



## **FGIC to MBIA: “You got me, who’s got you?”**

Yesterday, MBIA reported that they struck a deal with FGIC to re-insure \$184 billion worth of municipal bond debt in exchange for \$741 million in premium income. Should the agreement be accepted by the regulators in its current form, policy holders will have the right to file a claim in the event of a security default with either insurer, FGIC or MBIA. This type of agreement is referred to as “cut-through” re-insurance.

This appears to be a solid deal for MBIA, as they have an opportunity to enhance their revenue stream by accepting the risk of a relatively high quality municipal portfolio. The deal should also provide a boost to FGIC as they are removing potential liabilities from their books in exchange for an upfront fee of \$200 million.


On the back of this positive news, there are still more questions than there are answers, as the industry continues to face significant headwinds such as:

- The business model as a going concern is still being heavily challenged. As the major rating services recalibrate the municipal credit ratings to be consistent with their global ratings methodology, roughly 95% of the tax-exempt market will be rated “AA” or “AAA”. With the credit ratings of tax-exempt securities going higher the need / benefit of Issuers coming to the market with insurance is greatly diminished.
- As the credit / liquidity crisis intensifies, other portions of the financial guarantor’s exposure could be under heavy pressure. For example, the credit worthiness of other structured securities such as credit card receivables, home equity loans, auto loans, CLO's (collateralized loan obligations), and CBO's (collateralized bond obligations) could be stressed.
- Competition from Berkshire Hathaway (the only financial guarantor to remain “AAA” by all of the rating agencies with a stable outlook) could be formidable.

Stock prices of the financial guarantors are higher today but...The tax-exempt marketplace is continuing to paint the three largest financial guarantors (MBIA, FGIC, and AMBAC) with the same broad brush. Let’s remember that it was not the municipal insurance segment that caused the turbulence to these financial guarantors in the first place. It was the fact that they strayed into riskier segments lured by higher fees. To our way of thinking this deal may be helpful to the earning stream but doesn’t appear to solve the broken business model or the alphabet soup of toxic waste which they assigned their “AAA” stamp to. Perhaps, this is why investors are still valuing the benefit of the municipal bond insurance to be somewhere between a zero and a lottery ticket, depending upon the guarantor.

In summary, having insurance is still better than not as the buyer is receiving an option virtually for free that the insurer may survive. With that said, by MBIA accepting the liabilities of FGIC, it reminds me of a phrase from Superman (1978): as Lois was falling from a helicopter and Superman came to her rescue, he said “Don’t worry, I got you”, to which Lois replied “You got me, who’s got you!?”

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A large, faded image of a suspension bridge, likely the New York Thruway Express Bridge, spans the width of the page. The bridge is shown from a low angle, with its massive concrete towers and cables dominating the scene. The bridge is reflected in the water below, and the background is a soft, hazy sky.

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