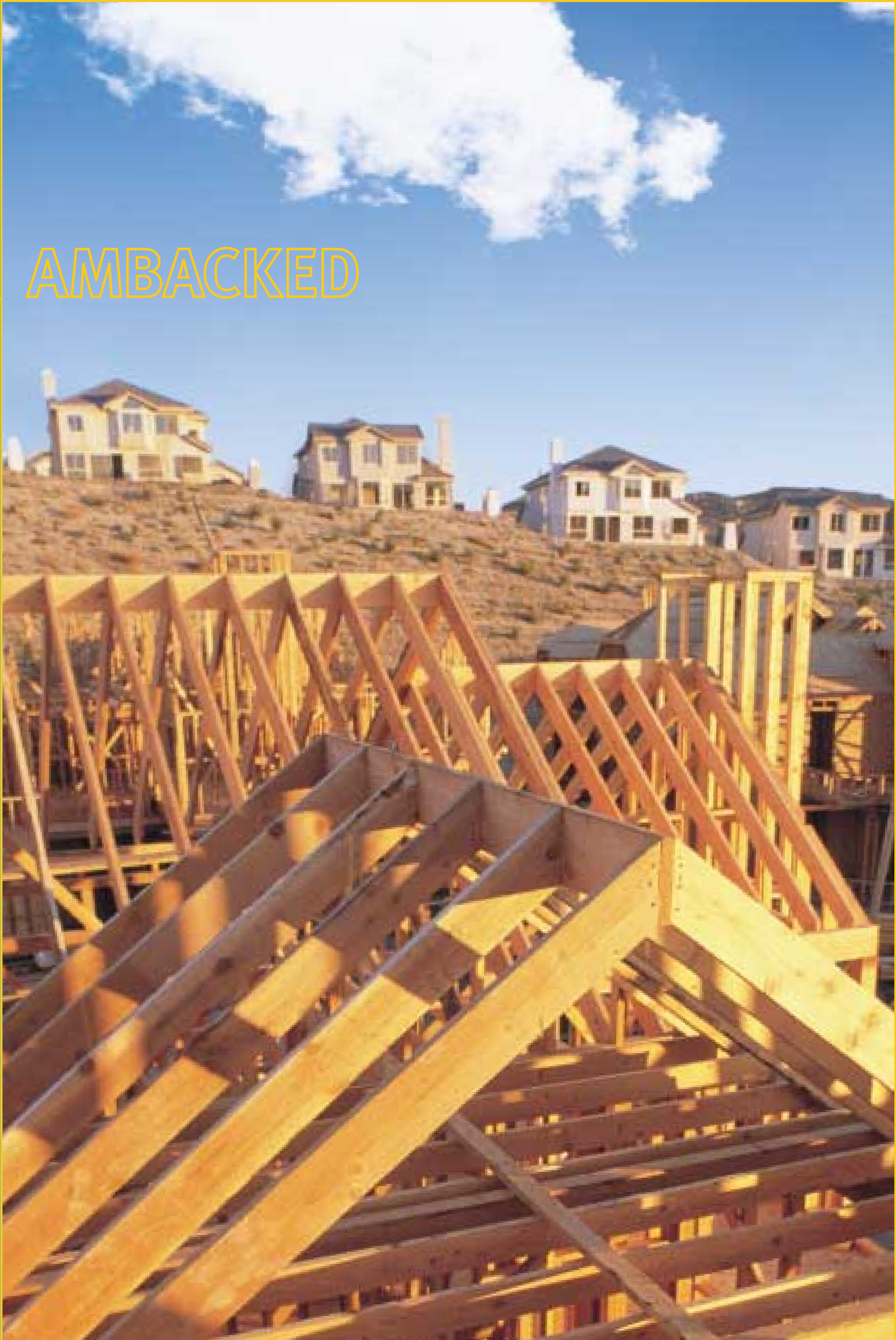

Left to right: John Bryan; Nicholas Goumas, Asset-Backed Securities; Michael Schozer; Scott Gordon, Structured Finance

Ambac's financial guarantee of complex asset-backed issues fortifies conduit credit strength

The use of Ambac's financial guarantee by financial institutions, asset-backed commercial paper conduits and corporations continues to grow. Ambac's triple-A credit enhancement strengthens issues backed by a diverse pool of assets, such as trade receivables, and increases investors' confidence in complex issues to attract a wider investor audience.

Exponential growth in the issuance of short-term financing by asset-backed commercial paper conduits has resulted in a $500 billion market that continues to expand. Decades of experience analyzing, structuring and guaranteeing financings bought by commercial paper conduits has resulted in a steady, strong and growing franchise for Ambac. In the highly competitive short-term financing market, conduits must uphold strict credit standards. Ambac's guarantee of a complex transaction – perhaps a deal collateralized by trade receivables or securitized by a pool of different types of receivables – ensures that investors will maintain continued confidence in the conduit's credit-worthiness. At the same time, Ambac's credit enhancement improves capital efficiency and returns for leading conduits.

To capitalize on the depth of structuring expertise gained over many years in the business, we formed a conduit in 1999 – Juneau Investments. Juneau has been created to enter into structured financings that meet Ambac's investment grade underwriting criteria and to issue medium-term notes with Ambac's triple-A guarantee into the private market.

Ambac further leverages its industry-leading structuring and analysis skills in the fast-growing market for credit derivatives. We help leading financial institutions hedge their portfolios of credit risk thereby managing exposure levels and improving capacity and flexibility. Opportunities continue to expand in this sector contributing to Ambac's ongoing growth.

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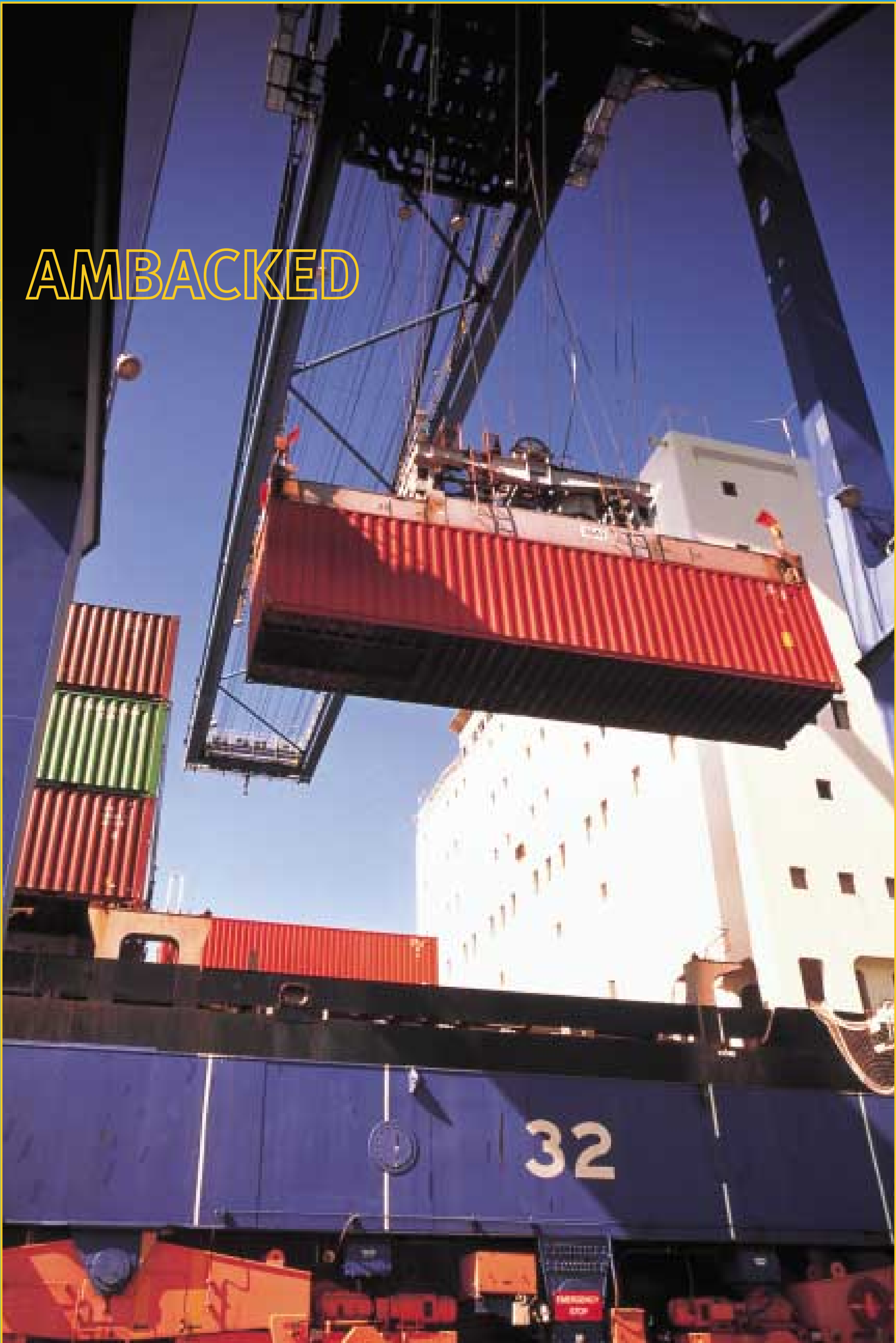

Left to right: Dennis Santo, Leasing & Product Development; Mark Spinelli, Public Finance – South; Robert Shoback, Public Finance – North; Mike Kelly, Financial Services

Ambac helps education issuers cost-effectively meet specific funding needs

Government education authorities and private universities raise capital more cost effectively when bond issues include financial guarantees from Ambac. In addition, Ambac works closely with education issuers to use creative financing techniques to better meet their specific funding challenges.

The funding needs of educational institutions are many and varied. At the same time, issuers in this sector are often less well-known to investors and market participants. Ambac works closely with education clients, including school districts, public and private universities and government education authorities, to structure and guarantee a full range of transaction types to fund construction of educational facilities or ongoing capital needs. For clients throughout the U.S. and Europe, Ambac's triple-A-rated credit enhancement brings transparency to new or complex financial structures. This provides issuers in the education sector an efficient way to strengthen financings, expand the marketability of bond issues and raise capital cost-effectively.

Ambac's innovative solutions for clients often include techniques such as interest rate swaps to achieve financing goals. Provided by Ambac Financial Services, L.P., swaps can lower present and future borrowing costs for issuers and provide a valuable tool for managing interest rate risk.

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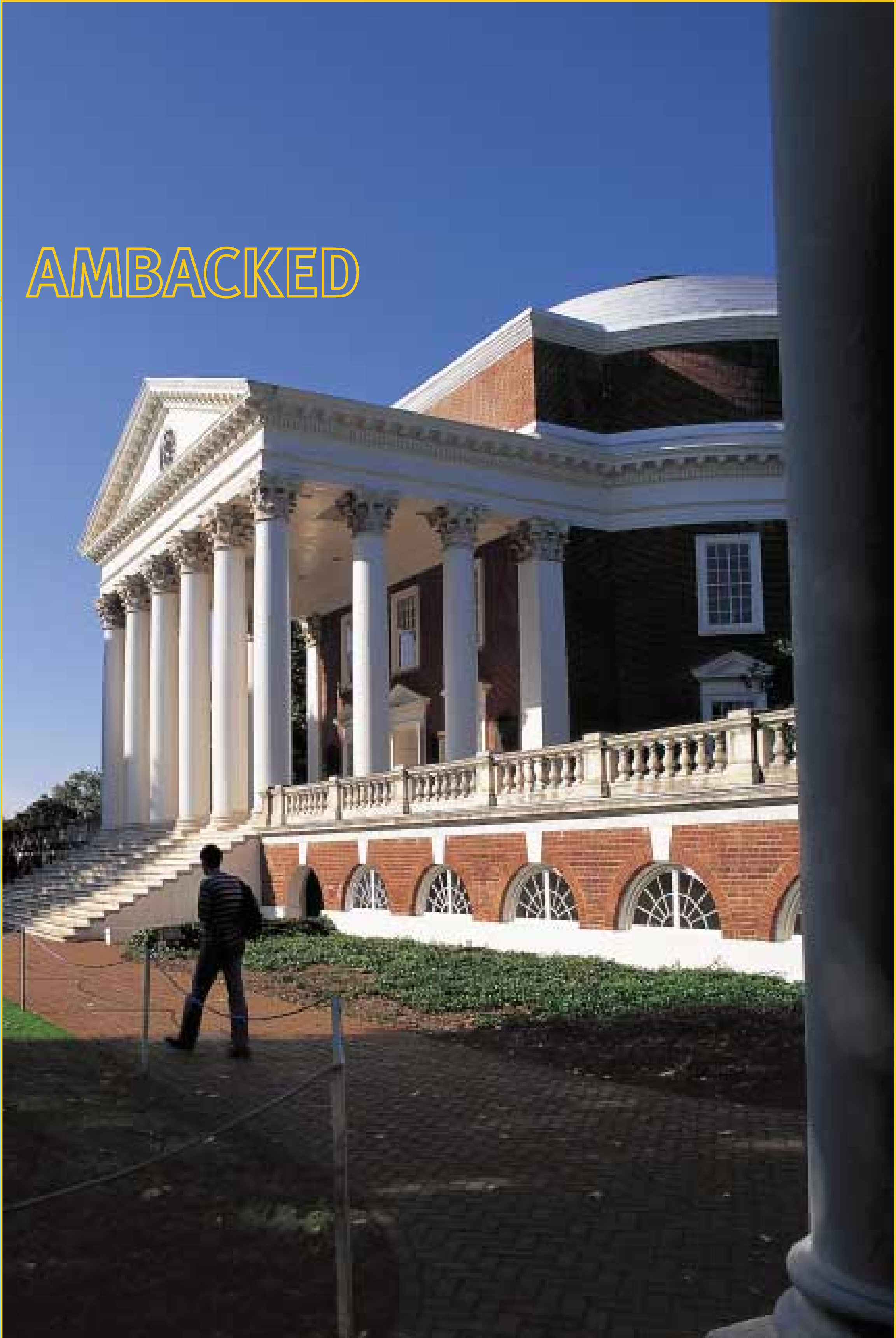

Left to right: Steven Renn, Surveillance; William McKinnon, Credit Management; Robert Selvaggio, Market Risk Management

Ambac's rigorous risk management focus reinforces the company's solid triple-A guarantee

Comprehensive risk management and surveillance encompassing all of Ambac's guaranteed portfolio strengthens the company's triple-A guarantee. Ambac's multi-disciplinary risk management approach, utilizing advanced analytical tools and proprietary risk management software, enables the company to assess, measure and manage risk in diverse, yet interrelated sectors.

Throughout the public and private sectors, capital raising and financing solutions are becoming increasingly complex. In this challenging arena, risk management stands out as a critical competency for financial guarantee companies. For nearly thirty years, Ambac's focus on comprehensive risk management has enabled the company to expand its business on the foundation of a solid, diversified portfolio of credits.

Ambac's range of expertise – across sectors, markets and geography – strengthens the company's risk management skills. Experience in virtually all bond types, as well as insight and perspective born out of global business activity, enable Ambac to excel with a multidisciplinary approach to credit analysis and portfolio surveillance. Our commitment to superior risk management is illustrated by the senior level of professionals dedicated to the function and the number of proprietary risk assessment tools in active use. In addition, Ambac-insured transactions typically include security features, legal provisions and covenants that enable us to act proactively to protect the integrity of transactions we insure.

Meaningful client relationships, developed and maintained over the long-term, further strengthen Ambac's risk management efforts. Ongoing dialogue with issuers and regular, formal review of credits in the portfolio enable us to prudently assess and manage an expanding book of business.

