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Assessing Bond Insurers' Exposure to Puerto Rico Still Tough.

Seven years after their ranks were decimated by the housing crisis, bond insurers are back in the spotlight as Puerto Rico struggles to stave off default.

Companies including Assured Guaranty Ltd., MBIA Inc. and others insure more than $14 billion out of the $72 billion in debt outstanding by the commonwealth's government, utilities and other agencies, according to financial documents from the insurers.

But investors and analysts say the lack of detailed disclosure has made it hard to assess the insurers' capacity to pay potential Puerto Rico claims should the territory default. While companies disclose principal and interest owed across their entire portfolios, sizable interest costs aren't disclosed for individual bonds in some cases–including certain Puerto Rico debt.

Insurance-company financial statements are "more complex than looking at your average government," said Bill Bonawitz, director of municipal research at PNC Capital Advisors, which oversees $6.5 billion in municipal debt. "There's a lot more moving parts."

Puerto Rico has been burdened for years with a sluggish economy and a high debt load, and warned in a report this month that it "may lack sufficient resources" to fund government programs and pay its debt in the upcoming fiscal year. Puerto Rico has been negotiating with creditors, but it is unclear whether the talks will allow the island to avoid what could rank as one of the largest municipal defaults ever.

Puerto Rico bonds are widely held by U.S. mutual funds and individual investors, in part because of generous tax advantages. If an issuer such as Puerto Rico defaults, insurers agree to make the scheduled principal and interest payments.

The island's financial problems represent a major test for a bond-insurance industry that is still recovering from the financial crisis. Insurers lost billions of dollars during the crisis on the default of mortgage-backed securities and some have stopped writing new policies.

Investors have penalized surviving bond insurers in part for the difficulty of analyzing their books. Shares of Assured Guaranty and MBIA trade below their adjusted book value, a measure of net worth. Assured Guaranty stock closed Friday at $27.07, a 50% discount to adjusted book value, according to brokerage firm BTIG. MBIA closed at $8.74, a 65% discount.

"The stock prices of the bond insurers are where they are in part because of the complexity discount," said Mark Palmer, an equity analyst at BTIG.

Assured's stock is up 4.2% on the year and MBIA is down 8.4%, compared with a 2.8% advance on the S&P 500. Both companies' shares, however, are trading higher than they were during the depths of the downturn. From 2007 to 2009, MBIA's stock fell 94% to $4.50, while Assured Guaranty's fell by 58% to $11.29.

Some insurers are planning to improve their disclosures, making it easier for investors to assess their claims-paying abilities. National Public Finance Guarantee Corp., a unit of MBIA, said it plans on Monday to update its website to include both principal and interest exposure for individual bond issues. Currently, only the principal amount is listed.

The distinction is important because bond insurers are on the hook for both principal and interest payments if an issuer defaults.

Assured Guaranty doesn't provide a full list of individual bonds it insures across its various subsidiaries. But a spokesman said it provides principal and interest exposure on specific issuers "where we feel that may be useful to the market." A breakdown of its principal and interest exposure to Puerto Rico entities is available on its website.

For a report in January, research firm CreditSights had to estimate certain figures regarding the insurers' principal and interest exposure to Puerto Rico.

The firm concluded that Assured Guaranty and MBIA are strong enough to withstand defaults from Puerto Rico public agencies that were subject to a restructuring law passed last year. The law has been struck down by a federal court, but is on appeal.

Rob Haines, senior insurance analyst at CreditSights, said it would be "very helpful" if insurers offered more information on both their principal and interest exposure.

"I don't see why the companies can't disclose this themselves," Mr. Haines said. "It won't violate any kind of conflict of interest they have or any kind of confidentiality that they have."

Of particular concern to some investors are so-called zero-coupon or capital-appreciation bonds, which pay no interest until they mature and can cost municipalities more in interest than regular bonds. Puerto Rico has sold billions of dollars of these bonds, including $2.6 billion tied to sales tax revenue in 2007.

Ambac Financial Group Inc., another large insurer, backs $808 million of that. When interest is factored in, Ambac is actually responsible for roughly $7.3 billion. The numbers were disclosed in a special report regarding Ambac's Puerto Rico exposure. In a separate spreadsheet, Ambac lists the principal amount for every bond issue it insures, but it doesn't provide the interest.

"A more accurate disclosure would be to provide full principal and interest," Mr. Bonawitz said. "The issue is more acute when you have a zero, because the difference between the principal and interest is so much greater."

A recent report by Kroll Bond Rating Agency showed insurance policies can still be beneficial, saying bond insurers paid claims in full and on time in 26 of 29 insured municipal-bond defaults between 2008 and the present.

Bond insurance "has some value," said Doug Benton, an analyst at Cavanal Hill Investment Management, which oversees roughly $6 billion in assets. "But anybody that's lived through '07 through '09, you've got to discount it."

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