

Lead Plaintiff Guido Bergamini (“Lead Plaintiff” or “Plaintiff”) makes the following allegations, except as to allegations specifically pertaining to Plaintiff and Plaintiff’s counsel, based upon the investigation undertaken by Plaintiff’s counsel which included analysis of publicly available news articles and reports, public filings, securities analysts’ reports and advisories about ACA Capital Holdings, Inc. (“ACA Capital” or the “Company”), press releases and other public statements issued by the Company, interviews with former employees of ACA Capital and media reports about the Company, and believes that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

NATURE OF THE ACTION

1. This is a federal securities class action on behalf of a Class consisting of all persons other than Defendants who purchased the common stock of ACA Capital pursuant and/or traceable to the Company’s initial public offering on or about November 10, 2006 (the “IPO” or the “Offering”) seeking to pursue remedies under the Securities Act of 1933 (the “Securities Act”).

2. Defendant ACA Capital is a holding company that provided financial guaranty insurance products to participants in the global credit derivative, structured finance capital, and municipal finance capital markets. ACA Capital is one of the companies at the epicenter of the sub-prime mortgage earthquake that has rocked the nation. The Company was heavily involved in the structuring and sale of collateralized debt obligations (“CDO”) and credit default swaps (“CDS”) and insuring such investment vehicles. Presently, ACA Capital has all but ceased operations and its municipal finance insurance division, ACA Financial Guaranty Corporation (“ACA Financial”) is no longer writing new policies, and is in run-off.

3. ACA Capital went public for \$13 per share via the IPO on November 10, 2006. Unbeknownst to investors, at the time of the IPO, the Company had materially increased its exposure to highly risky sub-prime CDOs and was planning to complete several more sub-prime CDO deals in

early 2007 that would greatly increase the Company's exposure. Furthermore, given the rising default rates on sub-prime mortgages, it was highly likely that the Company would experience losses on the policies it had written to insure numerous CDOs and it would experience losses on its CDS positions. The Registration Statement (as defined herein) issued in connection with the IPO failed to disclose these material facts and also contained misrepresentations about the nature and risks of ACA Capital's business.

4. As the market slowly learned about the true extent of the risks faced by ACA Capital, the price of ACA Capital stock declined dramatically. Today, ACA Capital is nothing more than an empty shell corporation and its stock trades over-the-counter for \$0.05 per share.

JURISDICTION AND VENUE

5. The claims asserted herein arise under and pursuant to Sections 11, 12(a)(2) and 15 of the Securities Act [15 U.S.C. §§77k, 77l(a)(2) and 77o].

6. This Court has jurisdiction of this action pursuant to Section 22 of the Securities Act [15 U.S.C. §77v] and 28 U.S.C. §§1331 and 1337.

7. Venue is properly laid in this District pursuant to Section 22 of the Securities Act and 28 U.S.C. §1391(b) and (c). The acts and conduct complained of herein occurred in substantial part in this District.

8. In connection with the acts and conduct alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including the mails and telephonic communications and the facilities of the New York Stock Exchange ("NYSE"), a national securities exchange.

PARTIES

9. Lead Plaintiff Guido Bergamini purchased ACA Capital common stock, as set forth in the certification attached hereto and incorporated herein by reference, pursuant and/or traceable to the Company's IPO, and was damaged thereby.

10. Defendant ACA Capital is a holding company that provides financial guaranty insurance products to participants in the global credit derivative, structured finance capital, and municipal finance capital markets.

11. Defendant Alan S. Roseman ("Roseman") served as President and Chief Executive officer of ACA Capital. Roseman signed the Registration Statement.

PLAINTIFF'S CLASS ACTION ALLEGATIONS

12. Plaintiff brings this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and 23(b)(3) on behalf of itself and all persons other than defendants who purchased the common stock of ACA Capital pursuant and/or traceable to the Company's IPO (the "Class"). Excluded from the Class are defendants, any person, firm, trust, corporation, officer, director or other individual or entity in which defendants have a controlling interest or which is related to or affiliated with defendants, and the legal representatives, agents, affiliates, heirs, successors-in-interest or assigns of any such excluded party.

13. The members of the Class are so numerous that joinder of all members is impracticable. ACA Capital sold more than 6.8 million shares of common stock in the IPO. The precise number of Class members is unknown to Plaintiff at this time but is believed to be in the thousands. In addition, the names and addresses of the Class members can be ascertained from the books and records of ACA Capital or its transfer agent or the underwriters to the IPO. Notice can be provided to such record owners by a combination of published notice and first-class mail, using

techniques and a form of notice similar to those customarily used in class actions arising under the federal securities laws.

14. Plaintiff will fairly and adequately represent and protect the interests of the members of the Class. Plaintiff has retained competent counsel experienced in class action litigation under the federal securities laws to further ensure such protection and intends to prosecute this action vigorously.

15. Plaintiff's claims are typical of the claims of the other members of the Class because Plaintiff's and all the Class members' damages arise from and were caused by the same false and misleading representations and omissions made by or chargeable to defendants. Plaintiff does not have any interests antagonistic to, or in conflict with, the Class.

16. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Since the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for the Class members to seek redress for the wrongful conduct alleged. Plaintiff knows of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

17. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

(a) Whether the federal securities laws were violated by defendants' acts as alleged herein;

(b) Whether the prospectus and registration statement issued by defendants to the investing public in connection with the IPO negligently omitted and/or misrepresented material facts

about ACA Capital and its business; and

(c) The extent of injuries sustained by members of the Class and the appropriate measure of damages.