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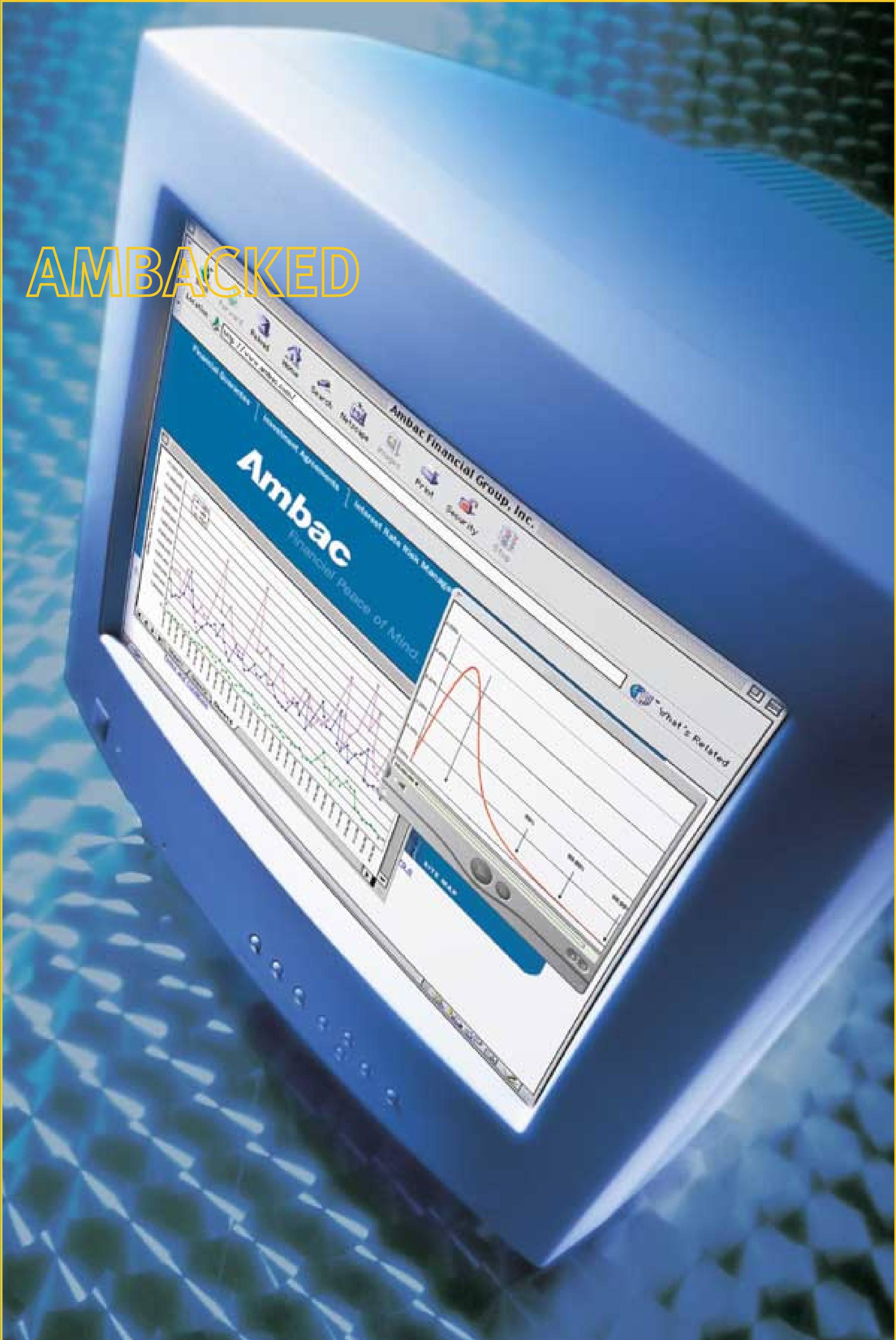

Financial Review

Facing Page, Left to right: Ruben Selles, Healthcare Finance; Eulogio (Joe) Ramos, Finance; Eulogio (Joe) Ramos, Portfolio Management; Narayan Nair, Internal Audit; Jeffrey Fried, Legal; Stephen Cooke, General Counsel–Ambac Assurance

Page 24, Left to right: Susan Oehrig, Corporate Marketing; Gregg Bienstock, Human Resources; Brian Moore, Investor Relations; Kenneth Plotzker, Technology; Thomas Gandolfo, Finance; Robert Starr, Finance

GENERAL

Ambac Financial Group, Inc. ("AFGI"), headquartered in New York City, is a holding company whose affiliates provide financial guarantees and financial services to clients in both the public and private sectors around the world.

The following paragraphs describe the consolidated results of operations of AFGI and its affiliates (collectively referred to as the "Company") for 1999, 1998 and 1997, and its financial condition as of December 31, 1999 and 1998. These results are presented for the Company's two reportable segments: Financial Guarantee and Financial Services. This discussion should be read in conjunction with the consolidated financial statements included elsewhere in this report.

Materials in this annual report may contain information that includes or is based upon forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995. Forward-looking statements give the Company's expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as "anticipate," "estimate," "expect," "project," "intend," "plan," "believe," and other words and terms of similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to future actions, prospective services or products, future performance or results of current and anticipated services or products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, and financial results.

Any or all of the Company's forward-looking statements here or in other publications may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining the Company's actual future results. The Company's actual results may vary materially, and there are no guarantees about the performance of the Company's stock. These statements are based on current expectations and the current economic environment. They involve a number of risks and uncertainties that are difficult to predict. These statements are not guarantees of future performance. Actual results could differ materially from those expressed or implied in the forward-looking statements. Among factors that could cause actual results to differ materially are: (1) changes in the economic, credit or interest rate environment in the United States and abroad; (2) the level of activity within the national and worldwide debt markets; (3) competitive conditions and pricing levels; (4) legislative and regulatory developments; (5) changes in tax laws; and (6) other risks and uncertainties that have not been identified at this time. The Company undertakes no obligation to publicly correct or update any forward-looking statement if we later become aware that it is not likely to be achieved. You are advised, however, to consult any further disclosures we make on related subjects in the Company's reports to the SEC.

RESULTS OF OPERATIONS

CONSOLIDATED NET INCOME. The Company's net income in 1999 was $307.9 million or $4.31 per diluted share, an increase of 21% from $254.0 million or $3.56 per diluted share in 1998. This increase was primarily attributable to growth in both Financial Guarantee and Financial Services operating income. Financial Guarantee revenues increased by $65.7 million, or 16%. Excluding realized gains and losses, Financial Guarantee revenues increased by 19%. Financial Services revenues increased by $16.1 million, or 50%, while its expenses decreased by $9.7 million, or 27%. Excluding realized losses, Financial Services revenues increased by 4%.

The Company's net income in 1998 increased 14% from $223.0 million or $3.13 per diluted share in 1997. This increase was primarily attributable to the growth in both Financial Guarantee and Financial Services revenues, partially offset by lower net realized gains and higher net realized losses in the Financial Guarantee segment and the Financial Services segment, respectively, in 1998.

FINANCIAL GUARANTEE

The Company provides financial guarantees for municipal and structured finance obligations through its principal operating subsidiary, Ambac Assurance Corporation ("Ambac Assurance"). Ambac Assurance's wholly-owned subsidiary, Ambac Assurance UK Limited, serves clients in the international market. Additionally, Ambac Assurance serves clients in international markets through its participation in an unincorporated joint venture with MBIA Insurance Corporation, MBIA·AMBAC International (the "JV Arrangement"). See Note 5 of Notes to Consolidated Financial Statements for further discussion about the JV Arrangement. Ambac Credit Products, L.L.C. ("ACP"), a

wholly-owned subsidiary of Ambac Assurance, also provides credit protection in the global markets in the form of structured credit derivatives.

GROSS PAR VALUE WRITTEN. Ambac Assurance guaranteed $73.3 billion of par value obligations during 1999, an increase of 19% from $61.5 billion in 1998. Par value written in 1998 represented an increase of 35% from $45.5 billion in 1997. Par value written in 1999 comprised $32.5 billion from the guarantee of municipal bond obligations, $33.4 billion from structured finance obligations and $7.4 billion from international obligations, versus $33.9 billion, $22.6 billion and $5.0 billion, respectively, in 1998 and $29.4 billion, $12.9 billion and $3.2 billion, respectively, in 1997. The 1999 decrease in guaranteed municipal bond obligations was affected by a 22% decline in total issuance that was largely offset by an overall increase in Ambac's municipal market share. The increases in guaranteed structured finance obligations during 1999 were principally in the mortgage-backed and asset-backed sectors while the 1999 increase in international obligations guaranteed resulted primarily from expansion of the financial guarantee product into structured credit derivatives.

Management anticipates, based on growth experienced in the last few years, that in the foreseeable future, the Company's structured finance and international businesses will grow more rapidly than the municipal business. Management believes that business written in the structured finance and international markets may see large quarterly variances primarily due to general market conditions and the developmental nature of these markets.

GROSS PREMIUMS WRITTEN. Gross premiums written in 1999 were $445.2 million, an increase of 23% from $361.0 million in 1998. Business activity in structured finance transactions as well as improved pricing in the municipal finance market has spurred this increase. Gross premiums written in 1998 increased 26% from $286.2 million in 1997. Increased new issue municipal finance and international premiums primarily drove this increase. The following table sets forth the amounts of gross premiums written and related gross par written by type:

(Dollars in millions)	1999		1998		1997	
	Gross Premiums Written	Gross Par Written	Gross Premiums Written	Gross Par Written	Gross Premiums Written	Gross Par Written
Municipal finance:						
Up-front:						
New issue	$261.5	$27,242	$228.2	$29,616	$178.9	$25,889
Secondary market	14.8	1,570	14.6	1,400	19.6	1,530
Sub-total up-front	276.3	28,812	242.8	31,016	198.5	27,419
Installment	21.7	3,649	17.7	2,899	13.5	2,024
Total municipal finance	298.0	32,461	260.5	33,915	212.0	29,443
Structured finance:						
Up-front	7.9	824	1.4	1,985	11.1	922
Installment	67.6	32,623	35.7	20,581	19.6	11,952
Total structured finance	75.5	33,447	37.1	22,566	30.7	12,874
International:						
Up-front	35.6	747	52.8	2,463	37.6	1,566
Installment	36.1	6,676	10.6	2,553	5.9	1,575
Total international	71.7	7,423	63.4	5,016	43.5	3,141
Total	$445.2	$73,331	$361.0	$61,497	$286.2	$45,458
Total up-front	$319.8	$30,383	$297.0	$35,464	$247.2	$29,907
Total installment	125.4	42,948	64.0	26,033	39.0	15,551
Total	$445.2	$73,331	$361.0	$61,497	$286.2	$45,458

ADJUSTED GROSS PREMIUMS[1]. While the majority of Ambac Assurance's municipal finance premiums written are collected up front at policy issuance, the majority of its structured finance premiums are collected on an installment basis. Adjusted gross premiums ("AGP") written, which are defined as gross up-front premiums written plus the present value of estimated future installment premiums written on insurance policies and structured credit derivatives issued in the period, were $595.0 million in 1999, up 30% from $458.0 million in 1998. The increase in 1999 was primarily due to the increased business activity in structured finance transactions, especially on mortgage-backed and asset-backed securities. AGP written in 1998 increased 39% from $329.3 million in 1997. The increase in 1998 was primarily due to increased up-front premiums written in the municipal finance market combined with the increase in the present value of structured finance and international installment policies. The aggregate net present value of estimated future installment premiums was $527.2 million, $308.4 million, and $210.8 million as of December 31, 1999, 1998 and 1997, respectively.

CEDED PREMIUMS WRITTEN. Ceded premiums written in 1999 were $61.8 million, up 25% from $49.6 million in 1998. Ceded premiums written in 1998 were affected by a one-time cession of $11.6 million of the Connie Lee insured portfolio. Excluding the one-time cession in 1998, ceded premiums written in 1999 increased 63% over ceded premiums written in 1998. The increase was primarily due to increased gross premiums written as well as an overall increase in international premiums ceded under the JV Arrangement during 1999. Excluding the one-time Connie Lee cession discussed above, ceded premiums written in 1998 were 17% higher than ceded premiums written in 1997 of $32.5 million. Ceded premiums written were 14%, 11% (excluding the one-time cession), and 11% of gross premiums written in 1999, 1998 and 1997, respectively.

NET PREMIUMS EARNED. Net premiums earned during 1999 were $264.4 million, an increase of 24% from $212.7 million in 1998. This increase was primarily the result of the larger financial guarantee book of business, partially offset by decreased refundings, calls, and other accelerations of previously insured obligations (collectively referred to as "refundings") during the year.

When a new or secondary market issue insured by Ambac Assurance has been refunded or called, the remaining unearned premium (net of refunding credits, if any) is generally earned at that time. Refunding levels vary depending upon a number of conditions, primarily the relationship between current interest rates and interest rates on outstanding debt. Net premiums earned in 1999 included $35.9 million (net income per diluted share effect of $0.29) from refundings of previously insured issues. Net premiums earned in 1998 included $46.9 million (net income per diluted share effect of $0.37) from refundings. Excluding the effect of accelerated earnings related to refundings, normal net premiums earned in 1999 were $228.5 million, an increase of 38% from $165.8 million in 1998. The increase in normal net premiums earned resulted from strong business written in all areas.

Net premiums earned during 1998 increased 38% from $154.0 million in 1997. This increase was primarily the result of the larger financial guarantee book of business and increased premiums earned from refundings. Net premiums earned in 1997 included $28.0 million (net income per diluted share effect of $0.22) from refundings. Excluding the effect of accelerated earnings related to refundings, normal net premiums earned in 1998 increased 32% from $126.0 million in 1997.

NET FEES EARNED AND OTHER INCOME. Net fees earned and other income in 1999 was $6.0 million, an increase of 3% from $5.8 million in 1998. Included in net fees earned and other income are revenues earned from structured credit derivatives, deal structuring fees and commitment fees. During 1999, Ambac Assurance's credit derivatives subsidiary, ACP, earned revenues of $3.9 million. Net fees earned and other income increased 32% in 1998 from $4.4 million in 1997. There were no revenues from structured credit derivatives in 1998 and 1997.

NET INVESTMENT INCOME. Net investment income in 1999 was $209.3 million, an increase of 12% from $186.2 million in 1998. This increase was primarily attributable to the growth of the investment portfolio resulting from the growth in the financial guarantee book of business. Additionally, investment income grew as a result of capital contributions from AFGI totaling approximately $200 million over the course of the year. The contributions were in the form of taxable securities. Investments in tax-exempt securities amounted to 74% of the total market value of the portfolio as of December 31, 1999, versus 74% and 75% as of December 31, 1998 and 1997, respectively. The average pre-tax yield-to-maturity on the investment portfolio was 6.08% as of December 31, 1999 compared with 6.17% and 6.40% for December 31, 1998 and 1997, respectively. Net investment income in 1998 increased 17% from $159.7 million in 1997. This increase was primarily attributable to the growth of the investment portfolio from ongoing operations and the net increase in the investment portfolio from the acquisition of Connie Lee.

NET REALIZED GAINS (LOSSES). Net realized losses in 1999 were $5.7 million, compared to net realized gains of $3.7 million and $21.1 million in 1998 and 1997, respectively. Realized gains and losses are generated as a result of the ongoing management of the investment portfolio.

LOSSES AND LOSS ADJUSTMENT EXPENSES. Losses and loss adjustment expenses in 1999 were $11.0 million, versus $6.0 million in 1998 and $2.9 million in 1997. Losses and loss adjustment expenses are based upon estimates of the ultimate aggregate losses inherent in the financial guarantee portfolio. The liability for losses and loss adjustment expenses consists of the active credit reserve ("ACR"), which represents an estimate of the expected annual levels of debt service

defaults resulting from credit failures on currently guaranteed issues that are not presently or imminently in default, and case basis loss reserves for obligations in monetary default or, in the judgement of management, for which default is imminent. The Company regularly reviews its outstanding obligations to determine an appropriate reserve for losses and loss adjustment expenses. The following table summarizes the Company's loss reserves split between case basis loss reserves and ACR at December 31, 1999 and 1998:

(Dollars in millions)	1999	1998
Net loss and loss adjustment expense reserves:		
Case basis*	$ 26.2	$ 33.9
ACR	94.8	78.2
Total	$121.0	$112.1

*After netting reinsurance recoverable amounting to $0.5 million and $3.6 million in 1999 and 1998, respectively.

