

BILL ACKMAN, THE BOND INSURERS, AND THE MOST  
CONTENTIOUS BATTLE OF THE CREDIT CRISIS

# CONFIDENCE GAME

HOW A HEDGE FUND MANAGER CALLED WALL STREET'S BLUFF



CHRISTINE S. RICHARD  
BLOOMBERG NEWS

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## Confidence Game

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by Christine S. Richard

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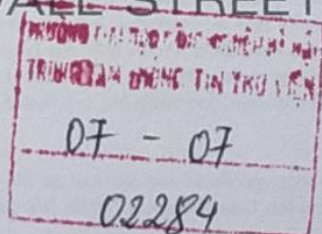
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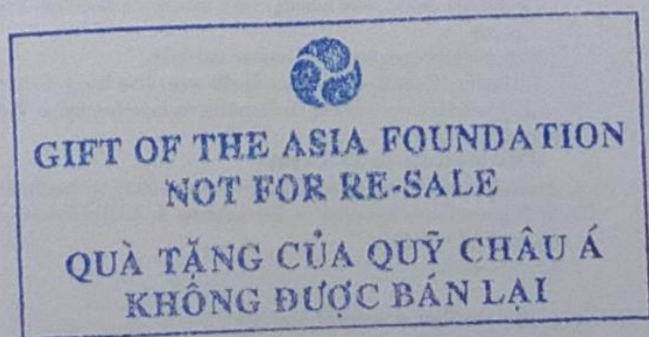
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Christine S. Richard

Bloomberg News



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## Preface

**F**OR NEARLY 10 YEARS, I covered the bond market as a Wall Street reporter, first at Dow Jones and later for Bloomberg News. It was a period of enormous growth and innovation in the credit markets. As the expansion peaked, Wall Street manufactured billions of dollars of debt every day, astonishing amounts of it considered triple-A or virtually risk-free. For a while, this was accomplished with true financial innovation. Later, the process was corrupted by delusion and dishonesty.

Of all the stories I covered, there was one that never seemed to go away: the battle between a company called MBIA and a hedge fund manager named Bill Ackman, who was obsessed with that company's practices.

What is MBIA? It stands for Municipal Bond Insurance Association. For years it was the largest of a handful of extraordinarily profitable companies that together guaranteed more than \$2 trillion of debt issued by entities ranging from the Cincinnati school system to a shell company in the Cayman Islands. Insurance transformed lower-rated bonds into triple-A-rated securities. Business boomed, giving MBIA some of the highest reported profit margins of any publicly traded company in the United States—even higher than Google and Microsoft.

If there was something about this business that was too good to be true, few people had any reason to point it out. Then in late 2002, Ackman, who ran a hedge fund called Gotham Partners, issued a research report titled *Is MBIA Triple-A?* in which he questioned just about every aspect of MBIA's business. Before he made his views public, Ackman bet against the company by purchasing derivative contracts called credit-default swaps, which would make his fund billions of dollars if MBIA filed for bankruptcy.



Ackman's research report was the opening shot in what became a long and bitter Wall Street feud between him and MBIA. From the start, MBIA was determined to silence Ackman's criticism, and he was no less determined to see MBIA leveled. Ackman was investigated at MBIA's urging by Eliot Spitzer, then New York's attorney general, and the Securities and Exchange Commission (SEC) followed suit.

For more than five years, the hedge fund manager questioned nearly every aspect of MBIA's business, bringing his research to the attention of rating companies, regulators, reporters, and investors. He cornered the chief executive officer (CEO) of PriceWaterhouseCoopers, MBIA's auditors, at a charity function, broached the issue with a bullish equity analyst at a funeral, and wrote to board members of Moody's Investors Service, warning them they could be held personally liable for inaccurate ratings. Eventually, Ackman turned the tables on MBIA, getting regulators to probe MBIA's business practices.

Big names have dominated the headlines during the credit crisis. Bear Stearns was the first major financial institution to collapse. American International Group required a \$180 billion government rescue, a larger commitment in inflation-adjusted dollars than the Marshall Plan that rebuilt Europe after World War II. Lehman Brothers was the financial failure felt around the world.

Before all of this happened, another crisis played out. Little known outside of Wall Street, MBIA made hundreds of millions of dollars a year selling its triple-A credit rating. At the same time, it boasted to analysts and investors that it insured bonds on which it saw no chance of loss.

In the lobby of MBIA's headquarters in Armonk, New York, visitors were greeted by a large photo of sunlight pouring through trees. The image is one you might expect to see on an inspirational greeting card—the sunlight, a symbol of some higher power. "We help our clients achieve their financial goals by providing AAA credit protection," read the message alongside the photo. The sanctity of MBIA and the permanence of its triple-A credit rating were articles of faith on Wall Street.

Brash, blunt, almost neurotically persistent, Ackman was the perfect foil to the bond insurance business. Even among his friends and colleagues, Ackman is known for being a font of not-always-welcome forthrightness. He will tell people straight out that their hairstyle is unflattering or they ought to consult with his nutritionist about losing