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HOW VALUABLE IS MUNICIPAL BOND INSURANCE

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In 1972, AMBAC became the first major company to guarantee payment of municipal bonds with a "AA" rating. In 1994, MBIA became the first bond insurer with a "AAA" rating on its insured bonds. By 1984, at least 5 bond insurers claimed "AAA" status. Beginning in 2008, all insurers lost their "AAA" ratings, and many had to stop business and sell assets to remaining insurers that had ratings between "A" and AA".

Originally, bond insurers limited their business to traditionally safe municipal bonds with low default rates. That changed in the late 1990's, when much of their business was dedicated to bond structures that garnered "AA" and "AAA" ratings on their own. It seemed like easy money, but those structured bonds had fatal weaknesses, and they began defaulting in 2008, overwhelming guarantees of several insurers.

Bond insurance companies that survived the defaults of 2008-2010 have "returned to their knitting" and now limit insurance to traditionally safe municipal bonds.

We now see Puerto Rico defaulting on billions of dollars of debt, but insured Puerto Rico bonds being paid 100% on time, and in full.

Are insured bonds totally riskless? Of course not. Fears that Puerto Rico's large defaults could again swamp insurers warrant concern. Many analysts believe that existing reserves will allow insurers to survive the Puerto Rico holocaust. But insurance gives investors at least 2 ways that they can be repaid: paid by the issuer, or paid by a bond insurer. Because of that secondary cushion, yields on insured bonds are generally lower than the municipal bond market in general. So investors have to balance their search for higher yields with the lower yields and/or the safety of bond insurance.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee. He ultimately left to take leading roles in municipal hi-yield analysis at firms JB Hanauer & HJ Sims.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.

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