[Bond Case Briefs]

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[Monoline Insurers 'Could Reach 10%' of Muni Market Again – Citi.]

Like bison on the Great Plains, monoline insurers used to roam in great numbers across the muni-bond landscape. Then the financial crisis hit and monolines nearly went extinct. But now they're on the rebound, and though far less abundant than they were a decade ago, they soon could climb back to relevance in the muni market.

Or not. Citi today says that monolines' share of wrapped new muni bonds "could reach 10% in the future" but acknowledges that "the vast majority of investors continue to largely ignore monoline wraps."

At their peak, monolines – financial institutions with pools of capital and triple-A credit ratings – would insure, or "wrap," bonds by lending their credit ratings (for a fee) to any lower-rated municipality looking to issue bonds. The monolines earned their fees, the issuers achieved lower borrowing costs, and investors could sleep better knowing their bonds were insured, without conducting in-depth credit research of every little municipality out there. At their peak, monolines insured over half the muni market, before most died out after insuring mortgage bonds that defaulted during the financial crisis. From Citi:

"Nowadays monoline insurers play a smaller role, but their market penetration has been growing over the last several years, helped by higher market volatility, as well as, several high profile credit events, and by the growing realization that a handful of insurers provided a solid credit backing for many new issuers. Consequently, monoline share of new issue supply increased from a low level of 4% in 2012 to 6% in 2014 year-to-date, and, in our view, could reach 8-10% over the next several years."

Currently, there are three active monolines: Assured (AGM and MAC) – the most active insurer; BAM – was created just several years ago, but already became a formidable competitor to Assured; and National (was carved out of MBIA), which has started wrapping new deals in 2014.

Citi points out that S&P recently upgraded Assured and National closer to triple-A, while monoline credit spreads have tightened, mirroring their credit quality improvement. Citi says the vast majority of investors continue to underestimate or undervalue the extent of its credit improvement, calling it a "mistake" for investors to ignoring monoline wraps when buying municipal bonds. Citi also sees a difference in value between the two main monolines today:

"With National getting into business again, an interesting question is whether there should be a substantial difference between bonds wrapped by Assured and National. Prior to 2014 this spread differential was as high as 100bp for sone stressed credits; currently, it is on the order of only 25-50 bps for the majority of low-rated names, Given that both insurers are moving in the positive direction, have somewhat similar claims-paying resources and Caribbean exposures, in our view, this differential should be tighter. Assured's wraps are more valuable, in our view, but this differential for similar credits and maturities may be worth as little as 10-15 bp."

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