Paid losses, net of salvage received, were $2.2 million, ($7.0) million and $2.5 million in 1999, 1998 and 1997, respectively.

UNDERWRITING AND OPERATING EXPENSES. Underwriting and operating expenses were $48.8 million in 1999, an increase of 4% from $46.7 million in 1998. Underwriting and operating expenses in 1998 increased 15% from $40.7 million in 1997. Underwriting and operating expenses consist of gross underwriting and operating expenses, less the deferral to future periods of expenses and reinsurance commissions related to the acquisition of new insurance contracts, plus the amortization of previously deferred expenses and reinsurance commissions. In 1999, gross underwriting and operating expenses were $74.5 million, an increase of 10% from $67.8 million in 1998. During 1998, gross underwriting and operating expenses increased 15% from $59.2 million in 1997. The increases in gross underwriting and operating expenses in both 1999 and 1998 reflect the overall increased business activity in those years and are primarily attributable to higher compensation costs and premium taxes. Underwriting and operating expenses deferred were $45.9 million, $38.2 million, and $32.8 million in 1999, 1998 and 1997, respectively. The amortization of previously deferred expenses and reinsurance commissions was $20.8 million, $18.2 million, and $14.2 million in 1999, 1998 and 1997, respectively.

FINANCIAL SERVICES

Through its financial services subsidiaries, the Company provides investment agreements, interest rate swaps, investment advisory and cash management services, principally to states, municipalities and their authorities, school districts, and hospitals and health organizations.

Revenues in 1999 were $51.7 million (excludes $3.1 million in net realized losses), versus $49.5 million (excludes $17.1 million in net realized losses) in 1998. This increase is primarily due to higher revenues on investment agreements from higher volume and improved net interest spreads, partially offset by lower revenues on interest rate swaps due to lower volume. In the fourth quarter of 1998, the Company discontinued development of electronic commerce applications for the municipal marketplace. This effort had been under way through an affiliate, Ambac Connect, Inc. ("Ambac Connect"). The decision resulted in an after-tax charge of $9.5 million, or $0.13 in net income per diluted share in 1998. This charge did not affect operating or core earnings(2). In 1998, the Company incurred a $15.7 million loss in a trading position. This trading position, which represented a small portion of the Company's assets, contained high quality municipal bonds hedged with Treasury futures. The loss was due to a change in the relationship between municipal and Treasury interest rates. This trading position was closed during the fourth quarter of 1998. The trading loss and the Ambac Connect charge were partially offset by $10.1 million of realized gains on fixed-income securities in the investment agreement business during 1998. Revenues in 1998 reflected a 41% increase from $35.2 million (excludes $0.6 million in net realized losses) in 1997. The increase was primarily due to higher revenues from interest rate swaps and investment agreements primarily resulting from increased volume.

Expenses in 1999 were $25.8 million, versus $32.5 million (excluding a $3.0 million restructuring charge for Ambac Connect) in 1998. This decrease was primarily due to savings related to the closing of Ambac Connect, as discussed above. Expenses in 1998 increased 33% from $24.5 million (excluding a $3.5 million 1997 restructuring charge for consolidating certain operations in New York). This increase resulted from higher compensation expenses in the investment agreement and swap businesses, as well as increased expenditures to develop the money management and electronic commerce businesses.

CORPORATE ITEMS

INTEREST EXPENSE. Interest expense in 1999 was $36.5 million, an increase of 11% from $32.8 million in 1998. The increase is primarily attributable to paying a full year's interest expense on AFGI's April 1998 issuance of $200 million in debentures. Interest expense in 1997 was $21.3 million.

OTHER REVENUE. Other revenue includes investment income of AFGI. Other revenue decreased to $9.9 million in 1999 from $13.7 million in 1998, primarily due to capital contributions to Ambac Assurance totaling approximately $200 million (see "Net Investment Income" section above). Other revenue increased in 1998 from $7.2 million in 1997, primarily due to higher investment income generated from investing the proceeds of the $200 million in debentures.

OTHER EXPENSES. Other expenses include the operating expenses of AFGI. Other expenses were $6.5 million in 1999, $7.1 million in 1998, and $2.9 million in 1997. The primary reason for the escalating expenses from 1997 to 1998 was increased compensation costs.

INCOME TAXES. Income taxes for 1999 were at an effective rate of 23.9%, compared to 22.8% and 22.0% for 1998 and

1997, respectively. The increasing effective tax rate is primarily the result of the growth in underwriting profits in proportion to the primarily tax-advantaged investment income.

SUPPLEMENTAL ANALYTICAL FINANCIAL DATA

CORE EARNINGS(2). In 1999, core earnings were $292.6 million, an increase of 24% from $236.5 million in 1998. This increase was primarily the result of continued higher normal premiums earned (defined as net premiums earned less the effect of refundings) from the growth in the financial guarantee book of business and higher net investment income from financial guarantee operations. In 1998, core earnings increased 21% from $195.8 million in 1997. The increase was primarily the result of higher normal premiums earned from the growth in the financial guarantee book of business and higher net investment income from financial guarantee operations, as well as higher revenues from the investment agreement and swap businesses in the financial services segment. Core earnings, which the Company reports as analytical data, exclude the effect on consolidated net income from net realized gains and losses, net insurance premiums earned from refundings and certain non-recurring items.

OPERATING EARNINGS(2). Operating earnings in 1999 were $313.1 million, an increase of 19% from $263.3 million in 1998. Operating earnings in 1998 increased 24% from $211.8 million in 1997. The Company defines operating earnings as net income, less the effect of net realized gains and losses and certain non-recurring items.

Following is a table reconciling net income computed in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") to operating earnings and core earnings for the years ended December 31, 1999, 1998 and 1997:

(Dollars in millions)	1999	1998	1997
Net income	$307.9	$254.0	$223.0
Net realized losses (gains), after tax	5.2	7.1	(13.3)
Non-recurring item, after tax	–	2.2	2.1
Operating earnings	313.1	263.3	211.8
Premiums earned from refundings, after tax	(20.5)	(26.8)	(16.0)
Core earnings	$292.6	$236.5	$195.8

LIQUIDITY AND CAPITAL RESOURCES

AFGI LIQUIDITY. AFGI's liquidity, both on a short-term basis (for the next twelve months) and a long-term basis (beyond the next twelve months), is largely dependent upon: (i) Ambac Assurance and other subsidiaries' ability to pay dividends or make payments to AFGI; and (ii) external financings. Pursuant to Wisconsin insurance laws, Ambac Assurance may declare dividends, provided that, after giving effect to the distribution, it would not violate certain statutory equity, solvency and asset tests. During 1999, Ambac Assurance paid dividends of $52.0 million on its common stock to AFGI. For further discussion, see Note 8 of Notes to Consolidated Financial Statements.

AFGI's principal uses of liquidity are payment of its operating expenses, interest on its debt, dividends on its shares of common stock, and capital investments in its subsidiaries. Based on the amount of dividends that it expects to receive from Ambac Assurance during 2000, and the income it expects to receive from its investment portfolio, management believes that AFGI will have sufficient liquidity to satisfy its needs over the next twelve months, including the ability to pay dividends on its common stock in accordance with its dividend policy. Beyond the next twelve months, Ambac Assurance's ability to declare and pay dividends to AFGI may be influenced by a variety of factors including adverse market changes, insurance regulatory changes and changes in general economic conditions. Consequently, although management believes that AFGI will continue to have sufficient liquidity to meet its debt service and other obligations over the long term, no guarantee can be given that Ambac Assurance will be permitted to dividend amounts sufficient to pay all of AFGI's operating expenses, debt service obligations and dividends on its common stock.

AMBAC ASSURANCE LIQUIDITY. The principal uses of Ambac Assurance's liquidity are payment of operating expenses, reinsurance premiums, income taxes, and dividends to AFGI. Management believes that Ambac Assurance's operating liquidity needs can be funded exclusively from its operating cash flow. The principal sources of Ambac Assurance's liquidity are gross premiums written, scheduled investment maturities, net investment income and receipts from structured credit derivatives. During 1999, AFGI contributed $200 million of capital to Ambac Assurance to support the growth in the financial guarantee business.

FINANCIAL SERVICES LIQUIDITY. The principal uses of liquidity by Financial Services subsidiaries are payment of investment agreement obligations pursuant to defined terms, net obligations under interest rate swaps and related hedges, operating expenses, and income taxes. Management believes that its Financial Services liquidity needs can be funded primarily from its operating cash flow and the maturity of its invested assets. The principal sources of this segment's liquidity are proceeds from issuance of investment agreements, net investment income, maturities of securities from its investment portfolio (which are invested with the objective of matching the duration of its obligations under the investment agreements), net receipts from interest rate swaps and related hedges, and fees for investment management services. Additionally, from time to time, liquidity needs are satisfied by short-term intercompany loans from AFGI. The investment objectives with respect to investment agreements are to achieve the highest after-tax total return, subject to a minimum average quality rating of Aa/AA on invested assets, and to maintain cash flow matching of invested assets to funded liabilities to minimize interest rate and liquidity exposure. Financial Services maintains a portion of its assets in short-term investments and repurchase agreements in order to meet unexpected liquidity needs.

CREDIT FACILITIES. AFGI and Ambac Assurance have a revolving credit facility with three major international banks for $150 million, which expires in August 2000 and provides a two-year term loan provision. The facility is available for general corporate purposes, including the payment of claims. As of December 31, 1999 and 1998, no amounts were outstanding under this credit facility.

Ambac Assurance maintains third party capital support in the form of a seven-year irrevocable limited recourse credit facility from a group of highly rated banks. This credit facility provides liquidity to Ambac Assurance in the event claims from municipal obligations in its covered portfolio exceed specified levels. Repayment of amounts drawn under the credit facility are limited primarily to the amount of any recoveries of losses related to municipal policy obligations. During 1999, total third party capital support was increased from $555 million to $750 million and its expiration reset to December 2, 2006. As of December 31, 1999 and 1998, no amounts were outstanding under this facility.

ACP has a revolving credit facility with one major international bank for $50 million that expires in June 2000 and provides a three-year term loan provision. The facility is available to ACP for general corporate purposes, including payments in regard to its credit derivative activities. The credit facility became effective on July 1, 1999. As of December 31, 1999, no amounts were outstanding under this facility.

STOCK REPURCHASE PROGRAM. The Board of Directors of AFGI has authorized the establishment of a stock repurchase program that permits the repurchase of up to 6,000,000 shares of AFGI's common stock. During 1999, AFGI acquired approximately 325,000 treasury shares for an aggregate amount of $17.6 million. Since inception of the Stock Repurchase Program AFGI has acquired approximately 4,573,000 shares for an aggregate amount of $160.3 million.

ADJUSTED BOOK VALUE.(3) Adjusted Book Value ("ABV") per share increased 6% to $44.68 at December 31, 1999 from $41.98 at December 31, 1998.

The following table reconciles book value per share to ABV per share as of December 31, 1999 and 1998:

	1999	1998
Book value per share	$28.85	$29.97
After-tax value of:		
Net unearned premium reserve	11.28	10.17
Deferred acquisition costs	(1.26)	(1.12)
Present value of installment premiums	4.90	2.86
Net unrealized gains on investment agreement liabilities	0.91	0.10
Adjusted book value per share	$44.68	$41.98

BALANCE SHEET. Total assets as of December 31, 1999 were $11.35 billion, relatively flat to $11.21 billion at December 31, 1998. Cash flows from operations and investment activities were largely offset by declines in the market values of the investment portfolio resulting from rising interest rates during 1999. Stockholders' equity as of December 31, 1999 was $2.02 billion, a decrease of 4% from $2.10 billion at year-end 1998. Net income for the year was more than offset by net unrealized losses in the investment portfolio (classified as "Accumulated Other Comprehensive (Loss) Income" in Stockholders' Equity).

The following table summarizes the composition of the Company's investment portfolio by segment at December 31, 1999, and 1998:

(Dollars in millions)	Financial Guarantee	Financial Services	Other	Total
1999				
Municipal obligations	$2,923.5	$ 39.4	$ —	$2,962.9
Corporate obligations	420.5	582.4	5.7	1,008.6
U.S. government obligations	60.9	1.6	—	62.5
Mortgage and asset-backed securities (includes U.S. government agency obligations)	111.0	4,593.5	—	4,704.5
Other	—	—	3.1	3.1
Total long-term	3,515.9	5,216.9	8.8	8,741.6
Short-term	207.1	1.5	12.3	220.9
Total investments	$3,723.0	$5,218.4	$ 21.1	$8,962.5
Percent total	41.5%	58.2%	0.3%	100%
1998				
Municipal obligations	$2,757.2	$ 44.1	$ —	$2,801.3
Corporate obligations	328.1	980.1	127.2	1,435.4
U.S. government obligations	122.9	—	—	122.9
Mortgage and asset-backed securities (includes U.S. government agency obligations)	101.8	4,078.9	81.9	4,262.6
Other	—	—	6.6	6.6
Total long-term	3,310.0	5,103.1	215.7	8,628.8
Short-term	93.9	1.5	24.1	119.5
Total investments	$3,403.9	$5,104.6	$239.8	$8,748.3
Percent total	38.9%	58.4%	2.7%	100%

The Company's investment objectives for the Financial Guarantee portfolio are to maintain an investment duration that closely approximates the expected duration of related financial guarantee liabilities and achieve the highest after-tax net investment income while maintaining a conservative credit risk profile. The Financial Guarantee investment portfolio is subject to internal investment guidelines, which are approved by the Board of Directors. Such guidelines set forth minimum credit rating requirements and credit risk concentration limits. As of December 31, 1999 and 1998, the Company's Financial Guarantee investment portfolio had a weighted average credit rating of AA.

Approximately 87% and 82% of the Mortgage and Asset-Backed Securities in the Financial Guarantee portfolio is composed of securities issued by various U.S. government agencies, as of December 31, 1999 and 1998, respectively.

Short-term investments in the Financial Guarantee portfolio consisted primarily of money market funds, foreign and domestic time deposits, and discount notes.

The Financial Services investment portfolio consists primarily of assets funded with the proceeds from the issuance of investment agreement liabilities. The investment objectives of the portfolio are to match the investment security duration to the duration of related liabilities under the investment agreements and achieve the highest after-tax net investment income. The investment portfolio is subject to internal investment guidelines, approved by the Board of Directors. Such guidelines set forth minimum credit rating requirements and credit risk concentration limits. As of December 31, 1999 and 1998, the Company's Financial Services investment portfolio had a weighted average credit rating of AA.

Approximately 51% and 67% of the Mortgage and Asset-Backed Securities in the Financial Services portfolio is composed of securities issued by various U.S. government agencies, as of December 31, 1999 and 1998, respectively.

CASH FLOWS. Net cash provided by operating activities was $454.4 million, $327.8 million and $316.0 million during 1999, 1998 and 1997, respectively. These cash flows were primarily provided by the Financial Guarantee operations. Net cash provided by financing activities was $181.2 million, $1,723.0 million and $1,564.3 million during 1999, 1998 and 1997, respectively. This activity included $199.2 million, $1,391.9 million and $1,096.5 million in investment agreements issued (net of draws paid) in 1999, 1998 and 1997, respectively. The total cash provided by operating and financing activities was $635.6 million, $2,050.8 million and $1,880.3 million during 1999, 1998 and 1997, respectively. From these totals, $630.3 million, $2,051.8 million and $1,878.8 million was used in investing activities, principally net purchases of investment securities, during 1999, 1998 and 1997, respectively.

