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. In recent years, one of every eight new issues sold in the municipal bond market has been issued with bond insurance. This information sheet will help you make an informed decision about the value of insurance in your portfolio.

What is municipal bond insurance?

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.

Who provides municipal bond insurance?

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 regulation.

Does it matter which company provides the bond insurance?

Absolutely. The guarantor's track record of protecting its financial strength is a paramount consideration. Look for bonds insured by seasoned companies that have high current financial strength ratings.

Two companies that provide bond insurance are Assured Guaranty Municipal (AGM) and Assured Guaranty Corp. (AGC). Both of these companies have been in business since the 1980s, and both came through the economic crisis with high financial strength ratings.[1] They are part of Assured Guaranty, which consists of Assured Guaranty Ltd. (AGL), a holding company traded on the New York Stock Exchange (ticker: AGO), and its subsidiaries. With a total of approximately $13 billion of claims-paying resources, Assured Guaranty is the leading provider of financial guaranty insurance in the capital markets.

Do I need municipal bond insurance?

While municipal bond defaults have been rare, they do occur, more frequently in periods of economic stress. The decision to buy insured bonds will depend on your circumstances and risk tolerance. Here are some questions to ask yourself and related reasons that you might prefer bonds with insurance:

"How well do I know the municipality's fiscal condition and the structure of the bond?" Insured bonds have been pre-selected for soundness by the guarantor. Guarantors back up their opinions with an obligation to pay interest and principal from their own capital if the issuer fails to do so. 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

[1] For the financial strength of both AGC and AGM, Moody's Investors Service (Moody's) has assigned Aa3 ratings and Standard & Poor's Ratings Services (S&P) has assigned AA- ratings. These ratings are characterized as "Excellent" at Moody's and "Very Strong" at S&P. On March 20, 2012, Moody's placed the ratings on review for possible downgrade. The S&P ratings outlook is stable.

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professionals spot trouble ahead of time and can call upon, or even require, the municipality to take remedial steps before a default looms.

"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.

"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 a municipality cannot make a scheduled payment on an insured bond when it is due, the bond insurer is obligated to make prompt payment in full. The value of this benefit has been evident during the prolonged efforts to resolve the incinerator debt problems in Harrisburg, Pennsylvania, where insured bondholders have continued to receive full and uninterrupted payments of principal and interest when due, even when the issuer has failed to pay.

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.) In addition, dealers may purchase insurance for bonds already trading in the secondary market. Dealers and financial advisors may be able to obtain insurance for lots as small as $100,000 for transactions executed through an electronic trading platform called TheMuniCenter.

I own bonds insured by Financial Security Assurance (FSA). 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.

Which insured bonds should I buy?

Every investor's situation is unique. Please contact your financial advisor to discuss which specific bonds are appropriate for your goals.

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