SUBSTANTIVE ALLEGATIONS

The Company and Its Business

18. Defendant ACA Capital was a holding company that provided financial guaranty insurance products to participants in the global credit derivative, structured finance capital, and municipal finance capital markets. The Company provided credit protection to third party investors through its structured credit business (40% of earnings) and municipal finance business (25% of earnings). These two lines of business were conducted through ACA Financial. ACA Capital also designed and managed CDOs for fixed income investors and often invested its own capital alongside investors in its deals (32% of the earnings).

19. At the time of the IPO, ACA Capital's fastest growing business was its CDO asset management business. This division designs and manages a portfolio of bonds or other instruments for investors. In order to align its interests with those who are investing in the CDO, ACA took a portion of the equity in its CDO deals which would expose it to the first losses experienced by the CDO. For the first nine months of 2006, 38% of revenues and 62% of pre-tax income was generated through the Company's CDO equity investments.

20. At present, ACA Capital is nothing more than an empty shell and its lone surviving business, ACA Financial, has been reorganized and is being run for the benefit of counter-parties to ACA's CDSs and other structured contracts.

An Overview of CDOs and Sub-Prime Mortgages

21. In the U.S. residential mortgage market, borrowers are generally classified as being either "prime," "non-prime" or "sub-prime." The sub-prime mortgage market generally refers to the

mortgage loan market associated with borrowers who have risk profile characteristics that are correlated with a high probability of default. The risk level of potential mortgage borrowers is often assessed by reference to Fair Isaac & Company (“FICO”) scores used by credit rating companies who assess a borrower’s credit history and a variety of other factors to help determine a borrower’s risk of default. It is generally accepted that a borrower with a FICO score less than 620 is considered sub-prime.

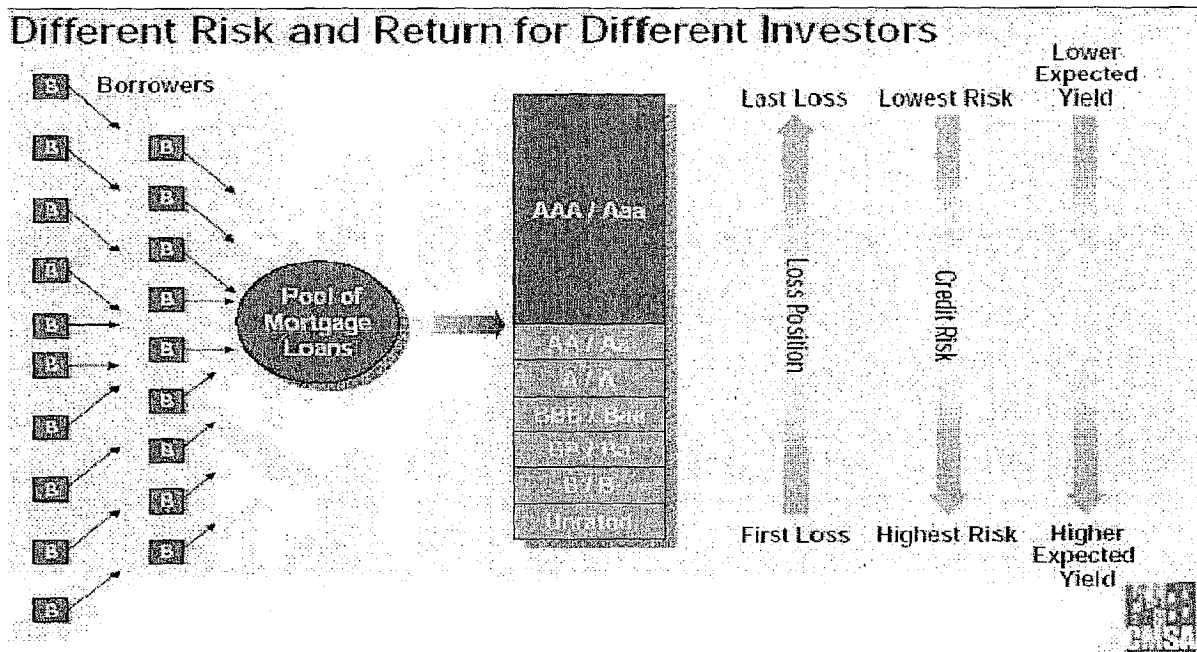
22. In addition to sub-prime mortgage market, other higher risk mortgages that have recently grown to prominence in the U.S. are “no income/no asset verification” loans, otherwise known as a “NINA” or “no-doc” loans. These type of mortgages are generally classified as “Alt-A,” which are associated with borrowers with FICO scores above 620, but are considered to be higher risk loans because they are originated with reduced or no information verification or borrower documentation. Accordingly, Alt-A mortgages are commonly referred to as “liar loans” by mortgage industry participants – that is, mortgages which were approved without requiring proof of the borrower’s income or assets.

23. To create a residential mortgage backed security (“RMBS”), a financial institution, acting as a RMBS sponsor, purchases a large number of residential mortgages (often numbering in the thousands) from bank and/or non-bank mortgage lenders. Usually, the purchased mortgages possess similar characteristics with respect to the quality of the borrower (prime, Alt-A or sub-prime), so that they can be easily pooled and rated. The pooled mortgages are then sold to a separate, specially formulated, bankruptcy-remote legal entity (“SPE” or “SPV”) created by the sponsor, in part so that sponsors can transfer the mortgages, and their related risks, off of their balance sheets.

24. The SPE or SPV takes title to the individual mortgages and issues bonds or RMBSs that are collateralized by the underlying mortgage pool real estate. The RMBSs are issued in tranches, ranging from “High Grade” (AAA and AA-rated bonds), “Mezzanine” (BBB- to B-rated bonds), and an unrated equity tranche, sometimes referred to as the “residual.” AAA-rated paper is derived from a pool of sub-prime mortgages through a prioritization of payments and the apportionment of losses among the different classes of bonds.