MATERIAL COMMITMENTS. The Company has made no commitments for material capital expenditures within the next twelve months.

RISK MANAGEMENT

In the ordinary course of business, the Company, through its affiliates, manages a variety of risks, principally credit, market, liquidity, operational and legal. These risks are identified, measured and monitored through a variety of control mechanisms, which are in place at different levels throughout the organization.

CREDIT RISK. The Company is exposed to credit risk in various capacities including as an issuer of financial guarantees, as counterparty to derivative and other financial contracts and as a holder of investment securities. The Company has a Portfolio Risk Management Committee ("PRMC") which has established various procedures and controls to monitor and manage credit risk. The PRMC is comprised of senior credit professionals and senior management of the Company. Its purview is enterprise-wide and its focus is on risk measurement, risk/return optimization, and capital attribution in a portfolio context.

All financial guarantees issued are subject to a formal underwriting process. Various factors affecting the credit worthiness of the underlying obligation are evaluated during the underwriting process. Senior credit personnel approve all transactions prior to issuing a financial guarantee. Subsequent to issuance of a financial guarantee, the Company periodically performs reviews of exposures according to a pre-determined schedule based on the risk profile of the insured obligations. The Company also monitors credit risk relating to derivative and other financial contracts.

The Company manages credit risk associated with its investment portfolio through adherence to specific investment guidelines. These guidelines establish limits based upon single risk concentration limits and minimum credit rating standards. Additionally, senior investment personnel monitor the portfolio on a continuous basis.

MARKET RISK. Market risk represents the potential for losses that may result from changes in the market value of a financial instrument as a result of changes in market conditions. The primary market risks that would impact the value of the Company's financial instruments are interest rate risk, basis risk (taxable interest rates relative to tax-exempt interest rates, discussed below) and credit spread risk. Below we discuss each of these risks and the specific types of financial instruments impacted. Senior managers in the Company's market risk management group are involved in setting and monitoring risk limits and the application of risk measurement methodologies. The estimation of potential losses arising from adverse changes in market conditions is a key element in managing market risk. The Company utilizes various systems, models and stress test scenarios to

monitor and manage market risk. This process includes frequent analyses of both parallel and non-parallel shifts in the yield curve, "value-at-risk" and changes in credit spreads. These models include estimates, made by management, which utilize current and historical market information. The valuation results from these models could differ materially from amounts that would actually be realized in the market.

Financial instruments that may be adversely affected by changes in interest rates consist primarily of investment securities, investment agreement liabilities, debentures, and derivative contracts (primarily interest rate swaps) used for hedging purposes. The following table summarizes the estimated change in fair value (based primarily on the valuation models discussed above) on the net balance of the Company's investment securities, investment agreement liabilities, debentures and derivative hedges, assuming immediate changes in interest rates at specified levels at December 31, 1999 and 1998:

(Dollars in millions) Change in interest rates	Estimated fair value	Estimated change in fair value
1999:		
300 basis point rise	$2,513	$ (927)
200 basis point rise	2,814	(626)
100 basis point rise	3,123	(317)
Base Scenario	3,440	—
100 basis point decline	3,763	323
200 basis point decline	4,098	658
300 basis point decline	4,454	1,014
1998:		
300 basis point rise	$2,172	$ (758)
200 basis point rise	2,401	(529)
100 basis point rise	2,655	(275)
Base Scenario	2,930	—
100 basis point decline	3,215	285
200 basis point decline	3,500	570
300 basis point decline	3,802	872

Financial instruments that may be adversely affected by changes in basis include the Company's municipal interest rate swap portfolio. The Company, through its affiliate Ambac Financial Services, L.P. ("AFSLP"), is a provider of interest rate swaps to states, municipalities and their authorities and other entities in connection with their financings. AFSLP manages its business with the goal of being market neutral to changes in overall interest rates, while seeking to profit from retaining some basis risk. If actual or projected tax-exempt interest rates change in relation to taxable interest rates, the Company will experience an unrealized mark-to-market gain or loss. Since late 1995, most municipal interest rate swaps transacted by AFSLP contain provisions that are designed to protect the Company against certain forms of tax reform, thus mitigating its basis risk. The estimation of potential losses arising from adverse changes in market relationships, known as value-at-risk, is a key element in management's monitoring of basis risk for the municipal interest rate swap portfolio. The Company has developed a value-at-risk methodology to estimate potential losses over a specified holding period and based on certain probabilistic assessments. The Company's methodology estimates value-at-risk using a 300-day historical "look back" period. This means that changes in market values are simulated using market inputs from the past 300 days. For the years ended December 31, 1999 and 1998, the Company's value-at-risk, for its interest rate swap portfolio, calculated at a ninety-nine percent confidence level, averaged approximately $1.1 million and $1.0 million, respectively. The Company's value-at-risk ranged from a high of $1.3 million to a low of $0.9 million in 1999, and from a high of $1.1 million to a low of $0.7 million in 1998. Since no single measure can capture all dimensions of market risk, the Company supplements its value-at-risk methodology by performing daily analyses of parallel and non-parallel shifts in yield curves and stress test scenarios which measure the potential impact of normal market conditions, which might cause abnormal volatility swings or disruptions of market relationships.

Financial instruments that may be adversely affected by changes in credit spreads include the Company's outstanding structured credit derivative contracts. The Company, through its affiliate ACP, enters into structured credit derivative contracts. These contracts require ACP to make payments upon the occurrence of certain defined credit events relating to an underlying obligation (generally a fixed income security). If credit spreads of the underlying obligations change, the market value of the related structured credit derivative could change. As such, ACP could experience an unrealized mark-to-market gain or loss. Market liquidity could also impact valuations. Changes in credit spreads are generally caused by changes in the market's perception of the credit quality of the underlying obligations. The majority of ACP's contracts are partially hedged with various financial institutions or structured with first loss protection. Such structuring mitigates ACP's risk of loss and the price volatility of these financial instruments. Personnel in the Company's credit surveillance group monitor credit spread risk. Additionally, management models the potential impact of credit spread changes on the value of its contracts. At December 31, 1999 the Company's models estimate ACP would experience an estimated unrealized loss of $0.8 million, $2.1 million and $4.2 million, based on overall credit spread widening of 15, 30 and 45 basis points, respectively. ACP would experience an estimated unrealized gain of $0.9 million, $3.0 million and $5.0 million, based on overall credit spread narrowing of 15, 30 and 45 basis points, respectively.

LIQUIDITY RISK. Liquidity risk relates to the possible inability to satisfy contractual obligations when due. This risk is present in financial guarantee contracts, structured credit derivatives, investment agreements, interest rate swaps and futures contracts. Ambac Assurance manages its liquidity risk by maintaining a comprehensive daily analysis of projected cash flows. Additionally, Ambac Assurance maintains a minimum level of cash and short-term investments at all times. ACP manages the liquidity risk inherent in the structured credit derivative portfolio by holding cash and short-term investments, closely matching the dates that derivative payments are made and received, and by maintaining a revolving credit agreement. The investment agreement business manages liquidity risk by matching the effective duration of its invested assets, including hedges, with the effective duration of its investment agreement liabilities. Additionally, the Company's policy is to maintain a minimum level of cash and short-term assets equivalent to a specified percentage of its investment agreement liabilities outstanding. AFSLP maintains cash and short-term investments, closely matches the dates swap payments are made and received, and limits the amount of risk hedged with futures contracts. See additional discussion in "Liquidity and Capital Resources" section.

OPERATIONAL RISK. Operational risk relates to the potential for loss caused by a breakdown in information, communication and settlement systems. The Company mitigates operational risk by maintaining systems and procedures to monitor transactions and positions, documentation and confirmation of transactions and ensuring compliance with regulations.

LEGAL RISK. Legal risks attendant to the Company's businesses include uncertainty with respect to the enforceability of the obligations insured by Ambac Assurance, as well as uncertainty with respect to the enforceability of the obligations of the Company's counterparties, including contractual provisions intended to reduce exposure by providing for the offsetting or netting of mutual obligations. The Company seeks to remove or minimize such uncertainties through continuous consultation with internal and external legal advisers to analyze and understand the nature of legal risk, to improve documentation and to strengthen transaction structure.

OTHER MATTERS

YEAR 2000. To date the Company has had no disruptions with its internal computer systems as a result of what is commonly known as the Y2K problem. Although the Company had been running tests on its critical systems throughout 1999, a final live test occurred on January 1, 2000. The results of that test indicated that the Company's internal computer systems, and the normal business activities and operations that depend on them have not been adversely impacted by Y2K sensitive dates.

Although the Company does not expect issuers of Ambac-guaranteed obligations to experience significant disruptions due to Y2K, it may take a considerable amount of time before a full assessment can be made of how each issuer fared.

FOOTNOTES.

(1) Adjusted gross premiums ("AGP") written, which is not promulgated under Generally Accepted Accounting Principles ("GAAP"), is used by management, equity analysts and investors to measure the financial results of the Company. AGP written, which the Company reports as analytical data, is defined as gross up-front premiums written plus the present value of estimated future installment premiums written on insurance policies and structured credit derivatives issued in the period. The definition of AGP written used by the Company may differ from definitions of AGP written used by other public holding companies of financial guarantee insurers.

All reinsurance cessions to MBIA under the joint venture reinsurance arrangement reduce adjusted gross premiums written. Consequently, adjusted gross premiums written recorded by the Company includes only the net retention on business written under the joint venture arrangement.

(2) Core earnings and operating earnings are not substitutes for net income computed in accordance with GAAP, but are important measures used by management, equity analysts and investors to measure the financial results of the Company. The definition of core earnings and operating earnings used by the Company may differ from definitions of core earnings and operating earnings used by other public holding companies of financial guarantee insurers.

(3) Adjusted book value ("ABV"), which is not promulgated under GAAP, is used by management, equity analysts and investors as a measurement of the Company's intrinsic value with no benefit given for ongoing business activity. Management derives ABV by beginning with stockholders' equity (book value) and adding or subtracting the after-tax value of: the net unearned premium reserve, deferred acquisition costs, the present value of estimated net future installment premiums, and the unrealized gain or loss on investment agreement liabilities. The definition of ABV used by the Company may differ from definitions of ABV used by other public holding companies of financial guarantee insurers. The adjustments to book value described above will not be realized until future periods and may differ materially from the amounts used in determining ABV.

REPORT ON MANAGEMENT'S RESPONSIBILITIES

The management of Ambac Financial Group, Inc. is responsible for the integrity and objectivity of the financial statements and all other financial information presented in this Annual Report and for assuring that such information fairly presents the consolidated financial position and operating results of Ambac Financial Group, Inc. The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles using management's best estimates and judgment. The financial information presented elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

Ambac Financial Group, Inc. maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that the financial records are reliable for use in preparing financial statements and maintaining accountability of assets. Qualified and professional financial personnel maintain and monitor these internal controls on a continuous basis. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control should not exceed the related benefits.

Ambac Financial Group, Inc.'s consolidated financial statements have been audited by KPMG LLP, independent auditors, whose audits were made in accordance with generally accepted auditing standards and included a review of internal accounting controls to the extent necessary to express an opinion on the fairness of the consolidated financial statements.

The Audit Committee of the Board of Directors, comprised solely of outside directors, meets regularly with financial management, the independent auditors and the internal auditors to review the work and procedures of each. The independent auditors and the internal auditors have free access to the Audit Committee, without the presence of management, to discuss the results of their work and their considerations of Ambac Financial Group, Inc. and the quality of its financial reporting. The Board of Directors, upon recommendation of the Audit Committee, appoints the independent auditors, subject to stockholder approval.

Phillip B. Lassiter
Chairman, President and Chief Executive Officer

Frank J. Bivona
Executive Vice President and Chief Financial Officer

January 21, 2000

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders
Ambac Financial Group, Inc.

We have audited the accompanying consolidated balance sheets of Ambac Financial Group, Inc. and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of Ambac Financial Group, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ambac Financial Group, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1999 in conformity with generally accepted accounting principles.

KPMG LLP
New York, New York

January 21, 2000

(Dollars in thousands, except share amounts) December 31,	1999	1998
ASSETS:		
Investments:		
Fixed income securities, at fair value (amortized cost of $9,028,184 in 1999 and $8,307,046 in 1998)	$ 8,738,471	$ 8,622,282
Short-term investments, at cost (approximates fair value)	220,896	119,528
Other, at cost	3,168	6,567
Total investments	8,962,535	8,748,377
Cash	13,588	8,239
Securities purchased under agreements to resell	103,000	252,295
Receivable for investment agreements	45,918	73,142
Receivable for securities sold	15,369	16,233
Investment income due and accrued	128,668	125,929
Reinsurance recoverable	500	3,638
Prepaid reinsurance	217,977	199,920
Deferred acquisition costs	135,324	120,619
Deferred income taxes	57,377	—
Loans	685,488	673,930
Receivable from brokers and dealers	717,000	750,000
Other assets	262,352	239,989
Total assets	$11,345,096	$11,212,311
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Liabilities:		
Unearned premiums	$ 1,431,076	$ 1,294,214
Losses and loss adjustment expenses	121,475	115,794
Ceded reinsurance balances payable	15,028	6,576
Obligations under investment and payment agreements	4,180,513	4,774,953
Obligations under investment repurchase agreements	1,959,741	1,181,810
Deferred income taxes	—	145,782
Current income taxes	24,831	6,949
Debentures	423,995	423,929
Accrued interest payable	91,142	89,615
Accounts payable and other liabilities	268,696	262,423
Payable to brokers and dealers	717,000	750,000
Payable for securities purchased	93,149	64,176
Total liabilities	9,326,646	9,116,221
Stockholders' equity:		
Preferred stock, par value $0.01 per share; authorized shares — 4,000,000; issued and outstanding shares — none	—	—
Common stock, par value $0.01 per share; authorized shares -— 200,000,000 at December 31, 1999 and December 31, 1998; issued shares — 70,680,384 at December 31, 1999 and December 31, 1998	707	707
Additional paid-in capital	525,012	519,305
Accumulated other comprehensive (loss) income	(187,540)	159,313
Retained earnings	1,713,446	1,449,832
Common stock held in treasury at cost, 722,592 shares at December 31, 1999 and 738,381 at December 31, 1998	(33,175)	(33,067)
Total stockholders' equity	2,018,450	2,096,090
Total liabilities and stockholders' equity	$11,345,096	$11,212,311

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except share amounts) Years Ended December 31,	1999	1998	1997
REVENUES:			
Financial Guarantee:			
Gross premiums written	$445,242	$361,011	$286,163
Ceded premiums written	(61,845)	(49,563)	(32,452)
Net premiums written	$383,397	$311,448	$253,711
Net premiums earned	$264,426	$212,684	$154,000
Net fees earned and other income	6,034	5,781	4,402
Net investment income	209,284	186,190	159,709
Net realized (losses) gains	(5,675)	3,735	21,084
Financial Services:			
Net revenue	51,669	49,510	35,249
Net realized losses	(3,124)	(17,096)	(637)
Other:			
Revenue	9,906	13,725	7,207
Net realized gains	797	2,507	748
Total revenues	533,317	457,036	381,762
EXPENSES:			
Financial Guarantee:			
Losses and loss adjustment expenses	11,000	6,000	2,854
Underwriting and operating expenses	48,804	46,720	40,672
Financial Services	25,824	35,540	27,993
Interest	36,525	32,761	21,346
Other	6,506	7,103	2,901
Total expenses	128,659	128,124	95,766
Income before income taxes	404,658	328,912	285,996
Provision for income taxes	96,741	74,918	62,966
Net income	$307,917	$253,994	$223,030
Net income per share	$ 4.40	$ 3.63	$ 3.19
Net income per diluted share	$ 4.31	$ 3.56	$ 3.13
Weighted average number of shares outstanding	69,913,147	69,939,710	69,988,497
Weighted average number of diluted shares outstanding	71,366,210	71,330,053	71,227,347

