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QUALITY IS JOB ONE!!

Long before there were municipal insurers (of the seven AAA rated municipal insurers, AMBAC is the oldest established in 1971) the underlying quality of the municipal bond issuer was paramount. The current financial deterioration of those Municipal Bond insurers certainly drives home the importance of that point.

It has long been the opinion of conservative municipal market makers that municipal insurance should be treated as “icing on the cake”. In other words, the underlying municipal credit should be able to stand on its own, from a quality standpoint.

One look at the insurer’s claims to paying ratio would clearly demonstrate that municipal insurance is clearly intended to protect bond holders from “isolated default scenarios” only. The chart listed below shows that ratio on the seven AAA rated municipal bond insurers:

	<u>Claims-Paying Ratio</u>
Ambac Assurance Corp. (AMBAC)	62:1
Financial Guaranty Insurance Co. (FGIC)	98:1
Financial Security Assurance (FSA)	92:1
MBIA Insurance Corp. (MBIA)	82:1
Assured Guaranty (AGC)	45:1
CIFG Guaranty	77:1
XL Capital Assurance (XLCA)	72:1

But paying claims for defaulted municipal bonds has not been the problem. Enter the herd of esoteric corporate IOU’s. No, indeed it would appear that the age old “element of greed” has been the culprit. Municipal insurers, in an effort to grow their business, began insuring much riskier structured debt. In fact, one of the seven AAA rated insurers, Assured Guaranty, has over half, (51.7%) of its portfolio of insured bonds composed of structured debt.

Most of these insurance companies are currently trying to take dramatic steps to right their financial ship. On December 12th, MBIA announced that it had entered into an agreement whereby Warberg Pincus, a global private equity firm, would inject \$1 billion of capital in MBIA through a combination of a stock purchase and a stock holders rights offering. At the time of submission of this article, Fitch and Moody’s Investors Service are in the process of reviewing capital adequacy analysis with the strong possibility of downgrading at least some of the major insurers. This could lead to a situation whereby a bond could have a higher underlying rating than the company that is insuring it. As you read this article, most likely further developments in this situation have occurred and information on the status should be readily available.

In another move, AMBAC Financial Group, the world's second-largest bond insurer is passing off the risk of \$29 billion of the securities it guarantees. Assured Guaranty LTD will reinsure the debt allowing AMBAC to free-up capital. The assured debt will not include any CDO's, but hopefully frees up enough capital for AMBAC to retain their AAA rating.

The "financial maneuvering" implemented by these companies doesn't seem to have fooled the ultimate judge, Wall Street, as is witnessed by the following erosions of their equity prices:

<u>Insurer</u>	<u>52 week high</u>	<u>Current Price</u>	<u>% Decline</u>
AMBAC	96.10	23.84	75
MBIA	76.02	29.51	61
RAM Holdings	17.34	4.80	72
Security Capital	34.58	3.56	90

So where does that leave the holder of these insured bonds? It leaves them on easy street as long as the entity itself is a viable credit. Ideally, that analysis was done at the time of the purchase and continues to be monitored over the holding period. The beauty of the electronic age is that current financial information is readily available on all but the most obscure of credits. Generally speaking, if you have followed the guidelines of your Investment Policy, you should be fine. All of this reminds us of an old bond saying that really applies to any purchase, "Quality remains long after the price is forgotten."

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