

Bond Case Briefs

Municipal Finance Law Since 1971

Investors Raise Bets Against Bond Insurers.

Short interest rises as consolidation is questioned

Investors are poking holes in a popular bet on the U.S. bond insurance business.

Shares of Assured Guaranty Ltd. and MBIA Inc. rallied in July, driven higher by investor expectations the bond insurance industry would continue to consolidate, said CreditSights analyst Josh Esterov. But other investors are questioning the rally. Short interest, a measure of negative bets, on Assured and MBIA rose by 18% and 16%, respectively, over the same month to roughly \$400 million, according to financial analytics firm S3 Partners LLC.

The two are monoline insurance companies that guarantee billions of dollars of U.S. municipal bonds and structured finance products. Bond insurers, an often-forgotten category of U.S. financial stocks, sell policies that depend on the strength of their balance sheets. Their most problematic exposure at the moment is Puerto Rico, which has asked them to cover billions of dollars in shortfalls on municipal debt obligations.

The rising short bets correlate to deteriorating conditions on the island. Early in July, Puerto Rico's federal financial supervisors placed its public power monopoly under what amounts to bankruptcy protection, exposing MBIA and Assured to losses on more than \$2 billion in utility debt.

Meanwhile, MBIA's efforts to win market share evaporated in late June when S&P Global Ratings cut the company's credit rating, forcing it to stop writing new municipal bond policies. It sparked a somewhat counterintuitive stock rally as investors took the downgrade as a potential catalyst for MBIA to seek a merger partner, Mr. Esterov said.

Assured has shown a desire to consolidate the sector before, striking deals in recent years to acquire CIFG Holding Inc., Radian Asset Assurance Inc. and MBIA's U.K. business. Normally, buying MBIA would remove another source of competition. The S&P downgrade, though, "did that for them," said William Bonawitz, research director at PNC Capital Markets.

MBIA told shareholders it had "reluctantly, but prudently and appropriately, ceased for now our efforts to actively pursue writing new insurance policies" but would "retool in a manner that continues to protect the interests of all of our policyholders."

The Wall Street Journal

By Andrew Scurria

Aug. 1, 2017 6:58 p.m. ET

Write to Andrew Scurria at Andrew.Scurria@wsj.com