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Dollars in thousands) Years Ended December 31,	1999		1998		1997	
RETAINED EARNINGS:						
Balance at January 1	$1,449,832		$1,262,740		$1,072,418	
Net income	307,917	$ 307,917	253,994	$253,994	223,030	$223,030
Dividends declared — common stock	(29,366)		(26,571)		(24,165)	
Exercise of stock options	(14,937)		(40,331)		(8,543)	
Balance at December 31	$1,713,446		$1,449,832		$1,262,740	
ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME:						
Balance at January 1	$ 159,313		$ 135,223		$ 58,911	
Unrealized (losses) gains on securities, ($552,645), $36,476, and $121,347, pre-tax in 1999, 1998 and 1997, respectively (1)		(346,211)		23,889		76,155
Foreign currency (loss) gain		(642)		201		157
Other comprehensive (loss) income	(346,853)	(346,853)	24,090	24,090	76,312	76,312
Total comprehensive (loss) income		$ (38,936)		$278,084		$299,342
Balance at December 31	$ (187,540)		$ 159,313		$ 135,223	
PREFERRED STOCK:						
Balance at January 1 and December 31	$ —		$ —		$ —	
COMMON STOCK:						
Balance at January 1	$ 707		$ 707		$ 353	
Stock split effected as dividend	—		—		354	
Balance at December 31	$ 707		$ 707		$ 707	
ADDITIONAL PAID-IN CAPITAL:						
Balance at January 1	$ 519,305		$ 500,107		$ 498,401	
Issuance of stock	—		—		(3,506)	
Exercise of stock options	5,707		19,198		5,566	
Stock split effected as dividend	—		—		(354)	
Balance at December 31	$ 525,012		$ 519,305		$ 500,107	
COMMON STOCK HELD IN TREASURY AT COST:						
Balance at January 1	$ (33,067)		$ (26,295)		$ (15,067)	
Cost of shares acquired	(17,626)		(52,738)		(40,397)	
Shares issued under equity plans	17,518		45,966		29,169	
Balance at December 31	$ (33,175)		$ (33,067)		($26,295)	
TOTAL STOCKHOLDERS' EQUITY AT DECEMBER 31	$2,018,450		$2,096,090		$1,872,482	

(1) Disclosure of reclassification amount:	1999	1998	1997
Unrealized holding (losses) gains arising during period	$(351,412)	$34,526	$88,744
Less: reclassification adjustment for net (losses) gains included in net income	(5,201)	10,637	12,589
Net unrealized (losses) gains on securities	$(346,211)	$23,889	$76,155

See accompanying Notes to Consolidated Financial Statements.

(Dollars in thousands) Years Ended December 31,	1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 307,917	$ 253,994	$ 223,030
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	2,969	2,460	1,925
Amortization of bond premium and discount	(4,444)	(4,942)	(3,257)
Current income taxes	17,882	(2,067)	9,978
Deferred income taxes	3,274	(2,034)	12,015
Deferred acquisition costs	(14,705)	(14,623)	(11,784)
Unearned premiums, net	118,805	98,796	99,706
Losses and loss adjustment expenses	8,819	13,030	408
Ceded reinsurance balances payable	8,452	(2,682)	1,303
Investment income due and accrued	(2,739)	(47,239)	(9,415)
Accrued interest payable	1,527	43,598	16,059
Loss (gain) on sales of investments and affiliates	8,002	10,854	(21,195)
Other, net	(1,359)	(21,349)	(2,762)
Net cash provided by operating activities	454,400	327,796	316,011
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sales of bonds	2,403,583	2,020,463	1,718,174
Proceeds from matured bonds	1,371,715	1,034,511	1,080,338
Purchases of bonds	(4,427,369)	(4,746,366)	(4,135,404)
Change in short-term investments	(101,368)	16,750	(23,767)
Securities purchased under agreements to resell	149,295	(166,829)	115,703
Loans	(11,558)	(170,738)	(503,192)
Purchase of affiliate, net of cash acquired	—	—	(120,006)
Other, net	(14,591)	(39,617)	(10,615)
Net cash used in investing activities	(630,293)	(2,051,826)	(1,878,769)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends paid	(29,366)	(26,571)	(24,165)
Proceeds from issuance of investment agreements	3,051,508	3,628,266	2,805,256
Payments for investment agreement draws	(2,852,350)	(2,236,348)	(1,708,775)
Proceeds from issuance of debentures	—	193,700	—
Payment agreements	11,558	170,738	503,192
Purchases of treasury stock	(17,626)	(52,738)	(40,397)
Proceeds from sale of treasury stock	17,518	45,966	29,169
Net cash provided by financing activities	181,242	1,723,013	1,564,280
NET CASH FLOW	5,349	(1,017)	1,522
Cash at January 1	8,239	9,256	7,734
Cash at December 31	$ 13,588	$ 8,239	$ 9,256
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Income taxes	$ 70,100	$ 66,853	$ 34,163
Interest expense on debt	$ 36,743	$ 33,056	$ 21,799
Interest expense on investment agreements	$ 298,309	$ 252,713	$ 169,875

See accompanying Notes to Consolidated Financial Statements.

1 BACKGROUND

Ambac Financial Group, Inc. ("AFGI") is a holding company whose subsidiaries provide financial guarantees and financial services to clients in both the public and private sectors around the world. AFGI's principal operating subsidiary, Ambac Assurance Corporation ("Ambac Assurance"), a leading provider of financial guarantees for municipal and structured finance obligations, has earned triple-A ratings, the highest ratings available from Moody's Investors Service, Inc., Standard & Poor's Ratings Group, Fitch IBCA, Inc., and Japan Rating and Investment Information, Inc. AFGI's Financial Services segment provides investment agreements, interest rate swaps, and investment advisory and cash management services, principally to states, municipalities and their authorities, school districts, and hospitals and health organizations.

2 SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements of AFGI and subsidiaries (the "Company") have been prepared on the basis of U.S. Generally Accepted Accounting Principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant accounting policies of the Company are described below:

CONSOLIDATION: The consolidated financial statements include the accounts of AFGI and its subsidiaries. All significant intercompany balances have been eliminated.

NET INCOME PER SHARE AND NET INCOME PER DILUTED SHARE: Net income per share is based on the weighted-average number of common shares outstanding during the year, retroactively adjusted to reflect a two-for-one stock split in 1997. Net income per diluted share reflects the potential dilution that would occur if securities, such as employee stock options or restricted stock units, were exercised or converted to common shares, respectively.

INVESTMENTS: The Company's investment portfolio is accounted for on a trade-date basis and consists primarily of investments in fixed income securities that are considered available-for-sale and are carried at fair value. Fair value is based primarily on quotes obtained by the Company from independent market sources. Short-term investments are carried at cost, which approximates fair value. Unrealized gains and losses, net of deferred income taxes, are included as a component of "Accumulated Other Comprehensive (Loss) Income" in stockholders' equity and are computed using amortized cost as the basis. For purposes of computing amortized cost, premiums and discounts are accounted for using the interest method. For bonds purchased at a price below par value, discounts are accreted over the remaining term of the securities. For bonds purchased at a price above par value which have call features, premiums are amortized to the most likely call dates as determined by management. For premium bonds that do not have call features, such premiums are amortized over the remaining terms of the securities. Premiums and discounts on mortgage-backed and asset-backed securities are adjusted for the effects of actual and anticipated prepayments. Realized gains and losses on the sale of investments are determined on the basis of specific identification.

SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL: Securities purchased under agreements to resell are collateralized financing transactions, and are recorded at their contracted resale amounts, plus accrued interest. The Company takes possession of the collateral underlying those agreements and monitors its market value on a daily basis and, when necessary, requires prompt transfer of additional collateral to reflect current market value. At December 31, 1999 such collateral had a market value approximately equal to 102% of the contract amount, had an average credit rating of triple-A and a weighted average maturity of less than 30 days.

LOANS: Loans are reported at their outstanding unpaid principal balances, net of any deferred fees. Interest income is accrued on the unpaid principal balance. Deferred fees are amortized to interest income over the contractual life of the loan using the interest method or the straight-line method if not materially different.

OBLIGATIONS UNDER INVESTMENT AND PAYMENT AGREEMENTS: Obligations under investment and payment agreements and investment repurchase agreements are recorded as liabilities on the consolidated balance sheets at the face value of the agreement, adjusted for draws paid and interest credited to the account. Unsettled agreements are accrued on a trade-date basis on the consolidated balance sheets at the time of commitment. Interest expense is computed based upon daily outstanding settled liability balances at rates and periods specified in the agreements. Net interest income relating to investment agreements and investment repurchase agreements is included as a component of Financial Services revenue.

PREMIUM REVENUE RECOGNITION: Up-front premiums are earned pro-rata over the period of risk. Premiums are allocated to each bond maturity based on par amount and are earned on a straight-line basis over the term of each maturity. Installment premiums are earned over each installment period, generally one year or less. When a new or secondary market issue insured by Ambac Assurance has been refunded or called, the remaining unearned premium (net of refunding credits, if any) is generally earned at that time.

LOSSES AND LOSS ADJUSTMENT EXPENSES: The liability for losses and loss adjustment expenses consists of the active credit reserve ("ACR") and case basis loss and loss adjustment expense reserves. The development of the ACR is based upon estimates of the expected annual levels of debt

service defaults resulting from credit failures on currently guaranteed issues that are not presently or imminently in default. When losses occur (actual monetary defaults or defaults which are imminent on guaranteed obligations), case basis loss reserves are established in an amount that is sufficient to cover the present value of the anticipated defaulted debt service payments over the expected period of default and estimated expenses associated with settling the claims, less estimated recoveries under salvage or subrogation rights. During 1999, 1998 and 1997, paid losses, net of salvage received were $2,182, ($7,030), and $2,474, respectively. All or parts of case basis loss reserves are allocated from any ACR available.

Ambac Assurance's management believes that the reserves for losses and loss adjustment expenses are adequate to cover the ultimate net cost of claims, but the reserves are necessarily based on estimates and there can be no assurance that the ultimate liability will not exceed such estimates.

DEFERRED ACQUISITION COSTS: Certain costs incurred, primarily related to the production of business, have been deferred. These costs include direct and indirect expenses related to underwriting, marketing and policy issuance, rating agency fees and premium taxes, net of reinsurance ceding commissions. The deferred acquisition costs are being amortized over the periods in which the related premiums are earned, and such amortization amounted to $20,843, $18,248 and $14,213 for 1999, 1998 and 1997, respectively. Deferred acquisition costs, net of such amortization, amounted to $14,705, $14,623 and $11,784 for 1999, 1998 and 1997, respectively.

DEPRECIATION AND AMORTIZATION: Depreciation of furniture and fixtures and electronic data processing equipment is provided over the estimated useful lives of the respective assets, ranging from three to five years, using the straight-line method. Amortization of leasehold improvements and intangibles, including certain computer software licenses, is provided over the estimated useful lives of the respective assets, ranging from three to 10 years, using the straight-line method.

DERIVATIVE CONTRACTS: *Derivative Contracts Held for Purposes Other Than Trading:* The Company uses derivative contracts (primarily interest rate swaps and futures contracts) for hedging purposes as part of its overall interest rate risk management.

The Company accounts for its futures contracts in accordance with the provisions of FAS Statement 80, "Accounting for Futures Contracts" ("FAS 80"). FAS 80 permits hedge accounting for futures contracts when the item to be hedged exposes the Company to price or interest rate risk, and the futures contract effectively reduces that exposure and is designated as a hedge. Futures contracts held for purposes other than trading are used primarily to hedge interest rate sensitive assets and liabilities. Futures contracts are designated at inception as a hedge to specific assets and liabilities. Gains and losses on futures contracts that qualify as accounting hedges of existing assets or liabilities are included as a component of "Accumulated Other Comprehensive (Loss) Income" in stockholders' equity, net of deferred tax, and amortized over the remaining lives of the assets and liabilities as an adjustment to interest income or expense. When the hedged asset is sold, or the hedged liability is settled, the unamortized gain or loss on the related hedge is recognized in income.

Interest rate swaps that are linked with existing liabilities are accounted for as a hedge of those liabilities, using the accrual method as an adjustment to interest expense. Interest rate swaps that are linked with existing assets classified as available for sale are accounted for as hedges of those assets, using the accrual method as an adjustment to interest income, with unrealized gains and losses included as a component of "Accumulated Other Comprehensive (Loss) Income" in stockholders' equity, net of deferred tax. Interest rate risk is managed through the linkage of the interest rate swaps, which synthetically changes the nature of the underlying asset or liability (for example, from a fixed to floating interest rate obligation).

Derivative Contracts Held for Trading Purposes: The Company, through its subsidiary Ambac Financial Services, L.P. ("AFSLP"), provides interest rate swaps to states, municipalities and their authorities, and other entities in connection with their financings. The Company, through its subsidiary Ambac Credit Products L.L.C. ("ACP"), enters into structured credit derivative transactions with various financial institutions. Interest rate swaps and structured credit derivatives are classified as held for trading purposes. These contracts are recorded on trade date at fair value. Changes in fair value are recorded as a component of Financial Services segment income for interest rate swaps and as a component of Financial Guarantee segment income for structured credit derivatives. The fair values of interest rate swaps and structured credit derivatives are determined by broker quotes or valuation models (when broker quotes are not available). Contracts are recorded on the balance sheet on a gross basis; assets and liabilities are netted by customer only when a legal right of set-off exists. Gross asset and gross liability balances for interest rate swaps and structured credit derivatives are recorded as other assets or other liabilities on the Consolidated Balance Sheets.

INCOME TAXES: AFGI files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on

deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS: The Company provides various postretirement and postemployment benefits, including pension, and health and life benefits covering substantially all employees who meet certain age and service requirements. The Company accounts for these benefits under the accrual method of accounting. Amounts related to the defined benefit pension plan and postretirement health benefits are charged based on actuarial determinations.

STOCK COMPENSATION PLANS: In 1997, the Company adopted the Ambac 1997 Equity Plan. Under this plan, awards are granted to eligible employees of the Company in the form of non-qualified stock options or other stock-based awards. The Company accounts for its incentive stock options and stock-based awards under FAS Statement 123, "Accounting for Stock-Based Compensation" ("FAS 123"). FAS 123 permits a company to choose either the fair value based method of accounting as defined in the Statement or the intrinsic value based method of accounting as prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), for its stock-based compensation plans. Companies electing the accounting requirements under APB 25 must also make pro-forma disclosures of net income, earnings per share and earnings per diluted share, as if the fair value based method of accounting had been applied. The Company has elected to account for its plans under APB 25.

ACCOUNTING STANDARDS: In June 1998, the Financial Accounting Standards Board issued FAS Statement 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities. The statement requires all derivatives to be recorded on the balance sheet at fair value and establishes special accounting for the following three different types of hedges: (1) hedges of changes in the fair value of assets, liabilities or firm commitments (fair value hedges); (2) hedges of the variable cash flows of forecasted transactions (cash flow hedges); and (3) hedges of foreign currency exposures of net investments in foreign operations. Though the accounting treatment and criteria for each of the three types of hedges is unique, they all result in recognizing offsetting changes in value or cash flow of both the hedge and the hedged item in earnings in the same period. Changes in the fair value of derivatives that do not meet the criteria of one of these three categories of hedges are included in earnings in the period of the change with no related offset. FAS 133 is effective for years beginning after June 15, 2000, but companies may adopt early. The Company will adopt FAS 133 effective January 1, 2001. The impact of adopting FAS 133 as of December 31, 1999 would have been insignificant to the Company's consolidated financial position and results of operations.

