MUNICIPAL BOND INSURANCE THE BASICS

IF YOU ARE CONSIDERING BUYING MUNICIPAL BONDS, you will need to decide whether to buy bonds with insurance policies designed to protect your investment. This information sheet will help you make an informed decision about the value of insurance in your portfolio.

What is municipal bond insurance and who provides it?

It is simply a guaranty that the holder of a municipal bond will receive scheduled interest and principal payments when due, even if the municipal issuer fails to make these payments. It is literally an insurance policy against an issuer's payment default. Only financial guaranty insurance companies may write bond insurance. You may hear these companies called "bond insurers," "financial guarantors," "monoline insurance companies" or just "monolines." All these terms refer to the same group of companies, which operate solely as guarantors of financial obligations and are subject to specialized insurance regulation.

Does it matter which company provides the bond insurance?

Absolutely. The guarantor's track record of protecting bondholders is a paramount consideration. Look for bonds insured by companies with a long history of proving themselves through both good and bad economic cycles and that maintain a large store of claims-paying resources and predictable future earnings. Another important consideration is market liquidity – how easy it is to sell your bonds when you choose to sell. Market liquidity is largely a function of the amount of bonds trading with a given insurer's guaranty. Therefore, the larger a company's insured portfolio, the more market liquidity its insured bonds will tend to have.

The leading provider of municipal bond insurance is Assured Guaranty, a group of insurance companies that includes Assured Guaranty Municipal Corp. (AGM), Municipal Assurance Corp. (MAC) and Assured Guaranty Corp. (AGC). For more than three decades, through every market cycle, investors in bonds insured by Assured Guaranty have received every principal and interest payment on time and in full – even when the issuer failed to pay.

Across the group, Assured Guaranty has more claims-paying resources than any other bond insurer. It has a proven business model based on disciplined credit selection, underwriting, pricing and enterprise risk management. Its large reserves of deferred premiums, which have been collected but not yet earned, provide a significant base of future earnings. The group's publicly traded holding company, Assured Guaranty Ltd. (ticker symbol: AGO), is subject to New York Stock Exchange and Securities and Exchange Commission regulation and therefore held to higher legal standards of disclosure, oversight and transparency than non-public companies.

Another strength of Assured Guaranty is the high level of market liquidity in the bonds it insures, with $2 billion of bonds traded each week, on average.

Do I need municipal bond insurance?

While municipal bond defaults have been rare, they do occur, more frequently in periods of economic stress. Major municipalities, such as Detroit, Michigan, and Jefferson County, Alabama, have declared and exited bankruptcy with significant losses for bondholders who did not have insurance. Puerto Rico defaulted before entering a bankruptcy-like process that may take years to resolve. Assured Guaranty insured bondholders were fully protected in all those instances.

The decision to buy insured bonds will depend on your circumstances and risk tolerance. Here are some questions to ask yourself and related reasons why you might prefer bonds with insurance:

"How well do I know the municipality's fiscal condition and the structure of the bond?" Assured Guaranty insured bonds have been pre-selected for soundness by the guarantor's trained underwriters. In general, each bond must be of investment grade quality before it is insured, and it must meet additional criteria based on the bond structure and other factors. Additionally, by choosing insured municipal bonds, you gain the benefit of a professional surveillance

staff whose job is to keep tabs on the issuers of the insured bonds. In many cases, these professionals spot trouble ahead of time and can call upon, or even require, the municipality to take remedial steps before a default looms. And unlike rating agencies, guarantors back up their opinions with an obligation to pay interest and principal from their own capital if the issuer fails to do so.

"Would I be able to tolerate a drop in market value, or even the potential inability to sell my bonds, if a municipal issuer's financial condition deteriorated?" Although bond insurance does not guarantee a particular market value or liquidity, distressed issuers' bonds insured by highly rated guarantors have historically held their trading value better than comparable uninsured issues. For example, insured Louisiana bonds lost far less market value than uninsured bonds after Hurricane Katrina and, more recently, Puerto Rico bonds insured by Assured Guaranty traded near par value while comparable uninsured bonds were deeply discounted.

"If a municipality missed one or more interest or principal payments, could I afford to be without the cash flow for a number of years until I could obtain a recovery?" If the issuer of an insured municipal bond cannot make a scheduled interest or principal payment when it is due, the bond insurer is obligated to make prompt payment in full to the paying agent or trustee. The value of this benefit was evident during the prolonged efforts to resolve the incinerator debt problems in Harrisburg, Pennsylvania, as well as during Detroit's bankruptcy and Puerto Rico's defaults. In these and other cases, insured bondholders continued to receive full and uninterrupted payments of principal and interest when due, even when the issuer failed to pay.

Assured Guaranty has shown strong commitment to fulfilling the timely payment obligation. When the trustee for certain Jefferson County, Alabama, obligations refused to draw on the insurance policy, Assured Guaranty arranged to make interest and principal payments directly to the Depository Trust Company, where the ownership accounts were maintained.

How are bond insurers regulated?

As insurance companies, financial guarantors must be licensed to write insurance by the state insurance department in each state where they insure bonds and must meet their obligations to policyholders before other creditors. Additionally, financial guaranty insurers must restrict their business to financial guaranty and related types of insurance (hence the name "monolines"). Under financial guaranty statutes, financial guarantors must comply with capital, liquidity and reserving requirements as well as limits on their financial guaranty exposures.

How do I get bond insurance?

You generally do not buy the insurance directly. Instead, you buy bonds that were issued with insurance. (Issuers arrange to have their bonds insured in order to attract more investors and improve the efficiency of their bond offerings.) Insured bonds are available through full-service and discount brokerage firms that sell municipal bonds.

In addition, dealers may purchase insurance for uninsured bonds that are already trading in the secondary market. Broker-dealers and financial advisors may be able to obtain insurance on behalf of their clients for lots as small as $50,000.

I own bonds insured by Financial Security Assurance (FSA), Radian Asset Assurance Inc. (Radian Asset) or CIFG Assurance North America, Inc. (CIFG NA). Is that insurance valuable?

Yes. FSA is the same company as AGM, which became an Assured Guaranty company in July 2009. The name change following the acquisition has no effect on the status of FSA-insured bonds. Radian Asset and CIFG NA were acquired by and merged into AGC, so bonds insured by Radian Asset or CIFG NA now enjoy exactly the same protection as bonds insured by AGC.

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