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MBIA Muni Wraps Upgraded: BTIG Says Reuters Misses the Point.

Bond insurer MBIA Inc. (NYSE:MBI)'s National Public Finance Guarantee Corp. recent upgrade to AA- from A by Standard & Poor's has caused some discussion about how much of a difference there really is between the two ratings for a bond investor. A recent post from Cate Long on Reuter's MuniLand concluded that the possibility of default is probably too low to merit bond insurance. While he doesn't disagree with her reasoning, according to bond analyst Mark Palmer at BTIG Research, it's not the impact on investors that really matters.

The MuniLand post imagines an investor who already owns bonds (or is thinking of buying some) and then weighs the expected returns with and without buying insurance. AAA and AA bonds don't really default (0.00% after 10 years according to Fitch), and A rated bonds only default 0.05% of the time after ten years, compared to 1.28% for BBB rated bonds. The A rated bonds that MBIA Inc. (NYSE:MBI) is now able to insure have such a minuscule default rate, that insuring them seems hard to justify.

Muni bond insurance is normally bought by munis

"The main problems with this analysis, in our view, are that it regards municipal bond insurance solely from the viewpoint of an investor," writes Palmer in a March 24 report. "The primary purchasers of bond insurance are the issuers of municipal bonds – the municipalities themselves."

Municipalities, particularly those with weak finances and low credit ratings, benefit from insurer's wraps by getting lower borrowing costs, and in some cases making access to capital markets feasible in the first place. The difference between a AA muni bond and an A rated muni bond is 69 basis points (4.72% versus 4.03% respectively). Even after the cost of the insurer's wrap is taken into account, that savings represents money that can be invested back into the city.

The S&P upgrade makes MBIA's wraps more valuable

Municipalities aren't really thinking about the possibility of default when they buy insurance wraps, they are just trying to raise money efficiently. Looked at from this perspective, the upgrade is important for MBIA Inc. (NYSE:MBI) because it means they are able to offer their municipal clients a better product (a better insurance wrap with lower rates) than they could when rated A. MBIA will either be able to sell more muni bond wraps, sell them for a better price, or both – all of which is good for their shareholders.

by Michael Ide

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