
Detroit Default Shines a Light on Bond Insurers.

CHICAGO – Detroit's threat to default on up to $2 billion of bond debt will shine a light on a beleaguered sector of the municipal market — monoline bond insurers that wrap nearly all the city's bonds.

"This is an important opportunity for bond insurance companies to prove their worth and validate the importance of their industry," Richard Ciccarone, chief research officer at McDonnell Investment Management LLC. "It's a real opportunity for the stronger insurance companies."

Three of the six insurers who wrap the city's debt pledged to cover missed payments after Detroit emergency manager Kevyn Orr announced Friday a moratorium on some debt payments.

The fiscal condition of the insurers could play a role as negotiations play out over the next month, market participants said.

Financial Guaranty Insurance Corp., for instance, recently worked out a plan with all its clients that has it covering only 30% of its claims up front, with the balance paid off after the claim matures, according to Matt Fabian, managing director, Municipal Market Advisors.

The remaining insurers, however, are expected to make 100% payments on the possible losses.

The collapse in the monoline bond insurance business since the 2008 financial crisis left Assured Guaranty Ltd. as the only active insurer until the recent launch of Build America Mutual. Moody's Investors Service in January downgraded Assured to A2 from Aa3, but noted that its capital adequacy remained strong.

National Public Finance Guarantee, after winning key ratings upgrades in May, has also signaled an intention to return to writing new business.

"Many of the bonds are insured, and that makes it easier for the bondholders," Ciccarone said. "It also makes a case for a comeback for those insurance companies that can stick around in distressed situations that they can cover it on your behalf."

Orr announced Friday that the city will stop making payments on debt that does not have a lien on a specific revenue pledge, a total of $11.4 billion. That includes more than $9 billion of employee retirement obligations, as well as general obligation bonds not secured by a specific revenue source.

The defaults began Friday when the city withheld a $39.7 million debt service payment due on $1.4 billion of pension certificates.

The certificates, like nearly all of Detroit's bonds issued before 2010, carry insurance by one of the six insurers. FGIC and Syncora Guaranty Inc. insure the pension COPs.

Syncora said Monday it had received claims notices on the pension certificates that it insures, which include Series 2005A and 2006B.

“The company will pay such claims as, when, and in the amounts due, under and in accordance with the terms of its insurance policies,” the firm said in the release. “The company continues to assess the situation in Detroit, Michigan.”

A spokesman for Syncora declined to provide more details, saying the firm does not comment on individual credits.

FGIC did not return phone calls by press time.

The pension COPs have generally been considered among the city’s least-secured debt, backed only by a contractual pledge to pay. In the event of a default, the insurers or bondholders have the same recourse as pensioners, which is to sue the city, and if they win, to get a judgment lien against the city that forces it to raise taxes to pay off the obligation.

Fabian said the expectation that insurers will cover losses does increase their value, though the amount of distressed credits on their books could pose a problem.

“They’re paying on Jefferson County, Detroit, Stockton,” Fabian said. “These are all very manageable claims, but when you’re talking about influencing investor behavior you have to look at both sides.

“This [Detroit default] proves their value,” Fabian said. “But the issue for the insurers has always been in pricing the value. How do you price it?”

He added that with Detroit’s debt, there is lots of reinsurance, and so it’s difficult to pin down exactly how much each firm insures. “The numbers are blurry,” he said.

A spokesman from National Public Finance Guarantee, a subsidiary of MBIA Inc., reiterated the company’s pledge to cover bond payments after Orr’s announcement.

“In the event that debt service payments by the City of Detroit are interrupted, National will ensure that its policyholders receive all of their principal and interest payments on time and in full,” spokesman Kevin Brown said in an email Friday.

National wraps nearly $2.5 billion of Detroit debt, including $2.4 billion of revenue bonds — most of them water and sewer — and $101 million of unlimited-tax GO bonds.

Like National, Assured Guaranty has repeatedly assured bondholders of its pledge to cover payments after the city was taken over by the state in mid-March.

After Friday’s announcement, Assured issued a statement to reassure bondholders, while noting that the bulk of the Detroit bonds it covers are secured by special revenues.

“As always, Assured Guaranty is committed to honoring its unconditional and irrevocable guaranty to holders of its insured obligations, a commitment backed by Assured Guaranty’s substantial claims-paying resources of $12 billion,” a spokesman said in an email.

Assured insures $2.2 billion of the city’s debt, the bulk of which is water and sewer bonds, and $355 million of GO bonds. The firm said in an email that the $1.8 billion of revenue bonds are “secured by a pledge of ‘special revenues’ and therefore timely payment of debt service should be insulated from any financial difficulties of the city.”

Assured also wraps another $320 million of GO general fund bonds that are not considered secured.

The city has $963 million of unlimited-tax and limited-tax general obligation bonds. Of that, roughly $205 million of bonds issued in 2008 are uninsured.

There is additional debt issued in 2010 and 2012 that is also uninsured — the junk-rated city could not buy insurance by that point — though those are backed by a pledge of state aid payments and are considered secured debt.

The city also has $5.9 billion of water and sewer bonds, all of which is insured except for $476 million with a 2041 maturity.

Another roughly $200 million of revenue bonds, including parking and convention center debt, carries insurance.

Detroit has not yet decided whether it will make its next general obligation bond payment, said Orr spokesman Bill Nowling.

“We have a moratorium on our debt payments,” Nowling said. “We’re going to evaluate those on a payment to payment basis. We let our creditors know [Friday] on the payment that was due that we would not be making it.”

Nowling added the city doesn’t think it’s technically in default because it has a 30-day grace period on all debt service payments.

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