25. Typically, the AAA-rated tranche of the RMBS received first priority on the cash flows from the underlying mortgages. The investors owning this higher rated RMBS tranche receive a lower interest rate, reflecting less reward for the presumed lower risk. Conversely, the equity tranche holders received the highest return on their investment because the equity tranche is the first tranche to experience losses in the event that the underlying pool of mortgages experience defaults.

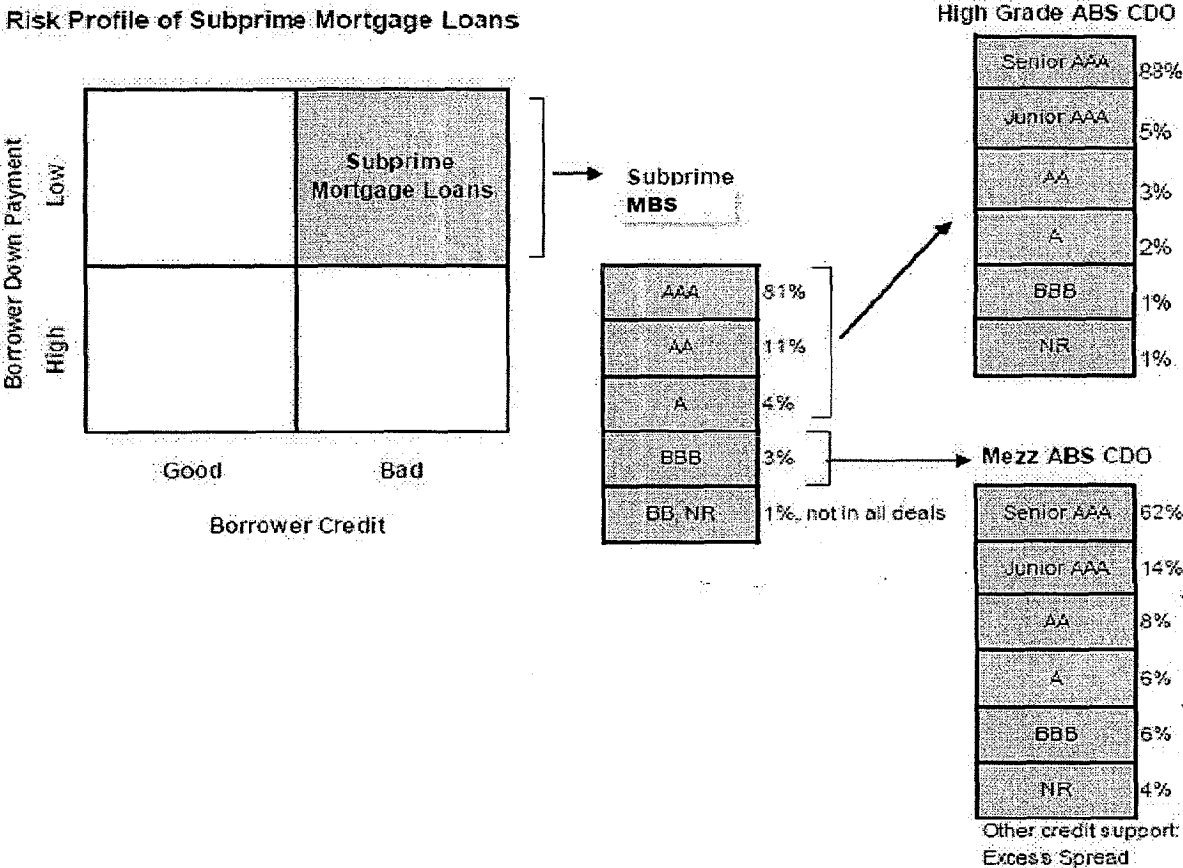
26. The following chart illustrates the creation and structure of a typical RMBS issuance:



27. Structurally, a CDO very much resembles a RMBS. Similar to a RMBS, CDOs involve a transfer of assets to an SPE or SPV and both involve the issuance of bonds by the SPE or

SPV that are collateralized with the transferred assets. The major difference between a RMBS and CDO is that RMBSs are collateralized by pools of residential mortgages and CDOs are collateralized by a pool of RMBS tranches. Ultimately, however, the RMBS and CDO are collateralized with the same real estate underlying the residential mortgages. Accordingly, a rise in real estate foreclosures will result in a domino-type of decline in value of the RMBS and CDO instruments upon which their cash flow is ultimately based.

28. Like a RMBS, CDO bonds are divided into tranches based on a prioritization of payments and the apportionment of potential losses suffered by the underlying RMBS. The equity tranche usually has variable yields over 10% but will experience the first losses that run through the CDO. The following chart illustrates the creation and structure of a typical CDO:



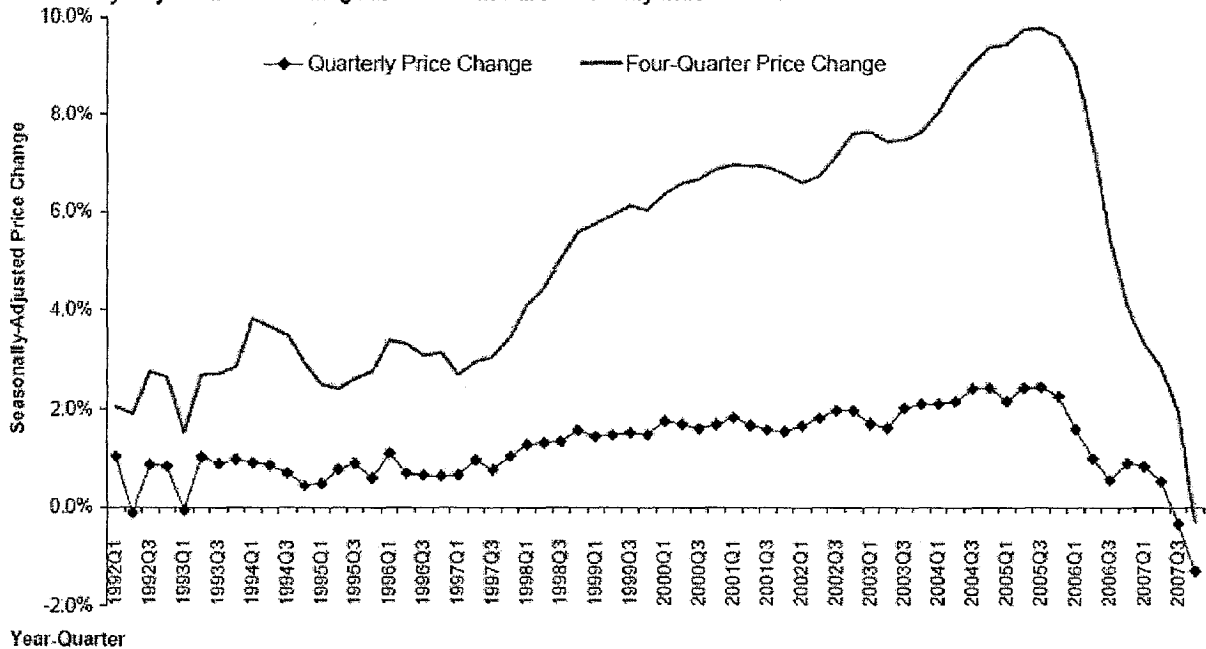
29. The financial structures described above are traditional or “cash” RMBSs and CDOs. In addition to these structured finance products, financial institutions created “synthetic” CDOs such as one backed by credit default swaps (“CDS”), which function as a form of insurance policy by protecting the holder of a CDO against default. Accordingly the issuer of a CDS, *i.e.*, the insurance seller, obtains periodic payments from the CDS purchaser, *i.e.*, insurance purchaser, in exchange for protecting the CDS purchaser from non-performance by the issuer of a CDO.

30. Three main indicators are used by industry experts to assess the current state of, and future prospects for, the U.S. mortgage market: (1) interest rates; (2) the U.S. Housing Price Index, which measures changes in home prices; and (3) delinquency rates, which monitor the percentage of mortgagors who default on their mortgage obligations.

31. In June 2004, the Federal Reserve signaled that it would begin to increase key short-term interest rates. As a result, the U.S. prime interest rate, which had remained flat at four percent for more than a year, climbed steadily throughout 2005 and 2006 before reaching 8.25% in June 2006. As key short-term and the prime rates rose, other interest rates rose as well, including those for most residential mortgage loans. This rise in interest rates made it more difficult for borrowers to meet their payment obligations, particularly since many of the borrowers of the sub-prime mortgage pools held adjustable rate mortgages.

32. As illustrated in the chart below, at the same time that interest rates were rising, U.S. property value appreciation began to slow significantly and actually began a decline in several U.S. markets during 2006:

OFHEO HOUSE PRICE INDEX HISTORY FOR USA
 Seasonally-Adjusted Price Change Measured in Purchase-Only Index



33. The combination of higher interest rates and the dramatic slowing of U.S. property appreciation was devastating to U.S. non-prime borrowers who over-extended themselves by purchasing homes that they could not afford without low initial “teaser” mortgage interest rates. Previously, when property values were increasing, non-prime borrowers were able to refinance their loans as mortgages adjusted to higher interest rates. As interest rates rose and property prices leveled, many non-prime U.S. borrowers were unable to refinance their existing loans when they could not meet their payment obligations. The result – beginning in 2005 – was a significant increase in U.S. mortgage default rates, particularly for sub-prime mortgage loans.

34. For example, in August 2005, HSBC Holdings PLC (“HSBC”) issued a memo to companies from which it was buying loans. The paper, called “Threads of Early Payment Default,” reported that delinquencies were rising. HSBC said mortgage lenders had seen “a wealth of surprising data” on loans originated in 2005, including “surges” in 60-day-past-due delinquencies, particularly on “borrower-friendly” second lien loans, and “heightened fraud incidents.” When

borrowers didn't have to verify their incomes, the report said they were overstating them, and they bolstered their false claims by overstating their job positions.

35. An August 23, 2006, story on CBS' *MarketWatch* noted, "July was dry for the U.S. real estate market, as sales of existing homes plunged 4.1% to a two-year low, prices stagnated and the number of homes on the market soared to a 13-year high, according to a report from the National Association of Realtors released Wednesday."

36. On August 29, 2006, *Dow Jones Newswires* reported "[m]ore subprime borrowers are defaulting in the early months of their home loans, a trend that has led to greater fear among investors and lenders of rising delinquencies and losses."

37. A September 15, 2006, article on *CNNMoney.com* noted:

In August, 115,292 properties entered into foreclosure, according to RealtyTrac, an online marketplace for foreclosure sales. That was 24 percent above the level in July and 53 percent higher than a year earlier.

It was the second highest monthly foreclosure total of the year; in February, 117,151 properties entered foreclosure.

Some of the bellwether real estate market states are among the leading foreclosure markets. Florida had more than 16,533 properties in foreclosure in August. That led all states and was 50 percent higher than in July and 62 percent higher than in August 2005.

California foreclosures are increasing at an even faster annual rate, up 160 percent since last year to 12,506. And the formerly red-hot Nevada market recorded a spike of 24 percent compared with July and a whopping 255 percent increase from August 2005.

* * *

Usually, foreclosures are a lagging [market] indicator [] But we've never had a situation like this with adjustable-rate mortgages amounting to \$400 billion to \$500 billion coming up for adjustment over the rest of the year.