RECLASSIFICATIONS: Certain reclassifications have been made to prior years' amounts to conform to the current year's presentation.

3 INVESTMENTS

The amortized cost and estimated fair value of investments in fixed income securities and short-term investments at December 31, 1999 and 1998 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
1999				
Municipal obligations	$3,094,469	$ 40,986	$172,516	$2,962,939
Corporate obligations	1,094,102	8,623	94,221	1,008,504
U.S. Government obligations	63,197	778	1,496	62,479
Mortgage- and asset-backed securities (includes U.S. Government Agency obligations)	4,776,416	1,014	72,881	4,704,549
Short-term	220,896	—	—	220,896
Total	$9,249,080	$ 51,401	$341,114	$8,959,367
1998				
Municipal obligations	$2,632,276	$172,960	$ 3,912	$2,801,324
Corporate obligations	1,335,749	103,030	3,352	1,435,427
U.S. Government obligations	114,385	8,511	—	122,896
Mortgage- and asset-backed securities (includes U.S. Government Agency obligations)	4,224,636	41,994	3,995	4,262,635
Short-term	119,528	—	—	119,528
Total	$8,426,574	$326,495	$ 11,259	$8,741,810

The amortized cost and estimated fair value of fixed income securities and short-term investments at December 31, 1999, by contractual maturity, were as follows:

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 296,784	$ 296,646
Due after one year through five years	284,950	292,852
Due after five years through ten years	402,370	402,065
Due after ten years	3,488,560	3,263,255
	4,472,664	4,254,818
Mortgage- and asset-backed securities	4,776,416	4,704,549
	$9,249,080	$8,959,367

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities carried at $5,442 and $6,191 at December 31, 1999 and 1998, respectively, were deposited by the Company with governmental authorities or designated custodian banks as required by laws affecting insurance companies.

Net investment income from the Financial Guarantee segment was comprised of the following:

	1999	1998	1997
Fixed income securities	$202,805	$181,437	$155,810
Short-term investments	7,790	8,139	6,506
Total investment income	210,595	189,576	162,316
Investment expense	(1,311)	(3,386)	(2,607)
Net investment income	$209,284	$186,190	$159,709

The Financial Guarantee segment had gross realized gains of $8,050, $14,219 and $25,641 for 1999, 1998 and 1997, respectively, and gross realized losses of $13,725, $10,484 and $4,557 for 1999, 1998 and 1997, respectively.

Net investment income related to the investment agreement business comprises gross investment income from its investment portfolio less interest expense from investment agreement liabilities, and is a component of Financial Services net revenue. The following table summarizes net investment income for the investment agreement business:

	1999	1998	1997
Gross interest income	$323,175	$281,904	$200,337
Gross interest expense	299,523	263,586	186,678
Net investment income	$ 23,652	$ 18,318	$ 13,659

The Financial Services segment had gross realized gains of $44,634, $22,592 and $3,766 for 1999, 1998 and 1997, respectively, and gross realized losses of $47,758, $39,688 and $4,403 for 1999, 1998 and 1997, respectively. Gross realized gains and losses in 1999 reflect actions taken to re-balance the investment agreement investment portfolio. This re-balancing caused the duration of invested assets to be more naturally matched to the duration of related liabilities, which allowed the Company to significantly reduce its derivative hedges. Gross realized gains and losses in 1998 and 1997 include amounts related to a trading position, which represented a small portion of the Company's assets, containing high quality municipal bonds hedged with Treasury futures. These gains were $2,967 and $1,309 for 1998 and 1997, respectively, and losses were $18,638 and $3,578 for 1998 and 1997, respectively. Gross realized losses in 1998 also include the Company's $11,548 write-off of its investment in Ambac Connect, Inc.

As of December 31, 1999 and 1998, the Company held securities subject to agreements to resell for $103,000 and $252,295, respectively. The Company held these securities as collateral under agreements that had terms of less than 30 days.

As of December 31, 1999 and 1998, the Company had pledged (or sold under agreements to repurchase) securities purchased under agreements to resell and investment securities to certain municipalities, with a fair value of $3,634,710 and $3,636,519, respectively, in connection with certain investment agreements (including agreements structured as investment repurchase agreements).

The Company has entered into security borrowing agreements, the purpose of which was to limit the Company's cost of collateralizing certain investment agreements (including agreements structured as investment repurchase agreements) by reducing the use of securities purchased under agreements to resell. The security borrowing agreements allow the Company to borrow securities with a maximum market value of $1,000,000. The borrowings are secured by Company-owned investment securities. As of December 31, 1999 and 1998, the Company had $717,000 and $750,000, respectively, in outstanding securities borrowed. The borrowings and related pledged securities are classified as "Payable to brokers and dealers" and "Receivable from brokers and dealers," respectively, on the Consolidated Balance Sheets.

4 LOANS

In the normal course of business, the Company has extended loans to customers participating in certain structured municipal transactions. The loans are collateralized with cash that the customers have deposited with a payment custodian in amounts adequate to repay the loan balance and interest thereon. Equipment and other assets underlying the transactions serve as additional collateral for the loans. The Company may act as the payment custodian and hold the funds posted as collateral. As of December 31, 1999, 1998 and 1997 the interest rates on these loans ranged from 6.25% to 8.42%.

5 REINSURANCE

In the ordinary course of business, Ambac Assurance cedes exposures under various reinsurance contracts primarily designed to minimize losses from large risks and to protect capital and surplus. The effect of reinsurance on premiums written and earned was as follows:

Years Ended December 31,	1999		1998		1997	
	Written	Earned	Written	Earned	Written	Earned
Direct	$420,669	$289,053	$333,652	$238,452	$277,814	$176,009
Assumed	24,573	19,161	27,359	7,367	8,349	3,614
Ceded	(61,845)	(43,788)	(49,563)	(33,135)	(32,452)	(25,623)
Net premiums	$383,397	$264,426	$311,448	$212,684	$253,711	$154,000

The reinsurance of risk does not relieve the ceding insurer of its original liability to its policyholders. In the event that all or any of the reinsurers are unable to meet their obligations to Ambac Assurance under the existing reinsurance agreements, Ambac Assurance would be liable for such defaulted amounts. To minimize its exposure to significant losses from reinsurer insolvencies, Ambac Assurance evaluates the financial condition of its reinsurers and monitors concentrations of credit risk. There were no reinsurance recoverables on paid losses as of December 31, 1999 and 1998. As of December 31, 1999, prepaid reinsurance of approximately $158,597 was associated with Ambac Assurance's three largest reinsurers. As of December 31, 1999, Ambac Assurance held letters of credit and collateral amounting to approximately $214,896 from its reinsurers to cover liabilities ceded under the aforementioned reinsurance contracts.

In 1995, Ambac Assurance and MBIA Insurance Corporation ("MBIA") formed an unincorporated joint venture, MBIA•AMBAC International. The joint venture was formed with the goal of bringing the combined capital and human resources of the two companies together to more efficiently serve the international market. Under the joint venture arrangement, financial guarantees are issued separately by each of the companies. Premiums assumed from MBIA under this arrangement were $24,503, $18,715 and $8,009 in 1999, 1998 and 1997, respectively, and premiums ceded to MBIA under this arrangement were $27,418, $15,505 and $8,874 in 1999, 1998 and 1997, respectively.

6 STOCKHOLDERS' EQUITY

The Company is authorized to issue 200,000,000 shares of Common Stock, par value $0.01 per share, of which 70,680,384 were issued as of December 31, 1999. The Company is also authorized to issue 4,000,000 shares of preferred stock, $0.01 par value per share, none of which was issued and outstanding as of December 31, 1999.

Dividends declared per share amounted to $0.42, $0.38 and $0.345 in 1999, 1998 and 1997, respectively.

The Board of Directors of the Company (the "Board") has authorized the establishment of a stock repurchase program that permits the repurchase of up to 6,000,000 shares of the Company's Common Stock. As of December 31, 1999, approximately 4,573,000 shares had been repurchased under this program for an aggregate amount of $160,300.

STOCKHOLDER RIGHTS PLAN: The Company adopted a Stockholder Rights Plan under which stockholders received (after giving effect to a stock split since adoption of the Plan) one Right for each two shares of Common Stock owned. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of Series A Junior Participating Preferred Stock, par value $0.01 per share, at a purchase price of $190 per share. The Rights generally detach and become exercisable when any person or group acquires 20% or more (or announces a tender offer for 20% or more) of the Company's Common Stock, at which time each Right (other than those held by the acquiring company) will entitle the holder to receive that number of shares of Common Stock of the Company with a value of two times the exercise price of the Right. If the Company is acquired in a merger or other business combination transaction in which the Company is not the surviving corporation or 50% or more of the Company's assets, cash flow or earning power is sold or transferred, each Right will entitle the holder to receive that number of shares of stock of the acquiring company having a value equal to two times the exercise price of the Right. The Rights, which expire on January 31, 2006, are redeemable in whole, but not in part, by action of the Board at a price of $0.01 per Right at any time prior to their becoming exercisable.

7 COMMITMENTS AND CONTINGENCIES

The Company is responsible for leases on the rental of office space. The lease agreements, which expire periodically through September 2019, contain provisions for scheduled periodic rent increases and are accounted for as operating leases. An estimate of future net minimum lease payments

in each of the next five years ending December 31, and the periods thereafter, is as follows:

	Amount
2000	$ 7,039
2001	6,206
2002	6,143
2003	6,117
2004	6,122
All later years	83,102
	$114,729

Rent expense for the aforementioned leases amounted to $5,347, $5,537 and $5,048 for the years ended December 31, 1999, 1998 and 1997, respectively. Total rentals to be received under future sublease agreements are estimated at $3,490.

8 INSURANCE REGULATORY RESTRICTIONS

Ambac Assurance is subject to insurance regulatory requirements of the States of Wisconsin and New York, and the other jurisdictions in which it is licensed to conduct business.

Ambac Assurance's ability to pay dividends is generally restricted by law and subject to approval by the Office of the Commissioner of Insurance of the State of Wisconsin (the "Wisconsin Commissioner"). Wisconsin insurance law restricts the payment of dividends in any 12-month period without regulatory approval to the lesser of (a) 10% of policyholders' surplus as of the preceding December 31 and (b) the greater of (i) statutory net income for the calendar year preceding the date of dividend, minus realized capital gains for that calendar year and (ii) the aggregate of statutory net income for three calendar years preceding the date of the dividend, minus realized capital gains for those calendar years and minus dividends paid or credited within the first two of the three preceding calendar years. Based upon these restrictions, at December 31, 1999, the maximum amount that will be available during 2000 for payment of dividends by Ambac Assurance is approximately $150,000. Ambac Assurance paid cash dividends of $52,000, $48,000 and $44,000 on its common stock in 1999, 1998 and 1997, respectively.

The New York Financial Guaranty Insurance Law establishes single risk limits applicable to all obligations issued by a single entity and backed by a single revenue source. Under the limit applicable to municipal bonds, the insured average annual debt service for a single risk, net of reinsurance and collateral, may not exceed 10% of qualified statutory capital, which is defined as the sum of insurer's policyholders' surplus and contingency reserves. In addition, insured principal of municipal bonds attributable to any single risk, net of reinsurance and collateral, is limited to 75% of Ambac Assurance's qualified statutory capital. Additional single risk limits, which generally are more restrictive than the municipal bond single risk limit, are also specified for several other categories of insured obligations.

Statutory capital and surplus was $1,503,303 and $1,162,639 at December 31, 1999 and 1998, respectively. Qualified statutory capital was $2,420,455 and $1,936,103 at December 31, 1999 and 1998, respectively. Statutory net income for Ambac Assurance was $262,756, $271,808 and $198,615 for 1999, 1998 and 1997, respectively. Statutory capital and surplus differs from stockholders' equity determined under GAAP principally due to statutory accounting rules that treat loss reserves, premiums earned, policy acquisition costs, and deferred income taxes differently.

9 INCOME TAXES

The Company's provision for income taxes is comprised of the following:

	1999	1998	1997
Current taxes	$89,543	$72,608	$51,036
Deferred taxes	7,198	2,310	11,930
	$96,741	$74,918	$62,966

The total effect of income taxes on income and stockholders' equity for the years ended December 31, 1999 and 1998 was as follows:

	1999	1998
Total income taxes charged to income	$ 96,741	$ 74,918
Income taxes credited to stockholders' equity:		
Unrealized (losses) gains on bonds	(206,433)	12,587
Exercise of stock options	(5,707)	(19,198)
Total credited to stockholders' equity	(212,140)	(6,611)
Total effect of income taxes	$(115,399)	$ 68,307

The tax provisions in the accompanying Consolidated Statements of Operations reflect effective tax rates differing from prevailing federal corporate income tax rates. The following is a reconciliation of these differences:

	1999	%	1998	%	1997	%
Tax computed at statutory rate	$141,630	35.0%	$115,119	35.0%	$100,099	35.0%
Reductions in expected tax resulting from:						
Tax-exempt interest	(43,241)	(10.7)	(38,926)	(11.8)	(35,682)	(12.5)
Other, net	(1,648)	(0.4)	(1,275)	(0.4)	(1,451)	(0.5)
Income tax expense	$ 96,741	23.9%	$ 74,918	22.8%	$ 62,966	22.0%

The tax effects of temporary differences that give rise to significant portions of the deferred tax liabilities and deferred tax assets at December 31, 1999 and 1998 are presented below:

	1999	1998
Deferred tax liabilities:		
Contingency reserve	$153,613	$ 119,150
Unrealized gains on bonds	—	87,930
Deferred acquisition costs	47,287	42,583
Unearned premiums	43,319	36,728
Investments	5,284	2,442
Other	2,347	1,189
Total deferred tax liabilities	251,850	290,022
Deferred tax assets:		
Tax and loss bonds	120,971	88,471
Unrealized loss on bonds	118,503	—
Loss reserves	33,339	27,918
Compensation	16,444	12,009
Alternative minimum tax carryforward	13,625	7,001
Amortization and depreciation	1,256	5,406
Other	5,089	3,435
Sub-total deferred tax assets	309,227	144,240
Valuation allowance	—	—
Total deferred tax assets	309,227	144,240
Net deferred tax assets (liabilities)	$ 57,377	$(145,782)

The Company believes that no valuation allowance is necessary in connection with the deferred tax assets.

10 EMPLOYEE BENEFITS

PENSIONS: The Company has a defined benefit pension plan covering substantially all employees of the Company. The benefits are based on years of service and the employee's highest salary during five consecutive years of employment within the last ten years of employment. The Company's funding policy is to contribute annually the maximum amount that can be deducted for Federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service-to-date, but also for those expected to be earned in the future.

The table below sets forth a reconciliation of the beginning and ending projected benefit obligation, beginning and ending balances of the fair value of plan assets, and the funded status of the plan as of December 31, 1999 and 1998.

	1999	1998
CHANGE IN PROJECTED BENEFIT OBLIGATION:		
Projected benefit obligation at beginning of year	$12,433	$ 9,374
Service cost	979	691
Interest cost	783	684
Amendments	—	116
Actuarial (gain) loss	(2,702)	1,843
Benefits paid	(292)	(275)
Projected benefit obligation at end of year	$11,201	$12,433
CHANGE IN PLAN ASSETS:		
Fair value of plan assets at beginning of year	$10,934	$ 9,644
Actual return on plan assets	1,679	1,595
Company contributions	520	—
Benefits paid	(292)	(275)
Expenses paid	—	(30)
Fair value of plan assets at end of year	$12,841	$10,934
Funded status	$ 1,640	$ (1,499)
Unrecognized net (gain) loss	(2,615)	1,118
Unrecognized prior service cost	(931)	(1,289)
Unrecognized net transition asset	(1)	(4)
Pension liability included in other liabilities	$ (1,907)	$ (1,674)

Net pension costs for 1999, 1998 and 1997 included the following components:

	1999	1998	1997
Service cost	$ 979	$ 807	$ 723
Interest cost on expected benefit obligation	783	684	601
Expected return on plan assets	(893)	(793)	(701)
Amortization of unrecognized transition asset	(3)	(3)	(3)
Amortization of prior service cost	(151)	(165)	(165)
Recognized net actuarial loss	39	15	33
Net periodic pension cost	$ 754	$ 545	$ 488

The discount rate used in the determination of the actuarial present value for the projected benefit obligation was 7.50% and 6.50% for 1999 and 1998, respectively. The expected long-term rate of return on assets was 9.25% for both 1999 and 1998. The rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation was 5.0% for both 1999 and 1998.

