

Richard, Christine S. - Confidence Game*John Wiley & Sons, 2010, [Equity Investing] Grade*

This is an almost epic tale of a clash between a blunt, stubborn-as-a-mule hedge fund manager with a fierce sense of justice called Bill Ackman and MBIA, the largest municipal bond insurer in the United States with a tough CEO named Jay Brown. It's also a story of lazy regulators, analysts and journalists with a wish for keeping a profitable status quo and a deep suspicion of short sellers. It is further a tale of the interconnectedness of the financial system where companies most people have never heard of can put entire economies on the brink of collapse. The author, Christine Richard, is a financial reporter previously at Dow Jones and now at Bloomberg Press.

Municipalities and other public entities at times need to borrow money by issuing bonds. Apparently there has been a "dual scale" applied by credit rating agencies since the 1920s (!) where public entities despite having lower probabilities for defaults, still received lower ratings. However, if the bonds could be insured against credit losses and the insurer was a triple-A institution the bonds would be as well.

MBIA was the leading insurer in this space getting a slice of the spread between the municipalities' too unfavourable credit rating and their own too favourable one. This was a high-risk insurer insuring low-risk municipalities. MBIA was in the business of getting paid for stamping AAA on anything that moved. The excellent credit quality of public lenders meant that the losses historically were close to non-existent – MBIA even bragged about their no-loss track record. If there is no perceived risk of loss then there is no real need to set aside reserves to tackle losses and the company hence had absurdly small reserves. Profiting from this bogus spread without having to deploy almost any capital to do it wasn't enough though. The company ventured into taking risks further and further away from its historical home turf and started to invest in CDOs, CDO-squared and even bought and securitized bad tax receipt portfolios that they then insured themselves!

Mats Larsson, March 11, 2014

Gotham Partners founded by Ackman and David Berkowitz saw this house of cards as the shorting opportunity of a lifetime. They issued a report called "Is MBIA Triple-A?" on the Internet. Ackman also communicated his view to credit agencies, regulators, analysts and journalists. As MBIA was a reseller of triple-A ratings this was an attack on its very existence. Without the rating there was no business model. What follows is a full counter attack. Few would have withstood the slander campaigns launched by media spin doctors and investigations by both SEC and Elliot Spritzer without giving in. MBIA also bought their own shares in days of bad news and sold CDS' on their own company to influence market prices and create the appearance of stability. In a case of possible corruption one of Gotham's funds was forced to shut down, parting Berkowitz and Ackman who now started Pershing Square. Ironically this freed Ackman from other chores and he could fully dig in to the MBIA case. After 5 years of struggles and MBIA desperately fighting to uphold the no-loss illusion, in June 2008 after the entire market had crashed both S&P and Moody's finally downgraded the company.

Richard's story is to a large extent written from Ackman's point of view. Still I have no doubts that it gives a more or less correct account of events and all legal investigations of Gotham also ended with no finding of wrongdoing. She is a skilled writer and even though the reader knows that the company will have to crash in the subprime crisis the text is still tense and exiting. However, at times the text is relatively dense and could have benefited from the author now and then taking a step back and repainting the full picture to remind the reader. Instead of casting suspicion on short sellers we should all be happy when they use the resources they have to dig into the shady areas that no one else has the energy or will to look at. When complying to the subpoena of the NY attorney general Pershing Square supplied approximately 140.000 pages of material on MBIA.