* * *

These exotic mortgages, which have been issued by lenders at much higher numbers the past few years, default at a higher rate than do fixed-rate mortgages. And sub-

prime loans, which are much more common than in the past, have a higher default rate as well.

38. On November 13, 2006, *American Banker* reported:

UBS Securities issued a report last week that found that sub-prime loans made this year are “going bad” at a rate that is 50% faster than the rate for those made last year. About 2.4% of sub-prime loans originated this year were more than 60 days delinquent by the sixth month, compared with 1.6% for 2005 loans and 0.9% for 2004 loans, the report said.

39. On November 30, 2006, the *National Mortgage News* reported:

“How bad is 2006 sub-prime collateral is a question I think most of you have an opinion on already,” said Mr. Zimmerman [the Executive Director of UBS Securities]. We were a bit surprised at the magnitude and speed at which this vintage year deteriorated.

Mr. Liu [a Director at UBS Securities] pointed out at the conference that the industry is seeing “a steady increase of delinquencies and that rate has been accelerating over the past two to three months.” Not only have there been higher delinquencies but also the delinquency numbers have been showing up earlier in 2006 than they had been in 2005. “2006 is tapped to be the worst vintage ever,” he said.

Foreclosures have also risen. And the foreclosures, like the delinquency rates, are also happening at earlier dates. [Emphasis added.]

40. On December 13, 2006, the *Associated Press* reported:

U.S. mortgage delinquency rate rises sharply

Late Mortgage Payments Jump in Summer

Late mortgage payments shot up in the third quarter as higher interest rates squeezed budgets and made it harder for homeowners – especially those with weaker credit records – to keep up with their monthly obligations.

The Mortgage Bankers Association, in its quarterly snapshot of the mortgage market released Wednesday, reported that the percentage of mortgage payments that were 30 or more days past due for all loans tracked jumped to 4.67 percent in the July-to-September quarter.

That marked a sharp rise from the second quarter’s delinquency rate of 4.39 percent and was the worst showing since the final quarter of last year, when delinquent payments climbed to a 2 1/2-year high in the aftermath of the devastating Gulf Coast hurricanes.

The association’s survey covers 42.6 million loans.

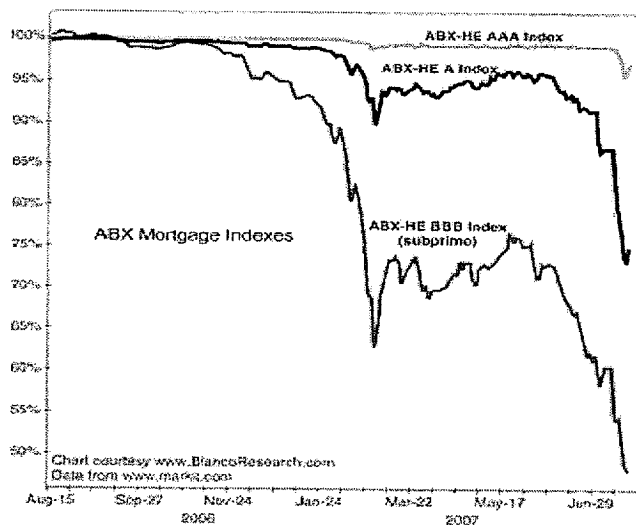
Delinquency rates in the third quarter were considerably higher for “subprime” borrowers – people with weaker credit records who are considered higher risks – especially those who have adjustable-rate mortgages.

Subprime borrowers had a delinquency rate of 12.56 percent in the third quarter, **the highest in more than three years**. The delinquency rate for these borrowers holding adjustable-rate mortgages was even higher -- at 13.22 percent in the third quarter, also the worst reading in more than three years. [Emphasis added.]

41. Indications of turmoil in the U.S. sub-prime mortgage market continued as other mortgage lenders, including Countrywide Financial and Washington Mutual, reported huge losses. According to a February 9, 2007 article published by *The Wall Street Journal*, foreclosure rates on sub-prime mortgage loans in 2006 **more than doubled** from 2005.

42. Moreover, public indices, such as the ABX Index, created via a collaboration among leading investment banks and with Markit Group Limited, a provider of financial data, indicated that by no later than October 2006, sub-prime mortgage-derived fixed income instruments were being adversely affected by the sub-prime mortgage crisis.

43. As set forth in the chart below, during the 4Q06 the value of the ABX Index plummeted, evidencing that the cost of insuring sub-prime RMBS and CDO bonds had increased dramatically due to a higher risk of default. The ABX Index tracked the performance of 15-20 equally-weighted RMBS tranches backed by sub-prime collateral and was used by market participants as a barometer for assessing how sub-prime loan related assets were performing in the market place. The following chart depicts this negative trend:



44. Accordingly, by the time of the IPO, the following U.S. mortgage market events had occurred: (a) mortgage interest rates trended higher during the two years preceding the IPO; (b) home prices had stagnated and began to fall; (c) there was a dramatic rise in sub-prime mortgage loans delinquency rates; (d) there was a significant increase in early payment defaults on non-prime mortgage loans; and (e) sub-prime and Alt-A mortgage loan originators were closing or winding down business.

45. Each of these factors were strong indicators that the problems being experienced by sub-prime lenders would generate huge losses for ACA Capital on the financial guarantees in the form of CDS arrangements it issued to its counterparties and that its CDOs would suffer from rising default rates thereby generating losses for ACA Capital. Additionally, the collapse of the non-prime series within the ABX Index indicated that at the time of the IPO, ACA Capital had a very high probability of incurring massive losses on its CDO investments and the CDSs it issued.

The IPO

46. On or about November 2, 2006, ACA Capital filed with the SEC a Form S-1/A Registration Statement (the “Registration Statement”), for the IPO.