Substantially all employees of the Company are covered by a defined contribution plan (the "Savings Incentive Plan"), for which contributions and costs are determined as 6% of each eligible employee's eligible base salary, plus a matching company contribution of 50% on contributions up to 6% of base salary made by eligible employees to the Savings Incentive Plan. The total cost of the Savings Incentive Plan was $2,165, $2,063 and $1,806 in 1999, 1998 and 1997, respectively.

ANNUAL INCENTIVE PROGRAM: The Company has an annual incentive program that provides for awards to key officers and employees based upon predetermined criteria. The cost of the program for the years ended December 31, 1999, 1998 and 1997 amounted to $18,091, $16,095 and $12,038, respectively.

POSTRETIREMENT HEALTH CARE AND OTHER BENEFITS: The Company provides certain medical and life insurance benefits for retired employees and eligible dependents. All plans are contributory. None of the plans are currently funded.

Postretirement benefits expense was $497, $316 and $262 in 1999, 1998 and 1997, respectively. The unfunded accumulated postretirement benefit obligation was $2,897 and the related accrued postretirement liability was $2,315 as of December 31, 1999.

The assumed health care cost trend rates range from 8.0% in 1999, decreasing ratably to 5.5% in 2003, and remaining at that level thereafter. Increasing the assumed health care cost trend rate by one percentage point in each future year would increase the accumulated postretirement benefit obligation at December 31, 1999 by $415 and the 1999 benefit expense by $78. The weighted average discount rate used to measure the accumulated postretirement benefit obligation and 1999 expense was 7.5%.

11 GUARANTEES IN FORCE

The par amount of bonds guaranteed, net of reinsurance, was $240,307,000 and $198,274,000 at December 31, 1999 and 1998, respectively. As of December 31, 1999 and 1998, the guarantee portfolio was diversified by type of insured bond as shown in the following table:

	Net Par Amount Outstanding	
(Dollars in millions)	1999	1998
Municipal finance:		
Lease and tax-backed revenue	$ 40,874	$36,929
General obligation	39,777	37,502
Utility revenue	28,867	27,014
Health care revenue	18,628	20,071
Transportation revenue	10,247	7,831
Investor-owned utilities	9,393	8,013
Higher education	9,172	7,720
Housing revenue	7,033	6,445
Student loans	5,474	4,528
Other	3,550	873
Total municipal finance	173,015	156,926
Structured finance:		
Mortgage-backed and home equity	33,294	19,478
Asset-backed and conduits	16,398	12,147
Other	3,270	1,238
Total structured finance	52,962	32,863
International finance:		
Asset-backed and conduits	6,023	3,180
Structured credit derivatives	2,110	—
Utilities	1,188	1,073
Mortgage-backed and home equity	1,172	607
Sovereign/sub-sovereign	1,097	1,027
Other	2,740	2,598
Total international finance	14,330	8,485
	$240,307	$198,274

As of December 31, 1999 and 1998, the international insured portfolio is shown in the following table by location of risk:

	Net Par Amount Outstanding	
(Dollars in millions)	1999	1998
United Kingdom	$ 2,416	$2,289
Japan	1,485	675
France	738	692
Australia	722	779
Mexico	569	375
Internationally diversified	5,686	1,621
Other international	2,714	2,054
Total international	$14,330	$8,485

Internationally diversified includes structured credit derivatives and other guarantees with multiple locations of risk. International business includes all transactions conducted through the MBIA·AMBAC International joint venture. Joint venture transactions may include components of domestic exposure.

Direct financial guarantees in force (principal and interest) was $430,536,000 and $367,801,000 at December 31,

1999 and 1998, respectively. Net financial guarantees in force (after giving effect to reinsurance) was $374,484,000 and $317,668,000 as of December 31, 1999 and 1998, respectively.

In the United States, California was the state with the highest aggregate net par amount in force, accounting for 10.5% of the total at December 31, 1999, and no other state accounted for more than ten percent. The highest single insured risk represented less than 1% of aggregate net par amount insured.

12 FINANCIAL INSTRUMENTS HELD FOR PURPOSES OTHER THAN TRADING

DERIVATIVE FINANCIAL INSTRUMENTS: In the normal course of business, the Company becomes a party to various financial instruments to reduce its exposure to fluctuations in interest rates. These financial instruments include interest rate swaps, exchange traded futures contracts and interest rate option contracts. The notional amounts of these financial instruments were as follows:

As of December 31,	1999	1998
Derivative financial instruments with off-balance sheet risk:		
Interest rate futures contracts	$ —	$5,836,700
Interest rate swaps	46,492	590,468
Other:		
Purchased interest rate options	—	15,000

Notional amounts are often used to express the volume of these transactions and do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk.

As discussed in Note 2, interest rate futures and option contracts held for purposes other than trading are used primarily to hedge interest rate risk inherent in the portfolio of interest-sensitive assets and liabilities. Interest rate swaps held for purposes other than trading are used to manage interest rate risk by synthetically changing the nature of specific assets or liabilities.

Futures contracts are purchased to hedge interest rate risk inherent in fixed rate liabilities. Futures contracts are sold to hedge interest rate risk inherent in fixed rate investment securities. Interest rate option contracts are purchased to hedge interest rate risk inherent in fixed rate assets and liabilities. At December 31, 1999 and 1998, futures and option contracts with an outstanding notional of $0 and $360,700, respectively, were designated as hedges of fixed rate liabilities. Additionally, at December 31, 1999 and 1998, futures and option contracts with an outstanding notional of $0 and $5,491,000, respectively, were designated as hedges of fixed rate investment securities.

Interest rate swaps that require the Company to pay a fixed rate are used primarily to hedge fixed rate investment securities. Interest rate swaps that require the Company to receive a fixed rate are used primarily to hedge fixed rate liabilities. The table below summarizes, for each major type of swap, the weighted average fixed rate paid or received on the respective notional amounts outstanding. Notional amounts are used to calculate the contractual payments to be exchanged.

Maturing after December 31,	2000	2001	2002	2003	2004	Thereafter
Pay fixed swaps:						
Notional amount	$33,570	$—	$—	$—	$—	$—
Weighted-average fixed rate	7.51%					
Receive fixed swaps:						
Notional amount	$12,271	$11,602	$10,913	$10,205	$9,477	$19,945
Weighted-average fixed rate	6.46%	6.46%	6.46%	6.46%	6.46%	7.09%
Range of implied floating interest rates	6.78% to 7.00%	7.12% to 7.12%	7.14% to 7.14%	7.16% to 7.16%	7.26% to 7.26%	

The floating rate side of the Company's interest rate swaps is based on several indices, ranging from three-month to one-year LIBOR. The floating rates shown above reflect the range of the implied forward LIBOR yield curve for those indices, as of December 31, 1999.

FAIR VALUES OF FINANCIAL INSTRUMENTS HELD FOR PURPOSES OTHER THAN TRADING: The following fair value amounts were determined by using independent market information when available, and appropriate valuation methodologies when market quotes were not available. In cases where specific market quotes are unavailable, interpreting market data and estimating market values require considerable judgment by management. Accordingly, the estimates presented are not necessarily indicative of the amount the Company could realize in a current market exchange.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

INVESTMENTS: The fair values of fixed income investments are based primarily on quoted market prices received from a nationally recognized pricing service or dealer quotes.

SHORT-TERM INVESTMENTS AND CASH: The fair values of short-term investments and cash are assumed to equal amortized cost.

OTHER: The fair value of other investments, primarily preferred stock, is based on an evaluation of the underlying company and recent transactions in such preferred stock.

SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL: The fair value of securities purchased under agreements to resell is assumed to approximate carrying value.

LOANS: The fair value of loans is assumed to approximate carrying value.

RECEIVABLE/PAYABLE TO BROKERS AND DEALERS: The fair value of receivable/payable to brokers and dealers, representing securities borrowed from various counterparties secured by Company-owned securities, are assumed to approximate carrying value.

DEBENTURES: The fair value of the debentures is based on quoted market prices.

OBLIGATIONS UNDER INVESTMENT, REPURCHASE AND PAYMENT AGREEMENTS: The fair value of the liability for investment agreements and repurchase agreements (including accrued interest) is estimated based upon internal valuation models. The fair value of payment agreements is assumed to approximate carrying value.

DERIVATIVE CONTRACTS: Fair values of derivative contracts (futures, swaps and interest rate options) are based on quoted market and dealer prices, current settlement values, or pricing models.

LIABILITY FOR NET FINANCIAL GUARANTEES WRITTEN: The fair value of the liability for those financial guarantees written where premiums are collected up front is based on the estimated cost to reinsure those exposures at current market rates, which amount consists of the current unearned premium reserve, less an estimated ceding commission thereon.

Certain other financial guarantees have been written on an installment basis, where the future premiums to be received by the Company are determined based on the outstanding exposure at the time the premiums are due. The fair value of Ambac Assurance's liability under its installment premium policies is measured using the present value of estimated future installment premiums, less an estimated ceding commission. The estimate of the amounts and timing of the future installment premiums is based on contractual premium rates, debt service schedules and expected run-off scenarios. This measure is used as an estimate of the cost to reinsure Ambac Assurance's liability under these policies.

The carrying amount and estimated fair value of financial instruments held for purposes other than trading are presented below:

As of December 31,	1999		1998	
(Dollars in millions)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS:				
Fixed income securities	$8,738	$8,738	$8,622	$8,622
Short-term investments	221	221	120	120
Other Investments	3	3	7	7
Cash	14	14	8	8
Securities purchased under agreements to resell	103	103	252	252
Loans	685	685	674	674
Receivable from brokers and dealers	717	717	750	750
FINANCIAL LIABILITIES:				
Debentures	424	403	424	476
Obligations under investment, repurchase and payment agreements (including accrued interest)	6,231	6,037	6,046	5,959
Payable to brokers and dealers	717	717	750	750
DERIVATIVE FINANCIAL INSTRUMENTS:				
Interest rate futures contracts	—	—	(4)	—
Interest rate swaps	(1)	(2)	(22)	(20)
Interest rate option contracts	—	—	—	—
LIABILITY FOR FINANCIAL GUARANTEES WRITTEN:				
Gross (up-front)	1,431	1,002	1,294	906
Net of reinsurance (up-front)	1,213	849	1,094	766
Gross installment premiums	—	454	—	248
Net installment premiums	—	369	—	216

13 FINANCIAL INSTRUMENTS CLASSIFIED AS HELD FOR TRADING PURPOSES

AFSLP is a provider of interest rate swaps to states, municipalities and their authorities and other entities in connection with their financings. If actual or projected tax-exempt interest rates change in relation to taxable interest rates, the Company will experience an unrealized mark-to-market gain or loss. The AFSLP swap portfolio is classified as held for trading purposes.

ACP enters into structured credit derivative transactions. These structured credit derivatives require ACP to make payments upon the occurrence of certain defined credit

events relating to an underlying obligation (generally a fixed income security). If credit spreads of the underlying obligations change, the market value of the related structured credit derivative could change. As such, ACP could experience an unrealized mark-to-market gain or loss. Market liquidity could also impact valuations. Changes in credit spreads are generally caused by changes in the market's perception of the credit quality of the underlying obligations. The majority of ACP's contracts are partially hedged with various financial institutions or structured with first loss protection. Such structuring mitigates ACP's risk of loss and the price volatility of these financial instruments. The ACP credit derivative portfolio is classified as held for trading purposes.

The following table summarizes information about the Company's financial instruments classified as held for trading purposes as of December 31, 1999 and 1998:

	Net Estimated Fair Value		Average Net Fair Value		Notional
	Assets	Liabilities	Assets	Liabilities	Amount
1999:					
Derivative financial instruments:					
Interest rate swaps	$177,192	$129,773	$134,991	$96,526	$6,260,740
Structured credit derivatives	27,704	27,438	13,572	13,069	6,315,954
Futures contracts	—	—	—	—	751,700
Other financial instruments	—	—	—	—	—
1998:					
Derivative financial instruments:					
Interest rate swaps	$200,454	$163,043	$130,984	$103,414	$5,357,450
Structured credit derivatives	—	—	—	—	—
Futures contracts	—	—	—	—	706,700
Other financial instruments	—	—	183,682	181,698	—

Financial instruments classified as held for trading purposes are carried at estimated fair value. The aggregate amount of revenue recognized from derivative financial instruments classified as held for trading purposes was $20,301, $705 and $7,454 for 1999, 1998 and 1997, respectively. Other financial instruments held for trading purposes consists of fixed income securities held in 1997 and sold during 1998. The aggregate amount of revenue recognized from other financial instruments was $2,967 and $1,309 in 1998 and 1997, respectively. Average net fair values were calculated based on average monthly net fair values. Notional principal amounts are often used to express the volume of these transactions and do not reflect the extent to which positions may offset one another. These amounts do not represent the much smaller amounts potentially subject to risk.

14 LONG-TERM DEBT AND LINES OF CREDIT

The carrying value of long-term debt was as follows:

As of December 31,	1999	1998
9⅜% Debentures, due 2011	$149,480	$149,434
7½% Debentures, due 2023	74,515	74,495
7.08% Debentures, due 2098	200,000	200,000
	$423,995	$423,929

Debentures due on August 1, 2011 were issued on August 8, 1991 in the principal amount of $150,000 and bear interest of 9⅜%, payable on February 1 and August 1 of each year and are non-callable.

Debentures due on May 1, 2023 were issued on May 11, 1993 in the principal amount of $75,000 and bear interest of 7½%, payable on May 1 and November 1 of each year and are non-callable.

Debentures due on March 31, 2098 were issued on April 1, 1998 in the principal amount of $200,000 and bear interest of 7.08%, payable on March 31, June 30, September 30 and December 31 of each year. The debentures may not be redeemed prior to March 31, 2003 and were sold at 100% of their principal amount. On or after March 31, 2003, the Company may redeem the debentures, in whole at any time or in part from time to time, at 100% of their principal amount, plus accrued interest to the date of redemption.

The Company and Ambac Assurance have a revolving credit facility with three major international banks for $150,000, which expires in August 2000 and provides a two-year term loan provision. The facility is available for general corporate purposes, including the payment of claims. As of December 31, 1999 and 1998, no amounts were outstanding under this credit facility.

Ambac Assurance maintains third party capital support in the form of a seven-year irrevocable limited recourse credit facility from a group of highly-rated banks. This credit facility provides liquidity to Ambac Assurance in the event claims from municipal obligations in its insured portfolio exceed specified levels. Repayments of amounts drawn under the credit facility are limited primarily to the amount of any recoveries of losses related to municipal policy obligations.

During 1999, such third party capital support was increased from $555,000 to $750,000, and its expiration reset to December 2006. As of December 31, 1999 and 1998, no amounts were outstanding under this credit facility.

ACP has a revolving credit facility with one major international bank for $50,000, which expires in June 2000, and provides for three-year term loans. The facility is available to ACP for general corporate purposes, including the settlement of transactions related to credit derivative instruments. The credit facility became effective on July 1, 1999. As of December 31, 1999, no amounts were outstanding under this credit facility.

