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Puerto Rico Crisis Seen Muddying MBIA's Bond-Insurance Comeback.

The risk of losses tied to Puerto Rico is clouding MBIA Inc.'s comeback in the resurgent business of guaranteeing state and municipal debt.

After years of healing from the financial crisis that wiped out insurers' AAA ratings, MBIA's National Public Finance Guarantee Corp. has been starting to win new business. National backed two deals in 2014 and eight more this year, mounting a challenge to Assured Guaranty Ltd., the biggest guarantor in the \$3.6 trillion municipal market.

A worse-than-expected outcome in the Caribbean commonwealth could derail MBIA Chief Executive Officer Jay Brown's progress. The bond insurer has almost double Assured's exposure to Puerto Rico's troubled power authority — known as Prepa — which is on the brink of an unprecedented \$9 billion municipal restructuring. The cost of debt insurance on MBIA has been climbing relative to Assured, and researcher CreditSights Inc. cut its recommendation this week on MBIA's obligations to "underperform."

'Severe Scenarios'

"Assured Guaranty is a company that can withstand some pretty severe Puerto Rico outcomes without discussions of whether it can still pay dividends up to the holding company," said Josh Esterov, an insurance analyst at CreditSights in New York. "That question becomes murkier for National in some of the more severe scenarios."

Assuming an immediate default on all Puerto Rico bonds, a recovery rate of 50 percent would just about wipe out all of National's statutory capital, according to the CreditSights report from May 13. Such a loss would require 40 percent of Assured's funds.

CreditSights maintained its "outperform" recommendation on Assured in a May 10 report.

National and Assured will be able to absorb losses from Puerto Rico, said Mark Palmer, an analyst at BTIG LLC in New York. For National, however, the cost will become clearer sooner, he said.

"MBIA is more levered to the outcome at Prepa," he said. "July 1 is a very important date for Prepa because that's when the next meaningful maturity occurs."

Kevin Brown, a spokesman at Armonk, New York-based MBIA, declined to comment on the CreditSights recommendation. CreditSights previously ranked the company "outperform."

Rating Increase

Standard & Poor's raised National's financial strength rating in March 2014 to AA-, the fourth-highest rank, giving the insurer an opening to back debt from weaker localities. The rating is one step lower than Assured's municipal-insurance units and competitor Build America Mutual

Assurance Co.

S&P analyst David Veno estimated in a July 2014 report that National could withstand \$450 million of losses from Puerto Rico beyond the credit rater's expectations before its grade would be at risk. That figure is probably higher now, he said in a telephone interview Thursday.

By comparison, Veno's report predicted Assured had a capital cushion of about \$1.55 billion.

MBIA shares climbed 4.9 percent to \$9.94 at 2 p.m. in New York, the biggest jump since March. Assured stock rose 2.1 percent to \$28.73. Puerto Rico's governor and lawmakers reached an agreement late Thursday on a plan to raise the sales tax on the island, which may help it sell debt and ease a cash crunch.

Of National's \$4.54 billion in Puerto Rico exposure, the largest portion of gross par outstanding rests with Prepa, which municipal analysts expect to be the first of the island's agencies to restructure its obligations. The insurer backed \$1.42 billion of the utility's debt through March 31, compared with \$773 million for Assured, company filings show.

Prepa Deadline

As Prepa gets closer to a creditor-imposed deadline in June to restructure and a \$416 million bond payment on July 1, the cost is increasing to own insurance on MBIA's obligations.

Credit-default swaps tied to MBIA have widened to 520 basis points from 489 basis points at the start of 2015, according to data provider CMA, which is owned by McGraw Hill Financial Inc. and compiles prices quoted by dealers in the privately negotiated market.

The cost of protection is 200 basis points more than swaps tied to Assured, up from 107.5 basis points in December, the data show.

Credit-default swaps, which typically fall as investor confidence improves and rise as it deteriorates, pay the buyer face value if a borrower fails to meet its obligations, less the value of the defaulted debt. A basis point equals \$1,000 annually on a contract protecting \$10 million of debt.

"In the insured portfolio, the uncertainty over Puerto Rico commands a lot of attention," MBIA Co-President Bill Fallon said in a May 12 call to discuss first-quarter results with analysts and investors. Prepa "is the immediate focus," he said.

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