47. On or about November 9, 2006, ACA Capital priced the IPO of 6,875,000 shares of newly issued common stock and 23,541 shares of existing common stock for \$13 per share generating gross proceeds of \$89.4 million. The Company's common stock commenced trading on the NYSE on November 10, 2006. In connection with the IPO, the Company's senior convertible preferred stock, convertible preferred stock and Series B senior convertible preferred stock all converted to common stock concurrently at their conversion ratios of 6,000:1 shares, 6,000:1 shares and 6:1 shares, respectively.

48. Shortly thereafter, the Prospectus with respect to the IPO (the "Prospectus"), which forms part of the Registration Statement, became effective and, including the exercise of the over-allotment, more than 6.8 million shares of ACA Capital's common stock were sold to the public at \$13.00 per share, thereby raising more than \$89 million.

49. As detailed further herein, the Registration Statement was negligently prepared and, as a result, contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and was not prepared in accordance with the rules and regulations governing its preparation.

**At the Time of the IPO, ACA Capital Had Materially
Increased Its Exposure to Highly Risky CDOs and CDSs**

50. Unbeknownst to investors, at the time of the IPO, ACA Capital had materially increased its exposure to risky CDOs which had substantial exposure to sub-prime RMBSs. The Company had purchased substantial quantities of below-investment grade bonds which it included in several of its CDO deals. These below investment grade bonds materially increased the risk of loss to ACA Capital. In addition, in the fourth quarter of 2006, the Company had completed several CDO deals and insured numerous other CDOs which had increased exposure to sub-prime RMBSs and in which the risk of loss to ACA Capital was greatly increased.

51. Unbeknownst to investors, certain of ACA Capital's 2005 and 2006 vintage CDO deals contained bonds that were non-investment grade and had ratings of as low as BBB or below. A rating of BBB- or better is considered investment grade. According to a former employee of ACA Capital who was employed in the Company's CDO asset management group as a credit team associate and responsible for purchasing mortgage bonds that were then packaged into CDOs, at least the following ACA Capital CDO deals contained bonds with a non-investment grade rating: ACA ABS 2005-1, ACA 2005-2 and ACA ABS 2006-1. This former employee was responsible for purchasing many of the bonds included in these CDOs and, therefore, was in a position to know that the CDOs contained below investment grade bonds.

52. In addition by the time of the IPO, unbeknownst to investors, ACA Capital had completed several CDO deals in the fourth quarter of 2006 and had several in the planning stages for early 2007 which had increased exposure to sub-prime RMBSs and in which the risk of loss to ACA Capital was greatly increased. ACA Capital had also entered into numerous CDS transactions which were exposed to risky sub-prime RMBSs. Thus, the Company's exposure to sub-prime RMBSs was far greater than that represented in the Registration Statement.

The Registration Statement Contained Materially Inaccurate Statements and Failed to Comply with the Rules and Regulations Governing Its Preparation

53. The Registration Statement positively described ACA Capital's business stating in pertinent part as follows:

ACA Capital is a holding company engaged in the business of providing financial guaranty insurance products to participants in the global credit derivatives markets, structured finance capital markets and municipal finance capital markets. We also provide asset management services to specific segments of the structured finance capital markets. We participate in our target markets both as a provider of credit protection through the sale of financial guaranty insurance products, for risk-based revenues, and as an asset manager, for fee-based revenues. We conduct our financial guaranty insurance businesses through ACA Financial Guaranty Corporation, our "A" rated, regulated insurance subsidiary. We conduct our asset management business through ACA Management, L.L.C., a subsidiary of ACA Financial

Guaranty. As of June 30, 2006, we had insured credit exposure of \$31.4 billion and our assets under management for third parties were \$12.1 billion. For the six months ended June 30, 2006, we had total revenues of \$215.3 million and net income of \$26.2 million. As of June 30, 2006, our stockholders' equity was \$412.7 million.

54. The Registration Statement positively described the Company's collateralized debt obligations ("CDO") asset management business stating in pertinent part as follows:

We serve as an asset manager of collateralized debt obligations, or CDOs. A CDO is a securitization of fixed income assets such as bonds, loans, asset backed securities, or ABS, and credit default swaps, or credit swaps. To grow our assets under management, we sponsor CDOs that acquire pools of fixed-income assets that we select and manage. CDO assets are funded by the issuance of various liabilities with credit profiles ranging from "AAA" rated debt to non-rated equity. Our CDOs have a diverse worldwide institutional investor base that includes banks, money managers, non-bank financial institutions, hedge funds, pension funds and insurance companies.

Our CDO Asset Management revenues consist of asset management fees and risk-based revenue in the form of return on our equity investments in our CDOs. Typically, we invest in some portion of the equity of our managed CDOs, currently between 5% to 25% of the total equity offered. These investments increase the marketability of our CDOs by aligning our interests as asset manager with those of our CDO investors and thereby maximizing our CDO assets under management. In 2005 and the first six months of 2006, we invested a total of \$16.0 million and \$2.9 million, respectively, in the equity of our CDOs while increasing our assets under management by \$2.1 billion and \$2.2 billion, respectively. We completed our first CDO in January 2002 and, as of June 30, 2006, we had closed 17 CDO transactions and have grown our CDO assets under management from \$2.4 billion as of year-end 2002 to \$12.1 billion as of June 30, 2006. At June 30, 2006, our weighted average asset management fee was 0.21% per annum on CDO assets under our management. Based on our knowledge of the market, we believe we are one of the largest global CDO managers as ranked by assets under management.