15 OBLIGATIONS UNDER INVESTMENT AGREEMENTS AND PAYMENT AGREEMENTS

Obligations under investment agreements, including those structured in the form of repurchase contracts, are recorded on a trade-date basis. Certain obligations may be called at various times prior to maturity at the option of the counterparty. As of December 31, 1999 and 1998, the interest rates on these agreements ranged from 4.00% to 8.14%. As of December 31, 1999 and 1998, the average yield on these agreements was 5.51% and 5.70%, respectively. Obligations under investment agreements and investment repurchase agreements as of December 31, 1999 and 1998 were as follows:

As of December 31,	1999	1998
Settled	$5,408,848	$5,209,690
Unsettled	45,918	73,142
	$5,454,766	$5,282,832

Net payments due under settled investment agreements in each of the next five years ending December 31, and the periods thereafter, based on expected draw dates, are as follows:

	Principal Amount
2000	$2,457,817
2001	1,384,598
2002	483,254
2003	69,164
2004	40,466
All later years	973,549
	$5,408,848

Obligations under payment agreements represent funds received by the Company from certain customers. These funds serve as collateral for loans extended by the Company in connection with certain structured transactions. In connection with these transactions, the Company is obligated to make periodic agreed upon payments. As of December 31, 1999 and 1998, the interest rates on these obligations ranged from 6.25% to 8.42%. Net (deposits)/payments due under payment agreements in each of the next five years ending December 31, and the periods thereafter, based on contractual payment dates, are as follows:

	Principal Amount
2000	$ (9,761)
2001	(175)
2002	7,525
2003	15,702
2004	23,566
All later years	648,631
	$685,488

16 COMMON STOCK INCENTIVES

The Ambac 1997 Equity Plan (the "Equity Plan") provides for the granting of stock options, stock appreciation rights, restricted stock units, performance units and other awards that are valued or determined by reference to the Common Stock. Stock options awarded to employees are exercisable and expire as specified at the time of grant. Additionally, such options generally may not have a per share exercise price less than the fair market value of a share of Common Stock on the date of grant or have a term in excess of ten years from the date of the grant. The Company also maintains the Ambac 1997 Non-Employee Directors Equity Plan (the "Directors Plan"), which provides awards of stock options and restricted stock units to non-employee members of the Company's Board of Directors. The number of options and their exercise price, and the number of restricted stock units, awarded to each non-employee director under the Directors Plan are determined by formula. As of December 31, 1999, approximately 5,373,000 shares were available for future grant under the Equity Plan and the Directors Plan. A summary of option activity is as follows:

	1999		1998		1997	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	3,389,364	$31.34	3,917,693	$22.15	4,248,642	$19.37
Granted	879,815	$54.92	969,698	$47.66	859,800	$33.59
Exercised	(527,966)	$25.10	(1,332,729)	$15.78	(898,942)	$19.05
Forfeited	(80,736)	$47.78	(165,298)	$34.46	(291,807)	$24.99
Outstanding at end of year	3,660,477	$37.49	3,389,364	$31.34	3,917,693	$22.15
Exercisable	2,126,910		1,819,872		2,392,853	

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 1999	Weighted Average Remaining Contract Life	Weighted Average Exercise Price	Number Exercisable at December 31, 1999	Weighted Average Exercise Price
$10 to 25	1,332,120	4.4	$22.07	1,332,120	$22.07
$26 to 45	1,309,838	4.5	$39.72	652,028	$37.67
$46 to 65	1,018,519	5.6	$54.78	142,762	$55.18
	3,660,477			2,126,910	

The Company applies APB 25 and related interpretations in accounting for its plans. Accordingly, since the fair value of the options at grant date equals the exercise price, no compensation cost has been recognized for its fixed stock option plan. Had compensation cost for the Company's stock-based compensation plan been determined consistent with FAS 123, the Company's net income, earnings per share and earnings per diluted share for the years ended December 31, 1999, 1998 and 1997, would have been reduced to the pro-forma amounts indicated below:

	1999	1998	1997
Net Income:			
As reported	$307,917	$253,994	$223,030
Pro-forma	$300,410	$248,089	$218,852
Earnings per share:			
As reported	$4.40	$3.63	$3.19
Pro-forma	$4.30	$3.55	$3.13
Earnings per diluted share:			
As reported	$4.31	$3.56	$3.13
Pro-forma	$4.21	$3.48	$3.07

The weighted-average fair value (determined as of the date of the grants) of options granted in 1999, 1998 and 1997 was $16.87 per share, $13.09 per share, and $9.85 per share, respectively. The fair value of each option grant issued was estimated as of the date of the grant using the Black-Scholes option-pricing model, with the following weighted-average assumptions used for grants in 1999, 1998 and 1997, respectively: (i) dividend yield of 0.74%, 0.85% and 1.08%; (ii) expected volatility of 26.3%, 20.5% and 19.4%; (iii) risk-free interest rates of 4.8%, 5.5% and 6.4%; and (iv) expected lives of approximately 5 years, 5 years and 6 years. The pro-forma amounts disclosed above are not likely to be representative of the effects of reported pro-forma net income for future years because options vest over several years and additional awards are granted each year.

17 SEGMENT INFORMATION

The Company has two reportable segments, as follows: (1) Financial Guarantee, which provides financial guarantees for municipal and structured finance obligations; and (2) Financial Services, which provides investment agreements, interest rate swaps, and investment advisory and cash management services. During the fourth quarter of 1998, the Company discontinued its operations relating to electronic commerce applications for the municipal marketplace. Balances relating to the electronic commerce business are included in the Financial Services segment for the years 1998 and 1997. Total losses before income taxes for the electronic commerce business were $6,946 and $3,557 for the years ended December 31, 1998, and 1997, respectively. Also included for both revenues and income before income taxes for the year ended December 31, 1998 for the Financial Services segment is a $11,548 charge representing the write-off of the investment in Ambac Connect.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different marketing strategies, personnel skill sets and technology.

The accounting policies of the segments are the same as those described in Note 2, "Significant Accounting Policies." Pursuant to insurance and indemnity agreements, Ambac Assurance guarantees the swap and investment agreement obligations of those financial services subsidiaries. Intersegment revenues include the premiums earned under those agreements. Such premiums are accounted for as if they were premiums to third parties, that is, at current market prices.

Information provided below for "Corporate and Other" relates to Ambac Financial Group, Inc. corporate activities. Corporate and other revenue from unaffiliated customers consists primarily of interest income and realized gains or losses from investment securities.

The following table is a summary of the financial information by reportable segment for the years ended December 31, 1999, 1998 and 1997:

	Financial Guarantee	Financial Services	Corporate and Other	Intersegment Eliminations	Total Consolidated
1999:					
Revenues:					
Unaffiliated customers	$ 474,069	$ 48,545	$ 10,703	$ —	$ 533,317
Intersegment	3,033	(3,574)	52,661	(52,120)	—
Total revenues	$ 477,102	$ 44,971	$ 63,364	$(52,120)	$ 533,317
Income before income taxes:					
Unaffiliated customers	$ 414,265	$ 22,721	$ (32,328)	$ —	$ 404,658
Intersegment	3,850	(3,595)	52,661	(52,916)	—
Total income before income taxes	$ 418,115	$ 19,126	$ 20,333	$(52,916)	$ 404,658
Identifiable assets	$4,184,010	$7,104,825	$ 56,261	$ —	$11,345,096
1998:					
Revenues:					
Unaffiliated customers	$ 408,390	$ 32,414	$ 16,232	$ —	$ 457,036
Intersegment	2,761	(2,819)	48,610	(48,552)	—
Total revenues	$ 411,151	$ 29,595	$ 64,842	$(48,552)	$ 457,036
Income before income taxes:					
Unaffiliated customers	$ 355,670	$ (3,126)	$ (23,632)	$ —	$ 328,912
Intersegment	2,761	(4,891)	48,610	(46,480)	—
Total income before income taxes	$ 358,431	$ (8,017)	$ 24,978	$(46,480)	$ 328,912
Identifiable assets	$3,825,411	$7,128,350	$258,550	$ —	$11,212,311
1997:					
Revenues:					
Unaffiliated customers	$ 339,195	$ 34,612	$ 7,955	$ —	$ 381,762
Intersegment	1,857	(194)	44,068	(45,731)	—
Total revenues	$ 341,052	$ 34,418	$ 52,023	$(45,731)	$ 381,762
Income before income taxes:					
Unaffiliated customers	$ 295,669	$ 6,619	$ (16,292)	$ —	$ 285,996
Intersegment	1,736	(1,031)	44,068	(44,773)	—
Total income before income taxes	$ 297,405	$5,588	$ 27,776	$(44,773)	$ 285,996
Identifiable assets	$3,392,333	$4,805,517	$ 93,855	$ —	$ 8,291,705

The following table summarizes gross premiums written and net premiums earned included in the financial guarantee segment, by location of risk for the years ended December 31, 1999, 1998 and 1997.

	1999	1998	1997
Gross premiums written:			
United States	$373,523	$297,565	$242,727
United Kingdom	17,587	30,337	16,144
Japan	6,106	3,970	2,349
France	2,546	1,318	2,911
Australia	739	16,166	—
Mexico	11,115	413	132
Internationally diversified	11,971	4,436	1,831
Other international	21,655	6,806	20,069
Total:	$445,242	$361,011	$286,163

	1999	1998	1997
Net premiums earned:			
United States	$234,679	$198,904	$145,988
United Kingdom	3,054	1,754	903
Japan	5,513	1,941	1,175
France	1,132	1,745	2,048
Australia	1,373	686	114
Mexico	4,365	413	132
Internationally diversified	8,154	3,654	1,409
Other international	6,156	3,587	2,231
Total:	$264,426	$212,684	$154,000

Internationally diversified includes guarantees with multiple locations of risk. International business includes all transactions conducted through the MBIA•AMBAC International Joint Venture. Joint venture transactions may include components of domestic exposure.

18 QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	First	Second	Third	Fourth	Full Year
1999:					
Gross premiums written	$90,154	$98,708	$106,841	$149,539	$445,242
Net premiums written	85,068	82,250	94,945	121,134	383,397
Net premiums earned	60,297	63,944	68,325	71,860	264,426
Net investment income	49,484	51,296	52,946	55,558	209,284
Financial services net revenue	12,712	13,138	12,097	13,722	51,669
Losses and loss adjustment expenses	2,500	2,500	3,000	3,000	11,000
Financial guarantee underwriting and operating expenses	11,917	11,872	11,976	13,039	48,804
Financial services expenses	6,977	6,779	6,174	5,894	25,824
Income before income taxes	95,951	91,985	105,383	111,339	404,658
Net income	73,194	70,969	79,802	83,952	307,917
Net income per share	1.05	1.02	1.14	1.20	4.40
Net income per diluted share	$ 1.03	$ 1.00	$ 1.12	$ 1.18	$ 4.31
1998:					
Gross premiums written	$77,487	$88,042	$88,731	$106,751	$361,011
Net premiums written	51,400	77,994	83,967	98,087	311,448
Net premiums earned	53,184	53,318	50,143	56,039	212,684
Net investment income	45,040	45,872	47,436	47,842	186,190
Financial services net revenue	12,754	12,732	13,541	10,483	49,510
Losses and loss adjustment expenses	1,577	1,423	1,500	1,500	6,000
Financial guarantee underwriting and operating expenses	12,018	11,190	11,844	11,668	46,720
Financial services expenses	7,443	8,603	8,237	11,257	35,540
Income before income taxes	86,197	78,513	85,199	79,003	328,912
Net income	65,658	60,796	65,382	62,158	253,994
Net income per share	0.94	0.87	0.94	0.89	3.63
Net income per diluted share	$ 0.92	$ 0.85	$ 0.92	$ 0.87	$ 3.56

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Chief Executive Officer
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Argus Associates
(Financial Consulting)

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C. RODERICK O'NEIL*†‡
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* Member Audit Committee
† Member Compensation and
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‡ Member Nominating Committee

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Vice Chairman – Portfolio
Risk Management Group

ROBERT J. GENADER
Vice Chairman –
Financial Insurance
Business Group

FRANK J. BIVONA
Executive Vice President
and Chief Financial Officer
Finance and
Investment Group

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Human Resources and
Employment Counsel

KEVIN J. DOYLE
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General Counsel

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WEST REGION
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DENNIS R. SANTO
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JOHN H. BRYAN III
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RUBEN SELLES
Managing Director

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TIMOTHY S. TRAVERS
Managing Director

STRUCTURED FINANCE AND CREDIT DERIVATIVES
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Managing Director

SCOTT D. GORDON
Managing Director

INTERNATIONAL
JOHN W. UHLEIN III
Managing Director

CREDIT MANAGEMENT
WILLIAM T. McKINNON
Managing Director

LEGAL
JEFFREY R. FRIED
Managing Director

FINANCIAL SERVICES

ASSET/LIABILITY MANAGEMENT SERVICES
MICHAEL W. KELLY
Managing Director

STEVEN L. DYMANT
Managing Director

PORTFOLIO MANAGEMENT
EULOGIO (JOE) RAMOS
Managing Director

CADRE FINANCIAL SERVICES, INC.
WILLIAM T. SULLIVAN, JR.
Chairman and Chief
Executive Officer

PORTFOLIO RISK MANAGEMENT

MARKET RISK MANAGEMENT
ROBERT D. SELVAGGIO
Managing Director

SURVEILLANCE
STEVEN C. RENN
Managing Director

CORPORATE

STEPHEN D. COOKE
Managing Director and
General Counsel and
Secretary, Ambac
Assurance Corporation

THOMAS J. GANDOLFO
Managing Director and
Financial Controller

ANNE G. GILL
Corporate Secretary

BRIAN S. MOORE
Managing Director,
External Relations

NARAYAN NAIR
Managing Director,
Internal Audit

SUSAN OEHRIG
Director of
Corporate Marketing

KENNETH S. PLOTZKER
Managing Director and
Chief Information Officer

ROBERT W. STARR
Managing Director and
Treasurer

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STOCKHOLDER INFORMATION

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ANNUAL MEETING OF STOCKHOLDERS
The Annual Meeting of Stockholders of Ambac Financial Group, Inc. will be held on Wednesday, May 10, 2000, at 11:30 a.m. in New York City. Detailed information about the meeting is contained in the Notice of Annual Meeting and Proxy Statement to be sent to each stockholder of record as of March 20, 2000. The Company estimates that it has approximately 34,000 stockholders.

FORM 10-K
A copy of the Company's 1999 Annual Report on Form 10-K for the year ended December 31, 1999, as filed with the Securities and Exchange Commission,
may be obtained without charge by writing to:
Ambac Financial
Group, Inc.,
Attn: Investor Relations
One State Street Plaza
New York, New York 10004

TRANSFER AGENT, REGISTRAR AND DIVIDEND PAYING AGENT
Citibank, N.A.
111 Wall Street, 5th Floor
New York, New York 10043
212-657-5997

INDEPENDENT AUDITORS
KPMG LLP
New York, New York

STOCK LISTING
Ambac Financial Group, Inc. common stock is listed on the New York Stock Exchange under the ticker symbol ABK.

INVESTOR RELATIONS
Frank J. Bivona
Executive Vice President
and Chief Financial Officer

Brian S. Moore
Managing Director
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COMMON STOCK DATA
The table below shows the high and low price per share for each quarter of 1999 and 1998.

	1999 Market Price				1998 Market Price			
Three Months Ended	High	Low	Close	Dividends Per Share	High	Low	Close	Dividends Per Share
March 31	$62⅛	$52¾	$54	$0.1000	$58 9/16	$44⅜	$58 7/16	$0.0900
June 30	61 11/16	50	57⅛	0.1000	61	53½	58½	0.0900
September 30	59⅜	45 13/16	47⅜	0.1100	65 15/16	45 9/16	48	0.1000
December 31	63	44 11/16	52 3/16	0.1100	62⅜	40⅞	60 3/16	0.1000

Ambac

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