55. The statements referenced above in ¶¶53 and 54 were each inaccurate statements of material fact because they failed to disclose that, as detailed above, the Company had materially increased its exposure to risky CDOs which had substantial exposure to sub-prime RMBSs. The Company had purchased substantial quantities of below-investment grade bonds which it included in several of its CDO deals. These below investment grade bonds materially increased the risk of loss to ACA. In addition, in the fourth quarter of 2006, the Company had completed several CDO deals

and insured numerous other CDOs which had increased exposure to sub-prime RMBSs and in which the risk of loss to ACA Capital was greatly increased.

56. At page 79 of the Registration Statement there is a chart which purports to represent ACA Capital's CDO deals as of June 30, 2006. The chart lists ACA ABS 2006-1 and represents that the collateral type is "investment grade." This statement was materially inaccurate because, as detailed herein, ACA ABS 2006-1 contained a material portion of non-investment grade bonds. The chart also created the impression that ACA Capital's CDO deals were all investment grade when at the time of the IPO, the Company had completed numerous risky CDO deals which greatly increased the Company's exposure to risky sub-prime RMBS.

57. Under applicable SEC rules and regulations governing the preparation of the Registration Statement and Prospectus, the Registration Statement was required to disclose that the rising trend of delinquencies and foreclosures in sub-prime RMBSs was likely to cause the Company to incur increased losses on its CDO positions and CDSs.

58. Pursuant to Item 11 of Form S-1, ACA Capital was required to provide in the Registration Statement the information required by Item 303 of Regulation S-K [17 C.F.R. §229.303], and the SEC's related interpretive releases thereto, including any known trends, events or uncertainties that have had or are reasonably likely to cause the registrant's financial information not to be indicative of future operating results. The rising trend of delinquencies and foreclosures in sub-prime RMBSs were reasonably likely to have a material impact on ACA Capital's continuing operations and therefore were required to be disclosed in the Registration Statement, but were not. The Registration Statement merely contained boilerplate warnings about the possibility that defaults would increase when they were then increasing.

59. In 1989, the SEC issued an interpretive release on Item 303 and the disclosure required under the regulation. *See* Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), SEC Release No. 6835, 1989 WL 1092885, at *1 (May 18, 1989) (hereinafter referred to as “1989 Interpretive Release”). In the 1989 Interpretive Release, the SEC stated that:

Required disclosure is based on currently known trends, events and uncertainties that are reasonably expected to have material effects, such as: A reduction in the registrant’s product prices; erosion in the registrant’s market share; changes in insurance coverage; or the likely non-renewal of a material contract A disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant’s financial condition or results of operation.

Id. at *4.

60. Furthermore, the 1989 Interpretive Release provided the following test to determine if disclosure under Item 303(a) is required:

Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:

(1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.

(2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant’s financial condition or results is not reasonably likely to occur.

Id. at *6.

61. Here, at the time of the IPO, it was known that the Company had materially increased its exposure to sub-prime RMBSs and that, given the rising trend of delinquencies and foreclosures in sub-prime RMBS, this increased exposure would have a negative impact on the Company’s

continuing operations. Accordingly, the Registration Statement was required to disclose these facts but did not.

Post-IPO Disclosures

62. Following the IPO, the market slowly began to learn of the true risks facing ACA Capital and the price of ACA Capital stock declined precipitously.

63. For example, on July 12, 2007, ACA Capital posted its “Structured Credit Business – RMBS Exposure Detail” on its website. The posting indicated that ACA Capital had greatly increased its exposure to sub-prime RMBSs by completing several CDO deals in late 2006 and early 2007 and that the Company would take losses even before all of the low-rated sub-prime mortgage bonds from 2006 and 2007 defaulted. In response to this posting, the price of ACA Capital stock started to decline precipitously falling from \$10.45 per share on July 9, 2007, to \$5.17 per share on July 24, 2007.

64. On November 7, 2007, ACA issued a press release announcing its financial results for the third quarter of 2007, the period ended September 30, 2007. For the quarter, the Company reported a net loss of (\$1.0) billion or (\$29.42) per share. The complaint attributed the huge loss to “mark-to-market” losses on the Company’s portfolio of structured credit transactions.

65. Shortly after this announcement, ratings agencies indicated that they were reviewing ACA Capital’s credit rating for a downgrade. This resulted in a series of forbearance agreements between ACA and its swap counterparties.

66. Then, on August 8, 2008, ACA Capital issued a press release announcing that ACA Financial had entered into a global settlement agreement with its structured credit and other similarly situated counterparties. According to the press release, the agreement provides for a comprehensive plan to satisfy and discharge all claims associated with ACA Financial’s exposure to CDSs,

including the swaps on all exposure to ABS and corporate CDOs. Under the agreement, the counterparties received a cash payment and surplus notes issued by ACA Financial. According to the press release, holders of the surplus notes will share pro-rate any future dividends or distributions from ACA Financial up to \$1 billion in the aggregate. 95% of the surplus notes were issued to the counterparties and the remaining 5% were issued to ACA Capital. ACA Capital has also agreed that it is no longer responsible for the management of ACA Financial. The press release further indicated that ACA Financial would operate as run-off financial guaranty insurance company “meaning it will not issue any new insurance policies or guarantees and will exist to adjust, defend and pay claims on its in-force book of financial guaranty insurance policies, virtually all of which relate to exposure on municipal debt obligations.”

67. At the time of the filing of this Complaint, ACA Capital stock trades for \$0.05 per share, well below the IPO price of \$13.00 per share and ACA Capital is nothing but an empty shell corporation.

COUNT I

Violations of Section 11 of the Securities Act Against All Defendants

68. Plaintiff repeats and realleges each and every allegation contained above.

69. This Count is brought pursuant to Section 11 of the Securities Act, 15 U.S.C. §77k, on behalf of the Class, against both defendants.

70. The Registration Statement for the IPO was inaccurate and misleading, contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and omitted to state material facts required to be stated therein.

71. ACA Capital is the registrant for the IPO. The defendants named herein were responsible for the contents and dissemination of the Registration Statement and the Prospectus.

72. As issuer of the shares, ACA Capital is strictly liable to Plaintiff and the Class for the misstatements and omissions.

73. Neither of the defendants named herein made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statement and the Prospectus were true and without omissions of any material facts and were not misleading.

74. By reasons of the conduct herein alleged, each defendant violated, and/or controlled a person who violated, Section 11 of the Securities Act.

75. Plaintiff acquired ACA Capital shares pursuant to the Registration Statement.

76. Plaintiff and the Class have sustained damages. The value of ACA Capital common stock has declined substantially subsequent to and due to defendants' violations.

COUNT II

Violations of Section 12(a)(2) of the Securities Act Against All Defendants

77. Plaintiff repeats and realleges each and every allegation contained above.

78. This Count is brought pursuant to Section 12(a)(2) of the Securities Act on behalf of the Class, against all defendants.

79. Defendants were sellers and offerors and/or solicitors of purchasers of the shares offered pursuant to the Prospectus.

80. The Prospectus contained untrue statements of material facts, omitted to state other facts necessary to make the statements made not misleading, and omitted to state material facts required to be stated therein. Defendants' actions of solicitation included participating in the preparation of the false and misleading Prospectus and participating in road shows to market the IPO to investors.

81. Defendants owed to the purchasers of ACA Capital common stock, including Plaintiff and other class members, the duty to make a reasonable and diligent investigation of the statements contained in the IPO materials, including the Prospectus contained therein, to ensure that such statements were true and that there was no omission of material fact required to be stated in order to make the statements contained therein not misleading. Defendants in the exercise of reasonable care should have known of the misstatements and omissions contained in the IPO materials as set forth above.

82. Plaintiff and other members of the Class purchased or otherwise acquired ACA Capital common stock pursuant to and/or traceable to the defective Prospectus. Plaintiff did not know, or in the exercise of reasonable diligence could not have known, of the untruths and omissions contained in the Prospectus.

83. Plaintiff, individually and representatively, hereby offers to tender to defendants those securities which plaintiff and other Class members continue to own, on behalf of all members of the Class who continue to own such securities, in return for the consideration paid for those securities together with interest thereon. Class members who have sold their ACA Capital common stock are entitled to rescissory damages.

84. By reason of the conduct alleged herein, these defendants violated, and/or controlled a person who violated, Section 12(a)(2) of the Securities Act. Accordingly, Plaintiff and members of the Class who hold ACA Capital common stock purchased in the IPO have the right to rescind and recover the consideration paid for their ACA Capital common stock and hereby elect to rescind and tender their ACA Capital common stock to the defendants sued herein. Plaintiff and Class members who have sold their ACA Capital common stock are entitled to rescissory damages.

COUNT III

Violations of Section 15 of the Securities Act Against Defendant Roseman

85. Plaintiff repeats and realleges each and every allegation contained above.

86. This Count is brought pursuant to Section 15 of the Securities Act against Defendant Roseman.

87. Defendant Roseman was a control person of ACA Capital by virtue of his position as a director and senior officer of ACA Capital.

88. Defendant Roseman was a culpable participant in the violations of Sections 11 and 12(a)(2) of the Securities Act alleged in Counts I and II above, based on his having signed the Registration Statement and having otherwise participated in the process which allowed the IPO to be successfully completed.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff, on behalf of himself and the Class, prays for judgment as follows:

A. declaring this action to be a plaintiff class action properly maintained pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure;

B. awarding Plaintiff and other members of the Class damages together with interest thereon;

C. with respect to Count II, ordering that the IPO be rescinded;

D. awarding Plaintiff and other members of the Class their costs and expenses of this litigation, including reasonable attorneys' fees, accountants' fees and experts' fees and other costs and disbursements; and

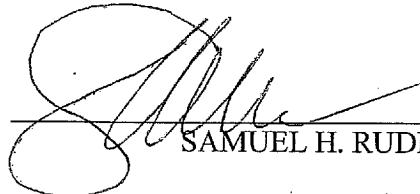
E. awarding Plaintiff and other members of the Class such other and further relief as may be just and proper under the circumstances.

JURY TRIAL DEMANDED

Plaintiff hereby demands a trial by jury.

DATED: November 14, 2008

COUGHLIN STOIA GELLER RUDMAN &
ROBBINS LLP
SAMUEL H. RUDMAN
DAVID A. ROSENFELD



SAMUEL H. RUDMAN

58 South Service Road, Suite 200
Melville, NY 11747
Telephone: 631/367-7100
631/367-1173 (fax)

ABRAHAM FRUCHTER & TWERSKY LLP
JACK G. FRUCHTER
One Pennsylvania Plaza, Suite 2805
New York, NY 10119
Telephone: 212/279-5050
212/279-3655 (fax)

Lead Counsel

CERTIFICATE OF SERVICE

I hereby certify that on November 14, 2008, a copy of the foregoing Consolidated Amended Class Action Complaint for Violations of Federal Securities Laws was sent, via U.S. Mail, postage prepaid to the following parties:

Counsel for Defendants

FRIED, FRANK, HARRIS,

SHRIVER & JACOBSON LLP

Douglas H. Flaum

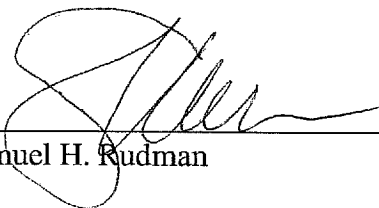
Stephanie J. Goldstein

One New York Plaza

New York, New York 10004-1980

Telephone: 212-859-8000

Facsimile: 212-859-4000



Samuel H. Rudman